FastTrac® GrowthVenture™
FOR CURRENT BUSINESS OWNERS WHO WANT TO GROW THEIR COMPANY.
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On a bitterly cold day in January 1993, Ewing Marion Kauffman scheduled to launch a new program for entrepreneurs called FastTrac®. Kauffman was legendary in Kansas City because his company, Marion Merrell Dow, provided more than 3,000 high-paying jobs, he was the owner of the Kansas City Royals baseball team, and through his foundation, he helped families in disadvantaged areas get an education—even paying for college for many.

On that same morning, however, nature decided to dump on Kansas City one of the worst snowstorms in its history. Kauffman’s staff debated whether to cancel the event, since people were being asked to stay off the roads, and Kauffman was extremely ill. He wanted to hold the event just in case someone did go to the trouble to get there. That day, 900 people showed up. Yes, some came because it was sponsored by “Mr. K” as he was affectionately called; but most came because they had a hunger to learn how to start and grow a business. They wanted to invest in themselves even if that meant braving the storm.

That Kansas City FastTrac® kickoff was one of the last public appearances for Kauffman, who passed away later that year at the age of 76. He was grateful for the opportunity to build a company and to share his abundance with others. He loved entrepreneurs and all they stood for—self-reliance, innovation, hard work, and providing good paying jobs and benefits. He was proud that his foundation was championing entrepreneurship.

The Ewing Marion Kauffman Foundation is proud to have played some small part in the decision-making process, skill development, and network building of hundreds of thousands of people engaged in the entrepreneurial process.
The Story of Ewing Marion Kauffman

The late entrepreneur and philanthropist Ewing Kauffman established the Ewing Marion Kauffman Foundation as the first foundation to focus on entrepreneurship as one of its primary areas of interest.

There is more to Ewing Kauffman’s beneficence than his fortune. He had an instinct for the future. He understood how to bring organizations to life to be productive and vital. Above all, he had a zest for life and a social awareness that was grounded in his belief in people. The Kauffman Foundation of Kansas City develops and advances innovative ideas that set the groundwork for institutional change, advance entrepreneurship, and improve the academic achievement of children and youth.

One of America’s most successful entrepreneurs, Kauffman was born on a farm in Garden City, Mo., in 1916. His family moved to Kansas City when he was a boy. He started his business in 1950 from modest beginnings. Working out of the basement of his Kansas City home, he built Marion Laboratories into a billion-dollar pharmaceutical giant. Kauffman set a high standard for his associates, inspiring them to work hard, and promising to share the rewards of the company’s success with those that produced.

Kauffman established the Kansas City Royals, bringing major league baseball back to Kansas City. He hired mavericks and encouraged them to bring new thinking to transform the hidebound culture of the baseball establishment. Following their owner’s unconventional path, the Royals built a model baseball franchise, developing talented young players into major league stars. Ewing Kauffman’s Royals were perennial playoff contenders, winning six division championships, two American League pennants and a world championship.

With his business succeeding beyond his wildest dreams, Kauffman turned his vigor, intellect, and wealth to a new style of philanthropy. He lost patience with charity work that never seemed to attack the core problem it sought to remedy. He wanted to dig deep and get at the roots of issues rather than talk about addressing the symptoms. Undaunted by the size of the challenge or the lack of resources, Kauffman encouraged his staff to become immersed in research, consult with the best minds, and devise bold approaches to address complex social problems. He told friends he was having more fun giving money away than he had earning it. He told associates he expected his foundation to be exemplary.

An epitome of American entrepreneurship, Kauffman saw business enterprise as one of the most effective ways to unleash human potential and stir the economy to life. He viewed entrepreneurship as the most powerful strategy to help individuals gain economic independence and serve as a catalyst for creating jobs and wealth in society.

Today the Kauffman Foundation is devoted to advancing entrepreneurship as one of the fundamental aspects of life in the United States. Focusing on research, education, technical assistance, and policy, we work to increase the number and success rate of individuals engaged in the process of starting or growing their own business or idea. We work with partners to design programs based on the proven principles, techniques, and leadership tactics that make starting and growing a business a more common choice for Americans of all walks of life.

To that end, the Kauffman Foundation’s FastTrac programs are part of a wide range of learning resources developed by and with hundreds of successful entrepreneurs who have shared their knowledge, insights, and stories so that others might learn from them. It is hoped that all entrepreneurs will find them useful as they work to write their own entrepreneurial success stories.

For more information on FastTrac, the nation’s leading, award-winning business training program for entrepreneurs, go to fasttrac.org or call (800) 689-1740. To order FastTrac materials call the FastTrac fulfillment center at (877) 450-9800. For more information about the Kauffman Foundation and entrepreneurship, go to entrepreneurship.org, kauffman.org, or call (800) 489-4900.
Every day you make countless decisions and take action as a routine part of running your business. Indeed, being able to juggle the day-to-day work while keeping an eye on the future is part of the fabric of entrepreneurship. By participating in FastTrac® GrowthVenture™ you’ll have the opportunity to take a step back, look at the big picture, and work on your business, not just in your business.

Through this program, you can strengthen your ability to make critical decisions and equip yourself with the knowledge and skills needed to improve the performance of your business. With FastTrac® GrowthVenture™, you’ll create a framework to determine the best way for you to grow your business. The primary objectives are to enable you to effectively evaluate and improve your:

- Overall business strategy and vision for the future.
- Ability to maintain a competitive advantage in the marketplace.
- Changing role in managing the business.
- Readiness for growth and profitability potential.
- Focus and alignment of all aspects of the business.

Written by entrepreneurs for entrepreneurs, FastTrac® GrowthVenture™ offers essential business information to build on your existing knowledge and expand the skills you need to grow a sustainable business. FastTrac® offers non-traditional, experiential learning with hands-on coaching sessions. Opportunities to network and learn from your peers as well as your facilitator, business coach, and guest speakers—seasoned entrepreneurs and professionals who work with entrepreneurs—are a key part of the experience.

You will be challenged to think critically about your business, practice decision-making skills, and ensure all aspects of your business are aligned for long-term sustainability and growth. Through readings and research, activities and action steps, you will plan and analyze your entrepreneurial vision as you create a thoroughly researched and tested plan for growth. FastTrac® GrowthVenture™ is divided into two parts: Setting Direction and Taking Action.
Setting Direction

The first three modules focus on analyzing your current business situation and deciding on a strategic direction for your business.

Each of these three modules explores a key element of successful entrepreneurship:

**Vision and Goals**—What do you want your business to be like in the future? What are your goals for yourself and for your business?

**Market Opportunities**—How do you research the market opportunities that are a good fit for your business? How do you evaluate the best opportunities?

**Strategy**—How are you going to achieve your goals? What opportunities will you pursue? How will you compete in the marketplace?

The first step is to analyze your current business situation—your strengths and weaknesses, opportunities and threats. You will also determine your core competencies—those skills and tasks at which you excel that are most valued by the customer.

Your vision articulates what you want your business to become. It captures what is important to you as it paints a picture of the future. This vision becomes the basis for setting goals you want your business to accomplish as well as specific goals you want to complete through this program.

An important part of determining how to improve your business is determining your readiness for growth and conducting market research. You will identify the information you need and the best way to gather the information. This is valuable in identifying potential opportunities and evaluating them.

The results of your research will provide critical information as you make decisions about your strategic direction. By matching your best opportunities with your vision and goals, you can develop a well thought-out strategy to guide your business.
Taking Action

The last seven modules will guide you as you evaluate each major aspect of your business. You will take apart your business, analyze the pieces, and put it back together to create the alignment needed to support your vision and strategic direction. With each module, you will plan what to keep, what to change, and the actions to take to improve your business performance.

In FastTrac® GrowthVenture®, the business planning process helps you map your path for growth, your strategy, the resources you will need, and who will be on your team. Business planning is more than just writing a business plan—it’s about researching and thinking through the different aspects of your business and how they fit together.

You’ll build your plan one section at a time by conducting the necessary research and answering relevant questions for each action step. Observing due dates for action steps will provide you with a workable timeframe for completing the plan during the program.

Your plan will contain several sections, including a Management and Organization Plan, Product/Service Plan, a Marketing Plan, an Operations Plan, and a Financial Plan. These sections will be completed progressively throughout the program. After collecting and analyzing information for your specific business, you will complete the action steps in each module to compile that section of the plan. Electronic templates streamline this process by providing questions to answer in a pre-formatted Word or Excel® template.

Whether you decide to complete a formal written business plan or simply draft an internal working business plan that lists your goals, strategies, and the actions to accomplish them depends on the purpose of your plan. Business plans that will be used for external purposes generally should be formal. Your business plan may have the following uses:

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<td>• Develop an effective marketing strategy</td>
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<td>• Identify back-up suppliers</td>
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<td>• Guide decision making</td>
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The end result of the planning process is not merely a written business plan. Instead, the end result is the realization of this plan. That’s why the final module is designed to ensure your business gets going and gets growing.
Entrepreneur Manual

The Entrepreneur Manual includes ten modules that guide you in setting direction and taking action. Be sure to complete every action step—they are the critical path to creating a plan for your business that outlines your vision, strategy, and the actions you will implement to achieve the performance and growth you are seeking.

As you read each module, you will notice questions and checklists to help you apply the key concepts directly to your business. A pencil icon will cue you that it’s time to write down your thoughts. Answering the questions and completing the checklists will help focus your thinking and provide a reference point for information you will want to include in the action steps at the end of the module. Doing this while you are reading the module will save you time later when you are working on your action steps.

Activities in the Entrepreneur Manual appear directly after the module summary and should be saved to complete during the sessions. The activities allow you to practice and apply new concepts to scenarios and your own business. Action steps appear after the activities but are introduced in facilitation or coaching sessions and will be finished between sessions.

It’s important to document the plans you have for your business with the action steps. A plan that is only in your head can create a number of problems. The writing process is a thinking process. If you skip this step, you will skip a thinking step that helps ensure that all the parts of your business fit together.

To create a formal business plan, you will want to use complete sentences and organized paragraphs when working on the action steps that use the Business Plan Template. If you don’t need a formal business plan, you may prefer using bullet points and notes as you plan for growth.
If you’re like most entrepreneurs, you’re constantly barraged with information, decisions, and opportunities and, when you have time to think about it, you may wonder whether your business is achieving its potential. What’s the best way to grow your business? Without a crystal ball to predict what will work and what won’t, you will want to invest the time to analyze your current business situation and define your vision and goals. With a clear view of your business today and an eye on the future, you will be on your way to realizing your entrepreneurial vision.

This module will guide you through some key questions about your business. Your responses to questions in this and subsequent modules will create a framework to help you improve the performance of your business and guide its growth. As you sharpen your skills in strategic thinking and decision making, you will be making fact-based decisions rather than guesses, and you will learn to push your business beyond the status quo, answering the strategic question, “Is my business doing the right things?”

**Key Questions**
- How is my business doing today?
- What are my vision and goals for the future?

**Action Steps**

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It’s Your Decision

Entrepreneurs who want to grow their business may feel like Alice in Lewis Carroll’s *Through the Looking Glass* when she is running with the Red Queen. Alice finds that no matter how hard she runs, nothing changes, and she gets nowhere. The queen explains, “It takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!”

Running faster and faster just to stay in the same place—the Red Queen paradox—is typical of entrepreneurs who have not planned their growth. They must work harder to keep the same position in the market. They want to move forward but have not figured out how to do so. Simply doing more of the same thing is usually not the answer.

Like many entrepreneurs, you may have started with a do-it-yourself approach, making decisions based on your intuition. Unfortunately, this type of approach can only take you so far. To really grow your business and create an entity that supports your ultimate goals, you’ll need to be more strategic. Sound decision making will be a key to your success, and your business will really excel when those decisions fit together to create a well-thought out business strategy. The FastTrac® GrowthVenture™ program is designed to improve your ability to view your business from a strategic perspective and make these critical decisions. You’ll be better equipped to understand what your options are—then it’s your decision.

You may have a specific reason for taking this program or you may have a general sense that your business results could be improved. Listing your key issues or concerns will help you start identifying what changes need to happen. Whether or not you are losing sleep over these issues, take the time to write them down. These concerns will be a focal point as you consider how to begin the planning process to improve your business.

What Keeps You Up at Night?

List three to five key issues or potential concerns you have for your business.

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gearing up for growth

Elizabeth Demas knows that business can be beautiful. The beauty of hard work, vision and perseverance has made her business the success it is today. Elizabeth is the owner of a top-producing Avon retail store.

After being laid off from her job with a major telecommunications company, she had a career choice to make. An optimist by nature, Elizabeth knew she wanted to own her own business. She also realized that simply having desire and passion were not enough to build and sustain a successful business. That’s when Elizabeth turned to the Kauffman FastTrac GrowthVenture course. Upon completion of the course, armed with the necessary business planning models and tools she opened her first business venture.

Years later, her business is booming and she regularly gets calls from Avon representatives throughout the nation asking for guidance on how to set up and run a successful business. Elizabeth provides some key recommendations to the new business owners; spend adequate time planning, remain focused, and develop perseverance. She is a big believer in making a plan and following that plan. Elizabeth also recommends others get the help they need to effectively run their business. Whether that help is from a professional bookkeeper, CPA, attorney or other trusted advisor, it is well worth their time and money.

Elizabeth now holds monthly mentoring meetings with Avon representatives as one way to give back to her community. She helps Avon retail owners understand how to manage their finances, control inventory and generate sales. She also gives back by organizing yearly fund raisers in her store for a local domestic violence shelter and an organization that supports local juvenile diabetes research. She uses her success to help others succeed.

Elizabeth offers some advice to business owners: “My business has been successful because I planned for success. I have my business goals in mind and I work to meet those goals. It is all a part of my business vision.”

Planning to Grow

Identifying key issues provides useful information as you begin to analyze your business. As you complete this module and work on the actions steps, you will take an in-depth look at how your business is doing today and use the insights you gain to clarify your vision and set goals for your business.

When Rodriguez decided to make some changes in her business, she worked with her management team to analyze the business situation before they determined how to address the key issues. Getting your team involved in the process typically results in a stronger strategy and a plan that everyone is committed to achieving.

The planning process is like putting a puzzle together. All of the pieces—product or service, marketing, management, operations, and financials—need to fit together so that your business will create the results you are seeking. You need to make sure all efforts are aligned with your vision and strategy because a decision in one area often has implications for other aspects of your business.

FastTrac® Planning Process

- Clarify Vision
- Set Goals
- Determine Business Strategy
- Align All Aspects of Business
  - Product/Service
  - Marketing
  - Management and Organization
  - Operations
  - Financials

Key Issues
- SWOT Analysis
- Core Competencies
- Growth Opportunities
- Competitive Advantage
Too often, entrepreneurs spend the majority of their time figuring out their vision and goals without carefully thinking through the details of implementation. It’s critical that you anticipate the activities your business will need to stop, start, or continue doing. At the same time, you will have tough questions to answer. How will your business make this transition? What is the timeline? Who in your company will do what? How will you measure performance?

The decisions you make will help ensure that all aspects of your business are aligned and should drive your daily activities.

The first step is determining where you are and where you want your roadmap to take you. This module focuses on the following:

• Defining success, growth, and values for you and your business
• Analyzing your business
• Clarifying your vision
• Setting goals

Defining Success and Desired Growth

Before you begin evaluating your business, you will find it helpful to define your concepts of success, growth, and core values. This information forms a foundation on which you can make decisions to create long-term growth.

What Does Success Mean to You?

You are committed to making your business a success. What does that mean? If you take the time to examine what you actually want to achieve and choose your own definition of success, you will be more satisfied with your business in the long run.

Don’t let other people define your goals for you. Your business will be a success if it helps you reach your personal, professional, and financial goals. Different entrepreneurs define success in different ways. For the serial entrepreneur, it may be the adrenaline of finding a new opportunity and being able to launch another business. For others, success may mean achieving financial targets to live the life they want. Examples range from achieving autonomy, innovation, and fun to influence and social benefits. Other people may try to define success for you, but why let them?

Tip

Your time is limited, so don’t waste it living someone else’s life.

—Steve Jobs

As you think about your goals, don’t forget to consider how you want to exit your business. Will you want to sell it to start another business? Fund your retirement? Or do you just want to keep doing what you love until the end of your years?

By knowing how you want to leave your business, you can follow a thoughtful exit strategy to achieve what you want.

Your definition of success should serve as a filter for the decisions you make. A clear definition of success will help you know when you achieve it. Answer the following questions to start thinking about what success means to you.
Success

As you answer these questions, go beyond what you think the answers “should be,” and answer them in a way that is meaningful to you. How will you know if you are a success?

How do you define success for your business?

Do you have an exit strategy? If so, at what point and how do you want to exit?

What Does Growth Mean to You?

Most entrepreneurs want to see their businesses grow, even if they don’t aspire to create the next Facebook. Entrepreneurs define growth in different ways including—but not limited to—an increase in profit, revenue, customers, market share, employees, or locations. How fast or how big do you want to grow? You may have high expectations, or you might be satisfied with nominal growth. By setting growth targets, you can work towards achieving your goals.

goals drive growth

When Brad McLeod bought a business that manufactures custom motorcycles in Britt, Iowa, he knew he would have to grow his business to help him achieve his exit strategy goal—selling his business for a targeted amount to fund his retirement. With this target in mind, he knew he would need to significantly increase the value of Red Horse Motorworks—but how? After analyzing his business, the market, and the competition, McLeod developed a plan to grow his business by increasing his Internet presence and adding dealerships in the United States. He also capitalized on the interest in American-made cycles in the global marketplace. He now has dealerships in Africa, China, and Europe selling Red Horse motorcycles. He’s careful to avoid decisions to momentarily improve cash flow or profits that don’t fit with the overall goals he’s identified. McLeod measures growth by the increase in profits and the number of active dealerships. This growth will be reflected in the price he will be able to get when he eventually sells his business. The more the business grows, the more it will be worth to McLeod. All of the decisions he makes, whether it’s adding a manager or attending a new trade show, support his overall goal for growth.
As a first step toward setting growth targets, answer the following questions to start thinking about how your ideas of growth can either support or hinder your definition of success.

### Growth

What type of growth would you like to see for your business?

Check those you would like to see increased:

- Profit
- Market share
- Power and influence
- Personal satisfaction
- Revenue
- Employees
- Intellectual property created
- Other
- Customers
- Locations
- Benefits to society

How does this type of growth support your definition of success?

---

### Your Core Values

The decisions you will be making throughout this program are a reflection of your core values: what is important to your business and what values do you live by? Values are the principles or beliefs that guide you and your employees as you conduct business. In your day-to-day words and actions, you communicate your values to your employees. A strong organization will have employees who are committed to the same core values as the entrepreneur.

When Nancy Rodriguez launched her research and development firm, one of her primary motivations was to create a family-friendly workplace for women. As she has grown her business, she has maintained the family-friendliness that is important to her and her employees. An entrepreneur’s values are reflected in how the business conducts its day-to-day activities.

Think about what motivates you and what values you want reflected in your business. You may want to involve your employees to help define the values that will guide your business.

In the future, you may decide to set new goals, change your strategy, or adjust your vision, but your core values will not change. They truly are the compass that guides you and your business when critical decisions need to be made. Use the checklist in *My Core Values* to start thinking about what is central to your business.

### My Core Values

Check each value that is important to you and your business. Then place a star ★ by the top five. You can also write your core values in sentence form below.

- Close relationships
- Involvement
- Respect for others
- Community
- Helping customers
- Reputation
- Ethical practices
- Honesty
- Treat others fairly
My Core Values  continued
- Excellence
- Integrity
- Other:
- Family friendly
- Personal development
- Other:
- Financial gain
- Recognition
- Other:

You can use this space to state your core values in phrases or sentences:


Evaluating Your Business

To better understand your business situation, the next part of this module will help you clarify your mission and complete an internal assessment and environmental scan. You will use this information to conduct a SWOT analysis and identify your core competencies. Your results will be used as part of the decision-making process in subsequent modules.

Mission Statement

A mission includes the purpose of the business, how it achieves its purpose, and the values that guide the business. These basic ideas can sometimes be difficult to articulate.

The right mission statement can inspire and motivate you, your employees, and your customers. It gives your business focus. As you work on your mission statement, seek input from your team. There is no single right way for a mission statement to be written. Most mission statements tend to be three or four sentences, but often a single sentence can be equally effective. In any case, your mission statement should be specific to your business. Stay away from generic references to quality and customer satisfaction because your vision—just like your business—is unique.

The following are examples of mission statements for a variety of large and small businesses:

- The mission of Google™ is to organize the world’s information and make it universally accessible and useful.
- Southwest Airlines’ mission is dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit.
- Red Horse Motorworks’ mission is to find out exactly what the customer wants, purchase the best parts, employ the best, most experienced people, build the motorcycle by hand (no assembly line), and give the customer the highest value at the best possible price.
- The mission of ActiveForever® is to be utilized as the most highly recommended source of medical assistive devices, physical rehabilitation products, pain relief, and convenience products for adults of all ages, for home and workplace, while avoiding direct involvement in insurance reimbursement.

Each of these examples describes the purpose of the business and how it is accomplished. ActiveForever® even includes what they don’t want to do—get involved with insurance reimbursement.
Tip
Some entrepreneurs may say a business’s purpose is to make a profit, but profit is actually an objective or result of the business accomplishing its purpose.

In *The Art of the Start*, Guy Kawasaki suggests distilling your mission statement into a powerful mantra, something short and sweet that will drive what you and your team do. Sometimes, simply two or three words can be powerful.

Volvo’s “First we think, then we build” helps remind employees what they are trying to accomplish—build cars that have intelligent designs. This brief sentence also communicates that intelligent approach to their customers as a competitive advantage.

Action Step 1.2 will guide you through clarifying your mission statement. If you already have one, take this opportunity to review and update it. Use *Clarifying My Mission* to make some notes for your mission statement.

## Clarifying My Mission

The purpose of my business—why does it exist?

---

How my business achieves its purpose—what does it do?

---

Key values of my business—what does my business stand for?

---

Putting it all together. Make a first-draft attempt at crafting a mission statement for your business.

---

Tip
By the way, doing this work will help you in completing your business plan. You’ll notice that many of these questions are directly tied into the sections required in your business plan.

Internal Assessment
Once you have a clear sense of your mission, it’s time to diagnose your company’s strengths and weaknesses. The following checklist will help you analyze your business—what’s working and what can be improved. It’s helpful to have your partners and employees complete it with you. By including others, you’ll not only get their good ideas, but you’re more likely to get their buy-in and motivate them to help you implement any plans that may arise from the assessment.
### Internal Assessment

Evaluate your business’s internal strengths and weaknesses using the statements below. Answer those that apply to your business. Add additional statements that are important to your specific business.

<table>
<thead>
<tr>
<th>Decision Making and Planning</th>
<th>Yes</th>
<th>No</th>
<th>Improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>My business has a formal process to identify business opportunities, potential risks, and pitfalls.</td>
<td></td>
<td></td>
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<tr>
<td>Goals are written and systematically reviewed by key management team members.</td>
<td></td>
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<tr>
<td>Success factors are tracked and measured against business plan projections.</td>
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<tr>
<td>I use the planning process to ensure that all aspects of my business work together and support the overall goals of the business.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I have an exit strategy in place that meets my personal and financial goals.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Product/Service</th>
<th>Yes</th>
<th>No</th>
<th>Improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>I know why customers choose to buy my product/service over someone else’s.</td>
<td></td>
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<tr>
<td>I know the benefits my customers believe they receive when they purchase my product/service.</td>
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</tr>
<tr>
<td>I am well aware of my product/service limitations.</td>
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<tr>
<td>I have identified and protected all intellectual property of my business.</td>
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<tr>
<td>I know the potential liabilities of my business and have taken steps to minimize them and protect my business from them.</td>
<td></td>
<td></td>
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<tr>
<td>I have a written plan in place to provide sufficient production capabilities to meet my projected needs.</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>I am aware of and comply with all laws and governmental regulations that apply to my business.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I use pricing strategies for my product/service to achieve my marketing and financial goals.</td>
<td></td>
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<tr>
<td>Other</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Marketing</th>
<th>Yes</th>
<th>No</th>
<th>Improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>I manage my business to distinguish it from competitors.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>My business’s core competencies create a competitive advantage in the market.</td>
<td></td>
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<tr>
<td>I know which market differentiators my competitors use.</td>
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<tr>
<td>I have clearly defined marketing goals and objectives for the year.</td>
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<tr>
<td>I have identified my target market and know who is most likely to buy from me.</td>
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<tr>
<td>My company has a distinctive brand that is communicated consistently to the market.</td>
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<tr>
<td>I have customer service strategies in place to turn a first-time sale into a long-term customer.</td>
<td></td>
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<tr>
<td>My distribution channels allow me to grow and achieve business goals.</td>
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<tr>
<td>I use an effective mix of advertising, promotion, and publicity to promote my product/service.</td>
<td></td>
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<tr>
<td>I evaluate the effectiveness of my marketing plan on a regular basis.</td>
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<tr>
<td>I know the return-on-investment of my marketing activities.</td>
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<tr>
<td>All of my proposed marketing activities are listed on an annual schedule.</td>
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<tr>
<td>Other</td>
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</tbody>
</table>
### Internal Assessment continued

#### Management and Organization

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
<th>Needs Improvement</th>
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<tbody>
<tr>
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</table>

- I spend most of my work time on high-priority tasks that drive my business results.
- I have a clear vision for my company and communicate it regularly to my employees and contractors.
- I use outside mentors, advisers, and coaches to continue to learn and grow as a leader.
- My employees and I have a clear idea of what we want to accomplish.
- Written job descriptions clarify roles.
- I have recently examined my management structure to determine if it is meeting my needs.
- My employees are as motivated and energized as they can be. They enjoy coming to work.
- I enjoy coming to work.
- My employees and I have the skills and knowledge needed to perform our jobs and make good decisions.
- My employees are able to work on their own with minimal supervision from me and my managers.
- My contractors and vendors are doing superior work, doing it in a timely manner, and providing good customer service.
- My company follows socially responsible business practices.
- My legal form of organization is the best choice and minimizes tax and legal liability.
- Other

#### Operations

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
<th>Needs Improvement</th>
</tr>
</thead>
<tbody>
<tr>
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</table>

- I have documented the processes in my business.
- I have controls in place to assure the safety, security, and quality of control of my business and its products/services.
- I have key measurements that I monitor on a monthly basis.
- I have my duties clearly outlined to make sure I complete my responsibilities.
- I provide ongoing training for all employees.
- I have and use the technology necessary to drive current business functions.
- I have a technology growth plan.
- I have a risk management strategy.
- Other

#### Financial

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
<th>Needs Improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- I monitor my profitability and cash flow on a regular basis.
- I can interpret the financial ratios for my business and use them to measure my performance.
- My employees understand the financial goals of the business and know if we are achieving them.
- I have established a good business relationship with a banker, accountant, insurance agent, and financial adviser.
- Other

#### Other (List additional areas that affect the success of your business.)

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
<th>Needs Improvement</th>
</tr>
</thead>
<tbody>
<tr>
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</tbody>
</table>
Environmental Scan

In addition to examining your business, you will also want to consider the external factors that affect it, such as the industry, competition, customers, economic conditions, and cultural trends. This type of review helps you focus on what is happening now and anticipate changes that may come. You will find this information to be a helpful starting point as you plan to grow your business in subsequent modules.

Complete an environmental scan for your business by responding to the following questions. Answer those that apply to your business and add additional ones that are important to your specific business. You may decide some questions require additional research. Module 2 Exploring Growth Opportunities will help you research this information.

Environmental Scan

Industry

How do you expect the demand for your type of product/service to change in the future? Why?

What are the trends that will affect demand? Consider demographic, economic, regulatory, and technological changes as well as global business trends that may affect demand.

What trends will affect the way you conduct your business?

How do economic conditions affect the demand for your type of product/service?
Environmental Scan continued

Competition

Who are your strongest competitors? For each one, describe their product/service, image, typical customer, pricing, marketing, and how they differentiate themselves. What do they do best? What is their weakness?

Market Segments

For each of your market segments, describe what a typical customer is like, using the following descriptors.

Demographic (relevant factors such as age, gender, educational level, ethnicity, income level)

Geographic (where they live)

Psychographic (lifestyle and attitudes)

Buying considerations (primary reasons customers purchase your product/service, such as benefits, price, convenience, service, and status)

What other market segments might be attractive for your business?
SWOT Analysis
A useful tool to help you better understand your business’s current prospects for success is the SWOT analysis. Factors that are internal to your business, such as key management personnel, are evaluated as strengths or weaknesses. External factors, such as the economic environment, are described as opportunities or threats. Your SWOT analysis will create a snapshot of your business’s situation. The information you captured for your Internal Assessment and Environmental Scan can be used to complete your SWOT analysis in Action Step 1.1.

Strengths can be used to gain a competitive advantage. You will want to nurture your strengths.
   Examples: recognized as market leader, adequate financial resources, strong management team, proprietary technology
Weaknesses are important because they need to be corrected in order to meet your goals.
   Examples: costs disadvantage with competitors, weak market image, no clear strategic direction, lack managerial depth, outdated facilities
Opportunities could allow you to improve your position in the market or grow your business.
   Examples: expand product line, add related service, form strategic alliance, target new market
Threats represent potential problems that you should consider and address.
   Examples: entry of strong competitor, increased regulation, change in customer buying preferences

Take a look at items in one category and you may see how, from a different perspective, they can fit into the opposite category. For example, if you ignore an opportunity, it can become a threat if a competitor decides to use it.

Core Competencies
You can use the SWOT analysis to help determine your core competencies. Competencies are those skills and tasks at which you excel and are valued by your customer. A core competence is a capability that could help your business achieve a competitive advantage, such as an expert sales team, strong branding, efficient processes, proprietary technology, or another asset that is critical to your success. Your business may have many competencies, but your core competencies are those that help differentiate it from the rest of the market. For example, Toyota is currently the car company with the most advanced core competency in building hybrid vehicles. Starbucks has core competencies in brewing full-flavored coffees, having the dominant coffee brand, the largest network of distribution outlets, and a predictable customer experience.

Looking at your business’s strengths is a starting point to identify its core competencies. Once core competencies are identified, they can form the cornerstone of your business strategy. Think of your core competencies as your invisible assets. Though they do not show up on your Balance Sheet, they are resources that you can use to beat the competition.

Your core competencies will change over time. For example, your business may have superior technological skills that give it a competitive edge. Eventually, competitors will catch up or new technological skills will supercede the current ones.

Tip
SWOT is an acronym for Strengths, Weaknesses, Opportunities, and Threats.

Tip
A core competence is difficult for a competitor to imitate.
When they do, your business will need to explore its opportunities and determine what changes it needs to make before it loses its competitive advantage. The name Schwinn used to be synonymous with quality bicycles. After losing touch with their market and outsourcing their production, they lost their competitive advantage and ended up in bankruptcy.

**Clarifying Your Vision**

Most entrepreneurs are driven by an overriding purpose when starting their business. Successful entrepreneurs take it one step farther and develop a vision for future growth. This vision helps guide the day-to-day operations and strategic decision-making necessary to achieve success.

Before deciding what steps are necessary to move toward your business goals, you must be very clear about your desires for yourself and your business. Identifying a three-year vision can add this clarity.

**Three-Year Vision**

What do you dream your business could be? Your vision can help you imagine your business beyond the details of its current day-to-day activities. Don’t mistake the vision you will create for FastTrac® for those formal vision statements with lofty aspirations that are framed and prominently displaced for all to read. A common problem with that kind of vision is that it often expresses nebulous and unattainable ideals. The vision you will be asked to create in Action Step 1.2 is intended to be one that will help you visualize specific things you would like to realize within a three-year time frame.

To identify your three-year vision, focus on the future. Don’t forget to consider changes in the global marketplace, the Internet, and technology. And remember, a vision does not have to be grounded in today’s reality. It is a goal to strive for, not a reflection of a business’s current position.

While your mission statement summarizes the business’s purpose, a vision paints a picture of what the future could look like. Consider the example on the following page of what one entrepreneur dreamed his business looked like three years into the future. Use this example to get ideas for Action Step 1.2, when you will have the opportunity to create your own vision.

**Closing the Gap**

Moving a business from the present to its vision requires a gap analysis. This process will help you identify the difference between the two and determine what changes in your business will close the gap and help you achieve your vision.

For example, if a business has recently seen its sales stagnate and its vision is to increase its profits, the entrepreneur could use a gap analysis to examine why the sales are flat, determine the best way to improve sales, and pay attention to ways to increase profitability, even if sales do not grow.

Another entrepreneur’s vision may include increased production for her manufacturing business. Since her current space and equipment are already at full capacity, she could bridge the gap by identifying the steps needed to increase production, including new space, additional equipment, employees, and the funds to accomplish these goals.
EXAMPLE

<table>
<thead>
<tr>
<th>My three-year vision</th>
<th>My staff</th>
<th>Management team</th>
<th>Vendors</th>
<th>Customers</th>
<th>Myself</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>What do I see?</strong></td>
<td>They have productive meetings with innovations emerging.</td>
<td>I see an energized committed top team.</td>
<td>They want to supply us and visit us regularly.</td>
<td>They are buying our products/services.</td>
<td>I am leading my team and the organization is very successful.</td>
</tr>
<tr>
<td><strong>What do things look like?</strong></td>
<td>They are eager to get to work. They work hard and collaborate.</td>
<td>They are taking care of their areas and producing top results.</td>
<td>They ask if they can form strategic alliances—perhaps finance product lines.</td>
<td>They are happy to visit our business and regularly give us positive feedback and suggestions.</td>
<td>My organization is following a solid strategic plan.</td>
</tr>
<tr>
<td><strong>What do I hear?</strong></td>
<td>I hear them taking good care of customers.</td>
<td>I hear them encouraging one another and offering assistance.</td>
<td>I hear them offering special payment plans and discounts.</td>
<td>They say they are satisfied with the quality of our products and are telling other potential customers about us.</td>
<td>My products/services are the best in the industry.</td>
</tr>
</tbody>
</table>

How to move from your current business situation to the business you envision is the focus of this FastTrac® program. The next step is to set your goals for your business, including some that you would like to accomplish during this program.

**Setting Goals**

With an eye toward their vision, entrepreneurs set goals for the organization, themselves, and their employees. Then they measure the results and hold people accountable, including themselves.

It is not enough to set goals. You must diligently work toward them and follow-up by measuring your results and making improvements. One of the most important things you can do is to define your business’s most critical goals then develop measurable targets, determine the gaps between desired and actual performance, and implement a strategy to close the gaps. You will set goals in Action Step 1.3 and then, in Module 3 Making Strategic Decisions, identify strategies to reach those goals.

Goals for your business should be **SMART =**

<table>
<thead>
<tr>
<th>SPECIFIC</th>
<th>MEASURABLE</th>
<th>ACHIEVABLE</th>
<th>RELEVANT</th>
<th>TIME-BASED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clearly defined by those who have the knowledge about their impact</td>
<td>Quantifiably defined in such a way as to gauge progress</td>
<td>Challenging and rewarding, but still within reach</td>
<td>Tied to current critical tasks and abilities of the team</td>
<td>Linked to an agreed-upon timeline</td>
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You will increase your odds of accomplishing your goals if you write them down. You’ll find that using the SMART guidelines will help improve your goals setting skills.

**EXAMPLE**

**Original** – Become a leader in the computer headphone/microphone industry, excelling in meeting customer requirements and providing the highest quality products.

**Rewritten** – Within two years, achieve 40 percent market share in the computer headphone/microphone industry, receive the J.D. Power highest quality rating in the industry, and receive 95 percent or above good or excellent ratings on our customer-service surveys.

**Goals for Your Business**

Businesses use many types of goals at different levels for different purposes. Your goals can be based at the organizational, departmental, team, or individual level. Consider these two lists of possible goals:

- **Organizational and Departmental Goals** – Profitability targets, sales targets, inventory targets, financial ratios, productivity, health and safety, environmental, community, employee satisfaction, turnover, customer satisfaction, quality, human-resource targets, government regulations, and waste reduction

- **Individual and Team Goals** – Number of units produced, specific tasks to be completed, deadlines met, completion rates, time on task, and quality rating

Regardless of whether you write the goals at the organizational, departmental, team, or individual level, they should be aligned with your overall business strategy.

In Action Step 1.3 you will create a set of goals that can be used to guide your business as well as specific goals for this program.

**Goals for this Program**

One of the best ways to make sure you accomplish your goals is to write them down and hold yourself accountable. As you think about the broader goals you have for your business, also think about the short-term goals you want to accomplish during this FastTrac® program. When you decided to take this program, you may have had some specific goals in mind. If not, now is the time to consider what it is you want to accomplish.

Perhaps you want to learn how to use your financial statements to make better decisions about your business. You may want to do some research to determine whether you are targeting the right markets, create a written plan to guide your business, or develop your networking skills during each session. This is an arbitrary list. You need to decide what you want to accomplish so that you can focus your efforts to get the best results. And don't forget personal goals that your business can help you fulfill. After all is said and done, if your business isn’t helping you personally, it’s time to make some changes.

**Tip**

Even if you are on the right track, you’ll get run over if you just sit there.  
—Will Rogers

**Tip**

Whatever goals you set, make them make a difference for you. Periodically review your progress to make sure you are accomplishing them.

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Summary

You’ve started defining your future. In this module, you identified what success means to you and the type of growth you want for your business. You also learned how to analyze your current business situation, clarify your vision, and set goals to achieve it. This process will help provide direction and focus for you and your employees.

Key Things to Remember

• Define what success means to you; this can serve as a filter for the choices and decisions you make for your business.

• Engage the planning process as a proven way to think through every aspect of the business before you commit financial resources.

• Seek input from your employees as you analyze your business and work on your plan. Their insights are valuable and their buy-in is crucial.

• Analyze your business’s internal strengths and weaknesses and its external opportunities and threats when developing your overall business goals.

• Know what you and your business are good at—your core competencies—and recognize that your role in the business will evolve as the business grows.

• Set goals and regularly measure your progress against them.

Module 2 Exploring Market Opportunities will focus on key aspects of growth: assessing the business’s readiness for growth, identifying and screening market opportunities, conducting market research, and determining market potential. You will use your vision and goals from Action Steps 1.2 and 1.3 as part of the screening process to determine if an opportunity is right for your business.
Activity 1a: Learning Moments

Recognize learning moments that trigger change.

Directions

By listening for signs, you will find opportunities to improve your business's performance. Sharpen your entrepreneurial skills as you read three short scenarios. Remember, sometimes you may be seeing a symptom and not the source of the problem.

Step 1 Read each scenario. In small groups, discuss the questions following each scenario.

Scenario A: As Jake walked into his office, he replayed this morning's conversation with his accountant. He was thinking about adjusting his prices to compete with a new business that was advertising services similar to his. Their grand opening was in two weeks. Jake wanted to discount some of his most popular services to make them slightly cheaper than the new business's advertised prices. He wanted the accountant to help him figure out what lowering prices would do to his profitability. His accountant asked a question that Jake could not answer: Why do your customers buy from you?

Is price the only way Jake can compete with the new business?

What types of things do customers want from a business?

What steps do you suggest Jake take next?
### Activity 1a: Learning Moments continued

**Scenario B**: Alex glanced up at the clock. It was fast approaching 6:00 p.m. and on his desk was the day’s mail, still unopened. He had planned to spend time evaluating a potential business opportunity brought to him by another entrepreneur, Taylor. She had suggested they work together on a proposal for one of her clients. Instead of considering the opportunity, Alex had spent much of the morning dealing with an employee problem. Taylor had asked Alex to let her know of his availability by tomorrow. The new opportunity sounded interesting and would be a great opportunity to work on a high profile project but Alex hadn’t had time to respond to her offer.

What are the issues facing Alex?

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What changes are needed?

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What steps do you suggest Alex take?

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**Scenario C**: An ergonomic consultant, Sarah contracts with corporations to evaluate potential problems and make recommendations for a healthier and more productive workplace. As part of her work, she tells her clients where they can find the items needed to improve their workstations. The local retailers are often out of stock, and her clients have to wait weeks for the products. One of Sarah’s best clients asked her why she didn’t carry some of these items herself. Sarah wants to find a way to grow her business but is not sure if this is the right direction.

To grow her business, what options might Sarah want to consider?

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Activity 1a: Learning Moments continued

What questions should Sarah ask herself first before she evaluates these options?

________________________

________________________

________________________

Step 2 Answer the following questions about your own learning moments.
Discuss your responses with your small group.

What are some of the learning moments or trigger points you have had as an entrepreneur? Think about specific events or symptoms you have noticed.

________________________

________________________

________________________

What type of change, if any, did you make as a result?

________________________

________________________

________________________

What type of change do you think your business needs?

________________________

________________________

________________________

What do you like about your business and what is already working well?

________________________

________________________

________________________
### Activity 1b: SWOT Analysis and Goal Setting

Identify business priorities and make recommendations.

**Step 1 Read the scenario and review the SWOT analysis.**

Ethan and Olivia started a technology security consulting business. They currently serve the needs of small businesses and schools, with the main task of securing their networks and Internet connections. They have a comfortable client base and have seen a steady increase in profits due to a growing demand for their services.

**EXAMPLE**

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
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<tbody>
<tr>
<td>Well positioned in the market (no strong competitors in their community)</td>
<td>Expand to serve mid-sized businesses</td>
</tr>
<tr>
<td>Ability to explain technical issues in a non-technical manner to clients</td>
<td>Increase services offered to existing clients</td>
</tr>
<tr>
<td>Keeps costs down by using independent contractors as needed</td>
<td>Industry expected to continue to grow</td>
</tr>
<tr>
<td>Stays current on latest technology</td>
<td>Diversify from being strictly services to offering software products</td>
</tr>
<tr>
<td></td>
<td>Additional safeguards for identity theft represent an untapped area for growth</td>
</tr>
<tr>
<td></td>
<td>Could include developing communication pieces for clients to use with their customers</td>
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</table>

<table>
<thead>
<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>No clear strategic direction</td>
<td>Potential entry of additional competitors</td>
</tr>
<tr>
<td>Weak image with potential customers</td>
<td>Changing customer preferences and needs</td>
</tr>
<tr>
<td>Marketing skills are not strong</td>
<td>Clients could opt to train employees to do the work in-house</td>
</tr>
<tr>
<td>Undocumented processes</td>
<td>Potential for new technology to change industry</td>
</tr>
<tr>
<td>No job descriptions for management team</td>
<td></td>
</tr>
<tr>
<td>Not sure of actual costs for each service—have not updated prices in two years</td>
<td></td>
</tr>
<tr>
<td>Have not identified or protected all intellectual property</td>
<td></td>
</tr>
</tbody>
</table>

**Step 2 Identify the most important items to work on first.** Add a star ★ after the most important items in each of the four categories above.
Activity 1b: SWOT Analysis and Goal Setting continued

Step 3 Write preliminary recommendations for Ethan and Olivia. Recommendations should capitalize on strengths and opportunities and correct or address weaknesses and threats.

EXAMPLE
To address weak image with potential customers, create a strong brand for the business.

Step 4 Prioritize the recommendations. Turn your top two recommendations into goals.

EXAMPLE
Olivia will determine the desired brand identity, the message(s) to communicate, and marketing activities to support this information. The plan will be ready to implement by March 23.
### Action Step 1.1: Conduct a SWOT Analysis

Create an overview of your business’s strategic situation.

**A. Complete the chart below.** Include the strengths and weaknesses you identified in your internal assessment and the opportunities and threats from your environmental scan.

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Opportunities</th>
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<table>
<thead>
<tr>
<th>Weaknesses</th>
<th>Threats</th>
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</table>

**B. Identify the three or four most important items to work on first.** Add a ★ next to the most important items in each of the four categories above.
Action Step 1.1: Conduct a SWOT Analysis continued

C. What are your core competencies? List the skills and tasks at which you excel and by which you are valued by your customers.

D. What do you want to research? Make a list of things you want to research as a result of the SWOT analysis.
Action Step 1.2: Define My Three-Year Vision

Articulate the core values, mission, and vision for your business.

A. **Identify the core values for your business.** Refer to *My Core Values* on p. 10–11.

B. **Write your mission statement.** Refer to *Clarifying My Mission* on p. 12.

C. **Define your three-year vision.** Describe what you want your business to be like in three years. Include your role in the business, the employees you will have, the customers you will serve, and the products/services you will provide. Write your thoughts below or use the chart on p. 30.
### Action Step 1.2: Define My Three-Year Vision

Think about what you would like your business to be like three years from now. Describe your thoughts in the following chart.

<table>
<thead>
<tr>
<th>My three-year vision</th>
<th>My staff</th>
<th>Management team</th>
<th>Vendors</th>
<th>Customers</th>
<th>Myself</th>
</tr>
</thead>
<tbody>
<tr>
<td>What do I see?</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>What do things look like?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>What do I hear?</td>
<td></td>
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</tbody>
</table>
### Action Step 1.3: Identify Goals for My Business and the FastTrac® Program

Create actionable goals that will focus your performance on what you want to achieve.

**Directions**

Consider your SWOT analysis and your vision for your business. Set three to four goals for your business that are key to achieving your vision. For the FastTrac® Program, set two to four goals that you want to accomplish as a result of this program.

**SMART Goal Setting**

Identify three to four specific goals you want to set for your business. Write the first draft of the goal in the Original Goal box in the left-hand column, then check to see if it is specific, measurable, achievable, relevant, and timely. Review the descriptions of these characteristics on p. 19. If the goal does not fulfill all these requirements, improve it in the Revised Goal box.

<table>
<thead>
<tr>
<th>Goals for My Business</th>
<th>Specific</th>
<th>Measurable</th>
<th>Achievable</th>
<th>Relevant</th>
<th>Time-based</th>
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<tbody>
<tr>
<td>A. Original Goal</td>
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<td>A. Revised Goal</td>
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<td>B. Original Goal</td>
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<td>B. Revised Goal</td>
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<td>C. Original Goal</td>
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<td>C. Revised Goal</td>
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<td>D. Original Goal</td>
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<td>D. Revised Goal</td>
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</table>
### Action Step 1.3: Identify Goals for My Business and the FastTrac® Program

**SMART Goal Setting**
Identify two to four specific goals you want to accomplish during the FastTrac® program. Write the first draft of the goal in the Original Goal box in the left-hand column, then check to see if it is specific, measurable, achievable, relevant, and timely. If the goal does not fulfill all these requirements, improve it in the Revised Goal box.

<table>
<thead>
<tr>
<th>My Goals for the FastTrac® Program</th>
<th>Specific</th>
<th>Measurable</th>
<th>Achievable</th>
<th>Relevant</th>
<th>Time-based</th>
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<tbody>
<tr>
<td>A. Original Goal</td>
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<td>A. Revised Goal</td>
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<td>B. Original Goal</td>
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<td>B. Revised Goal</td>
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<td>C. Original Goal</td>
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<td>C. Revised Goal</td>
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<td>D. Original Goal</td>
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<td>D. Revised Goal</td>
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The most successful entrepreneurs don’t question whether or not they should grow their business, but rather how, when, and how much. Making decisions about growth requires careful analysis as well as clarity in personal values, vision, and goals. Because profitability is a primary measure of a business’s ultimate success and longevity, this module explores growth opportunities that focus on sales and profitability. Sales increases come from expansions in markets served, target customers reached, products and services offered, and other business expanding methods. In Module 1 you began your analysis by evaluating your current business situation, clarifying your three-year vision, and setting goals to achieve it. This module will help you evaluate growth indicators that show your business’s readiness for growth. In addition, you will assess the industry’s own potential for growth and identify and screen opportunities for your business.

Key Questions

- What growth opportunities are right for my business?
- What market research do I need to make decisions about my business?

Action Steps

- 2.1 Assess Industry Potential
- 2.2 Develop My Customer Profile
- 2.3 Analyze My Direct, Indirect, and Future Competition
- 2.4 Evaluate Growth Opportunities
- Read Module 3 Making Strategic Decisions
Growth Analysis

It’d be great if entrepreneurship were a clearly marked road with signs telling you where each lane would take you and how long it would take to get there, when there is a curve or dead end ahead, and speed limits so you don’t go too fast and get in trouble.

In this module, you will learn the signs that indicate your readiness for growth and what pace is appropriate for your business. You’ll also learn how to research and evaluate opportunities so you know what direction you want to take your business.

Growth analysis includes basic structures for assessing the direction and potential of your business, but it is a flexible process that can be adapted to suit the kind of growth your company most needs. The questions, checklists, and action steps in this module will help clarify your options for growth and focus on the best opportunities.

shifting gears to grow

John Fries and his brother Mark, own wiredMD. Their initial product was streaMed Patient Education Solution, a series of streaming videos describing diagnoses, procedures, and treatment plans for airing in doctors’ waiting and examining rooms. Their mission: to empower healthcare professionals to improve patients’ healthcare experience and reduce costs by making patient education more engaging, effective, and efficient to deliver. Their vision: to educate the masses.

They started their business by selling streaMed to doctors’ practices. Their first sign that they needed a different means to grow their business was a financial one. When they began to get a handle on their marketing budget, they determined it was too costly. They found that not only were doctors a hard sell, but also that the trade shows to target them were expensive. It was costing them $110 to $125 for each qualified lead.

Then, while pitching a medical group at a women’s health center, they were directed down the hall to a health resource center. It featured an Internet-connected computer that patients could use for accessing information. With just some slight engineering tweaks, their product would be perfect for such an environment. With the interest exhibited in the health resource center, they realized that a more effective and scalable strategy was selling a video patient education software product that patients could access directly over the Internet—in health resource centers, libraries, or even on home computers.

So they shifted gears—halting all marketing efforts aimed at doctors’ practices directly to reach the new health resource center audience. With a new marketing focus, they adjusted both the product and the message. In changing gears, however, they understood that some things don’t change. Brand identities, color schemes and corporate culture begin to belong to the entity and come to be identified with it. They hired two people to make cold calls all day, every day, from free Internet databases. They created direct mail materials and direct e-mail campaigns. All of these efforts helped bring down the cost-per-qualified lead to $25 from $110 to $125.

In addition, the Freiss brothers have refined their goals. With their new business model, their customers are medical libraries, health-resource centers, and small to large physician groups. What is important, they’ve determined, is carving out a definitive chunk of the market—specifically, licensing streaMed in one manner or another to 3,000 physicians, which is equal to one half of one percent of the total marketplace. That amount of market share would place them in the ranks of highly viable healthcare information software companies, opening up many doors for their future.
In the case of wiredMD, the Freiss brothers discovered the best way to grow was to target a new market, tweak the product, and adjust their marketing and distribution. With this revised business model, they are growing their business by working hard and smart.

Entrepreneurs measure growth in different ways: company size, market share, and profits. They all, however, seek growth for the same reason—to create a business with a sustainable future. All successful businesses grow, though some grow faster than others.

The key to successful growth is understanding how much growth your business can support. In this module you will first evaluate growth readiness. Next you will turn your attention towards the industry to evaluate its potential for growth. Finally, you will identify and screen opportunities for growth, conducting market research to evaluate them. This research will help you determine the market potential by providing information about your customer, target market, and industry. In Module 3 you will determine your business strategy and throughout the rest of the program develop a plan to implement it.

The Growth Analysis Map on p. 36 illustrates a framework to guide your evaluation of growth opportunities and strategies. An overriding consideration in the entire process is to establish growth strategies that align with the vision and goals for your business.

With your vision and goals from Module 1 clearly in mind, you will follow a four-step process to determine a growth strategy for your business:

1. Evaluate Growth Indicators
2. Assess Industry Potential
3. Identify and Screen Growth Opportunities
4. Determine Market Potential

**Evaluate Growth Indicators**

In this step, you will take a close look at two key indicators of your business’s ability to undertake growth—its financial strength and stage of growth. Businesses that are still struggling to maintain profitability or are in the early growth phase will benefit from different growth strategies than businesses that have achieved financial stability and are more mature. Determining these factors up front will help you make realistic plans for your business’s future.

**Financial Performance**

Your business’s financial strength is of particular importance in assessing growth readiness. Growth requires money to purchase additional equipment, invest in added staff, and support the rest of the growing operations. To determine if your business has internal sources of cash to invest in growth, you will need to review historical and projected financial statements on a regular and ongoing basis. By assessing the numbers, you can see where you’ve been, where you are going, and what it will take to get you there.

Information on your business’s sales, profits, and cash flow are key. Conducting a preliminary analysis of net profit and its components will provide you with a greater understanding of the current financial condition of your business. It will also tell you if you need to limit your plans for growth because of financial constraints.
One key consideration is the amount of cash generated from business operations available to support growth. Alternatively, does your business have the ability to obtain external funding? What about contingency planning? If cash from current operations were invested in growth, would there be sufficient additional resources available to offset unforeseen challenges that might also require a cash infusion?

Growth financing is typically the easiest to obtain from external sources, but it comes with costs: banks earn interest on loans and investors expect a strong return on their investment and may insist upon ownership in the business to ensure it. “Investors can make your stomach twist and turn,” says entrepreneur Natalie Tessler, founder and owner of Spa Space, a state-of-the-art day spa located in downtown Chicago. “On one hand you feel incredibly grateful to these people. They are facilitating and enabling you to live out your dream.” Tessler continues, “On the other hand, knowing that they are out there is bedeviling because you feel indebted and concerned about any failure and how they’ll respond to it. It’s really scary to think that I could let them down.”
You will continue this financial assessment in the financial modules, 4 and 9, comparing your financial information with norms for similar-sized businesses within your industry—a process known as **benchmarking**. You can find this information through industry trade organizations and financial statement guides, such as Dun & Bradstreet and Risk Management Association (RMA).

### Stage of Business

Growth, in some form, can occur at every stage of your business. The types of opportunities that are realistically available to you may be influenced by where your business is in its growth and development. Businesses go through similar, predictable stages; however, the length of time for each stage can vary considerably from one business to another. Your business’s stage of development will have a significant impact on the type and extent of growth appropriate to pursue. It will also have a major influence on the types of funding available to you.

A business’s growth pattern typically follows these stages:

- **Conception**—Entrepreneurs determine the feasibility of the new business by evaluating the needs of the market, the potential profitability, and the availability of needed resources.

- **Start-up**—The business is launched and cash is usually tight. Sales are typically inconsistent at best, seldom meeting the entrepreneur’s expectations. Entrepreneurs modify products or services and experiment with different market penetration tactics. Resources are scarce and must be used judiciously.

- **Early stage**—Customer responses validate the business concept and marketing efforts, but the business struggles to find its competitive advantage. All activities are focused on increasing sales.

- **Growth**—Sales and profits are increasing as a result of new customers and expanding markets. Cash flow, staffing, and developing systems are issues because of the costs and considerations of growth. Minor modifications to the business strategy may be warranted as entrepreneurs learn more about the market and customer response.

- **Rapid growth**—The business outpaces the industry growth rates and establishes itself as a viable concern. Sales increase rapidly. Some entrepreneurs decide to sell their business at this stage.

- **Maturity**—Sales hit their highest point or may level off as a result of saturated or very competitive markets. Profits decrease as prices are lowered to compete. Customer retention and managing resources are key. Adoption of a new strategy to maintain historical growth trends is important if continued business growth is desired.

- **Innovation or decline**—Sales and profits start or continue their descent. Without innovation, the business declines. New products or services and new markets are needed to recapture the historical growth trends of the business.

---

**Tip**

Many businesses do not follow a direct path through these stages but move in and out of them during the life of the business.

**Tip**

To realize the economies of scale from accumulated sales growth, a thorough cost analysis of the business should be conducted periodically.
Now it is time to look at growth indicators in your business to help determine what level and type of growth your business is capable of supporting. To do so, complete *Business Growth Indicators* with the information you have available for your business.

### Business Growth Indicators

**Step 1 Review my financial information.** A review of your financial statements will help you begin assessing your financial strength in terms of sales, profits, and cash flow. Make this review prior to examining the various growth strategies available to your business as it will help you identify the financial constraints that may impact your decisions.

- **a. Sales for the last twelve months and last two years**

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<tr>
<th>Current Year by Month</th>
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- **b. Sales by major category for last twelve months and last two years**

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- **c. Net Profit last twelve months and last two years**

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Business Growth Indicators continued

d. Reviewing sales and profits for the last two years, what sales and/or profit trends, if any, can you identify?


e. Are internal sources of funds available for pursuing growth opportunities?  Yes  No

Review historical Cash Flow Statement(s), your current cash balance, and the availability of a line of credit to determine your answer. Prior to determining what cash is available for growth, project your cash flow for the next twelve months so you know what you will need to operate your business.

f. Are you able to obtain external sources of funds for pursuing growth opportunities at this time?  Yes  No

If yes, identify potential sources and amounts you know of right now:

Step 2 Determine my business’s stage of growth. Based on your answers in Step 1, is your business in the start-up, early stage, growth, rapid growth, maturity, or innovation/decline phase?
Assess Industry Potential
Prior to assessing individual growth strategies, you will first want to look at the big picture, that of the industry as a whole, and assess its growth potential. In determining industry potential, key considerations include its current size and rate of growth as well as profitability characteristics and trends.

Size and Growth
Knowing the current size of your industry can help you place your business in a larger context and assess its potential for growth. Industries go through phases similar to businesses—start-up, early stage, growth, rapid growth, maturity, and innovation or decline. The following questions will help you determine if your industry offers the growth potential you seek. Action Step 2.1 Assess Industry Potential will provide additional information and guidance to complete this industry research.

- How many companies similar to yours exist nationally, regionally, and locally?
- How does the current size of the industry compare to historical figures from five or ten years ago? Are sales growing? Leveling off? Declining?
- What are the total dollars spent, or the total units consumed, by buyers nationally, regionally, and locally?

The answers to these questions can help you determine your future prospects. Examining the industry’s history and current size may reveal a great deal about the stability of opportunities in your industry. You might compare the size of the industry five years ago with today to determine whether it is growing or shrinking locally, regionally, or nationally. You might compare historical profit margins with today to see if the industry is showing growth in profitability. Such comparisons are particularly helpful in established industries such as finance and retail because history reflects how these industries have grown over time.

Profitability
Identifying profit margins typical of your industry can help you assess your business’s potential to succeed and make money. Some industries are notorious for their small profit margins, while others are much more lucrative. These questions can help you determine profit margins that you can use as benchmarks:

- What are the industry’s standards for Gross Margins and Net Profit percentages?
- What factors affect Gross Margins and Net Profits?

Trends and Changes
The marketplace has changed dramatically over the last ten years and will continue to change. These changes affect the way business is conducted and the choices customers have to access information or buy products and services. For example with the Internet and wireless computing, businesses may be virtual and on the other side of the world from their customers.

Understanding trends specific to your industry can help you plan and predict the future. These trends may be based on seasonality, economic fluctuations, or changing customer demographics and psychographics. Other industries may also have a direct or indirect impact upon yours. For instance, bank interest rate increases or decreases affect investment and real estate industries. What other industries affect sales in your industry?
For example, a new-home builder has noted that a current and emerging trend within the home construction industry is to build homes with either a ranch style or reverse story and a half floor plan in response to the preferences and needs of the aging baby boomers. This market is now in their fifties and prefer homes with the master bedroom on the first floor, a large kitchen for family get-togethers, and a relatively small yard for ease of maintenance.

As this trend will continue into the next decade, the builder has added several floor plans to accommodate this target market. Continual monitoring of demographic changes within the local community will allow the builder to provide floor plans to meet consumer preferences. That, along with monitoring key indicators such as interest rates, new home sales, and local growth rates will help the builder determine the product mix (various floor plans to offer) and forecast sales.

**Identify and Screen Growth Opportunities**

Now that you have looked at key indicators within your business and at your industry as a whole, you are ready to focus more specifically on growth opportunities for your business. Growth opportunities abound, but how can you learn about them? What information should you seek concerning potential opportunities? And where can you find the information you need?

Talking with customers, suppliers, and industry associates as well as reading to learn about your business’s environment can provide a wealth of helpful information about possible growth opportunities. In addition to the following ideas which will help you begin to gather information to identify opportunities, more specific guidelines for market research will be given throughout the Action Steps:

**Research**

- **Commercial research**—Leading sources include Dun & Bradstreet and Risk Management Associates (RMA). Business reference librarians at your local library can provide assistance in finding these and additional research sources. Many commercial research companies charge a fee for services.
- **Surveys, questionnaires, and focus groups**—Conduct surveys, questionnaires, or focus groups to obtain information on consumer preferences, satisfaction, demographics, and lifestyle changes. Read A Closer Look @ Primary Research on pp. 71–72 for information on how to conduct surveys, questionnaires, and focus groups.
- **Trade resources**—Check the internet, scan trade journals, browse the library, attend trade shows and talk to people in your industry to discover what is new and interesting. Ask questions about other organizations, markets, products, services, and challenges.
- **Marketplace**—Scour the marketplace to find products and services already in circulation and ask industry people, customers, and suppliers about present and possible rivals.
- **Demographic changes**—Population statistics change more rapidly today than in the past. For example, Peter Francese of American Demographics® Inc., points out that the fastest-growing age group in America is people eighty-five years and older. For this market, assisted-living centers, recreational activities, and delivery services are fertile ground for new opportunities.

**Tip**

Take time to look at your business through the eyes of your key customers to identify ways to improve your relationship, solve their problems before the competition does, and grow your business.

**Tip**

Consider involving your whole management team and/or bringing in a marketing consultant to facilitate the process of identifying and evaluating growth opportunities.
Thinking Beyond “Research”

Many times opportunities occur because entrepreneurs engage in activities that stretch beyond traditional ideas of research. Entrepreneurs have their eyes and ears open for trends and changes that might present an opportunity for them and their businesses. The following are additional behaviors that can help you identify opportunities:

**Tip**
You can see a lot by just observing. —Yogi Berra

**Use the Internet**—Online information provides a great source for the latest information in various industries. Entrepreneurs spot new trends on the Internet, exchange information on electronic bulletin boards, and shop various e-commerce sites. Helpful online resources include fasttrac.org and the Kauffman Foundation’s entrepreneurship.org.

**Read constantly**—Read publications outside of your own industry as well as major metropolitan newspapers and local business journals which cover community developments and trends in local markets to find what is different, new, and exciting.

**Tune into your environment**—The secret of this technique is watching the media, the Internet, and professional journals for recurring themes and emerging trends that may lead to new products, services, or markets.

**Establish a personal network**—Successful entrepreneurs build a network of people to serve as mentors and advisers throughout the life of their business. This network provides insights and information concerning the business’s market or industry. You can build such a network through industry and trade associations, business organizations, interactions with service providers (accountants, attorneys, and bankers), suppliers, and key customers.

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**Industry Trends**

What trends did you identify in your Environmental Scan on pp. 14–15 in Module 1?

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Which of these merits further research?

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What local trends may impact your business?
Once you have compiled some information about growth opportunities in your industry, you can look at the following four basic strategies for growth to see which form the opportunities you have identified will take.

Variations on these growth strategies include franchising, licensing, strategic partnerships, distributors, and acquisitions.

**Market Penetration (Current Product/Service, Current Market)**

Growing the business by penetrating its market more thoroughly is typically the first step a business takes to grow. Your experience with your business’s current markets increases the odds of succeeding using this growth strategy. Wise entrepreneurs carefully assess what untapped sales remain.

If answers to the questions in Market Penetration Opportunities indicate that growth opportunities still exist via market penetration, identify ways to eliminate internal barriers to sales and increase promotional and sales efforts to sell more to current customers or to sell to new customers in your current target markets. This growth strategy is particularly appropriate for start-up and early stage businesses. Keeping current customers satisfied is much easier and less costly than finding and cultivating new ones. For an example of one entrepreneur’s market penetration goal, read FMSI’s story on the following page.

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### Growth Analysis

1. Evaluate Growth Indicators
2. Assess Industry Potential
3. Identify and Screen Growth Opportunities
   - Market Penetration
   - Market Expansion
   - Line Expansion
   - New Business Development
4. Determine Market Potential

---

### a bold goal

Financial Management Solutions, Inc. (FMSI) is gearing up to double its revenues for the upcoming year. “A bold goal, but a doable one,” says W. Michael Scott, co-founder of the Atlanta company that provides performance-management information services to help banks and credit unions schedule tellers, lower costs, and increase productivity.

FMSI plans to survey current clients from the past two years to better understand why they chose FMSI. That information will be used to craft the campaign and to improve FMSI’s products and services.

To further prepare for its new “big, audacious goal,” FMSI created a formal sales plan detailing individual and incremental steps needed to reach the magic number by the end of the year. As part of the plan, each salesperson knows what to do—including telephone calls to prospective clients and the number of demonstrations and closures required each month.

Still, Scott understands the importance of their existing client base. “We need to have clients as successful as possible because that makes us successful.”
## Market Penetration Opportunities

Answer these questions to help you determine if you should consider growing by focusing on increasing market penetration.

Are sales increasing as compared to last year?  
- Yes  
- No

Two years ago?  
- Yes  
- No

Three years ago?  
- Yes  
- No

What is your sales growth trend and how does it compare to the sales growth trend in your industry?

What is your market share (if known)? Is your market share increasing or decreasing? Can it be increased?

Are there additional customers in your market that you are not reaching, and could you target them?

How can you increase sales to current customers?

How can you sell to more customers in your current market?

---

## Market Expansion (Current Product/Service, New Market)

Market expansion is an attractive strategy if you determine that sales to current customers and markets have been maximized. One restaurant owner grew her business by adding a second market—private catering. She is also considering a third market of selling signature dessert items through local grocery stores.

## Market Expansion Opportunities

Answer these questions to help you determine if you should consider growing by expanding to new markets. What markets am I currently reaching?

What other markets exist for my product/services?

Which potential markets are easiest to reach?

Which potential markets offer the greatest sales and growth opportunities?
Consider which markets would be easiest for you to reach in light of your knowledge, experience, and contacts. A property management company that purchases run-down homes, remodels them, and either sells or rents them carefully analyzed their markets. Recognizing that their skills could be applied to commercial real estate as well, they began purchasing older office buildings, remodeling them, and renting out office space.

Cash flow and profits and/or the ability to finance growth from external sources are usually required to expand to new markets. Advertising and marketing efforts can be costly. However, with the advances in communications, technology, and transportation, many entrepreneurs have successfully broken into previously untapped markets at all levels—from local to global markets. Gary and Trish Walker and their company Magic Touch Cleaning, found success when they focused on a new market.

**savvy business sense**

Gary and Trish Walker are the owners of Magic Touch Cleaning. They began their company as a janitorial commercial cleaning company. Over time, they began to suspect the cleaning products they used were posing health threats. They also realized there was an opportunity to do something to set their business apart from the crowd. After conducting some industry research it quickly became apparent that there was a way to differentiate their business and do something good for their customers, the community and environment.

Long before “going green” was the norm, Gary and Trish transitioned their business to use only environmentally friendly cleaning products. Magic Touch is the only all green company in the Midwest. The products are not only good for the environment; they are also safe for Magic Touch workers and their clients.

**Line Expansion (New Product/Service, Current Market)**

Growth using a line expansion strategy involves developing and offering new or complementary products to your current market. Customers’ needs change over time. The entrepreneur’s understanding of customers’ needs increases with experience. As one entrepreneur stated, “I started out selling my customers what I thought they needed and ended up selling them what they wanted,” which reflects an important skill of successful entrepreneurs—listening and responding to customers.

In addition to listening to current customers, your experience in the marketplace allows you to improve your products or services to satisfy new customers or solve additional customer problems.

Adding a service component to your product may allow you to better satisfy customer needs. Services such as delivery, assembly, installation, or product training provide additional value. A small computer retailer and parts store quickly found themselves in the computer repair business. As a result of the relationship they established with their customers, they were the first place the customer called when something went wrong.

Your search for new and innovative products may lead you to invent something new. A word of caution about inventions: new inventions

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**Tip**

Evaluate customers’ requests. Consider the sincerity and credibility of the customer making the request. Test the request by running it by other customers to see if you have uncovered sufficient demand for the pursuit.
are often a poor vehicle for business growth because of the high cost of research and development and the extreme difficulty in marketing. For every successful invention, thousands of inventions fail to become a profitable product.

New product offerings do not necessarily need to be products that you develop and manufacture yourself. Buying the licensing (or distribution) rights to a well-known product or service may be a way of offering your current customers something new or expanding into new markets. Licensing offers several advantages. It may give you a unique selling advantage over competitors. In many cases, because of perceived value, you can charge a higher price than for similar unlicensed products.

A good source of licensing ideas are trade shows and association meetings where entrepreneurs can meet distributors and sales representatives to learn about potential licensing opportunities and marketing trends. Colleges and universities, corporations, and nonprofit research institutes are also resources for licensing information.

Offering a new product or service to your existing market takes advantage of the reputation and relationships you have already established. In addition, your experience and knowledge of the target market greatly increases the odds that the new product or service will succeed. Businesses in the growth and maturity stage are apt to consider this strategy.

**Line Expansion Opportunities**

Answer these questions to help you determine if you need new or complementary products/services to grow or revitalize your offering.

Are sales flat or decreasing?  
- [ ] Yes  
- [ ] No

Is market share flat or decreasing?  
- [ ] Yes  
- [ ] No

Does my customer feedback offer any hints to explain this trend? My employee feedback?

What customer requests have I had in the last year or two?

What are my competitors offering in these markets?
"As you consider your business’s area of expertise, also consider the most closely aligned variations,” says entrepreneur Rebecca Smith, founder and president of the A.D. Morgan Corporation.

“A ‘slight shifting’ is really a simple concept,” she continues. “For example, the expertise of the A.D. Morgan Corporation is the construction of commercial and public-use facilities. In addition to constructing new facilities, one closely aligned expertise is an understanding of existing facilities designed for expansions and sizable renovations.”

How did this shift help create an opportunity for A.D. Morgan’s diversification? “Very simply,” says Smith. “We identified that we were offering this service to the clients who retained us for the construction of additions and renovations to their facilities. We also identified other commercial and institutional property owners who needed this type of property evaluation to periodically catalogue the status of their investment as well as guide their development of capital improvement budgets for the future.”

Smith points out this “slight shifting” requires very little capital expense. “We utilized our existing expertise and refocused it for a new and diverse client base that otherwise would not be a target market for our mainstream service.”

New Business Development (New Product/Service, New Market)

A new business development strategy involves using your business’s reputation or other strengths in order to sell new products or services in new markets. This strategy is often pursued after the others have been exhausted. A word of caution—new product or service development may involve a significant learning curve and requires extensive research depending on how far removed the products or services and markets are from your current business.

Product/Service Development Opportunities

Answer these questions to help you determine if new business development is the right strategy for you. Why am I considering offering a new product/service to new markets? What do I hope to gain?

Have I maximized sales of current products/services?

Have I maximized sales of new products/services to current markets?

Are industry-wide sales flat or declining?

Do I need to diversify?

What will it cost?

How quickly can I take the new product/service to market?
global markets

“Diversification is critical if entrepreneurial companies are to dodge inevitable business downturns and thrive,” explains entrepreneur Rebecca Herwick, founder, president, and CEO of Global Products—a company which licenses and sells novelties, giftware, and other specialty products.

“When Harley-Davidson® did not renew their apparel license with us, their products constituted 30 percent of our gross sales,” says Herwick. “We were devastated but not defeated.”

Since that loss, global diversification has taken center stage. Global Products expanded its product line and opened a distribution center in Germany for European expansion; a year later, it opened another in Canada. On the drawing board are plans for distribution outlets in Asia and possibly Latin America.

Within five years, international revenue accounted for 6 percent of Global Products’ annual revenue. Herwick notes that her company launched its diversification effort from the strength of its distribution system, which “proved to be a buttress against the many obstacles we would face—among them language barriers, a vast amount of paperwork, and a lack of historical data against which to set inventory goals.”

Herwick acknowledges that “global expansion is far from the ‘natural evolution’ I had envisioned. Breaking into and maintaining a presence in our foreign markets has been a formidable challenge.”

“My message to entrepreneurs aiming to do the same is simply that global expansion must be managed carefully and intelligently against the backdrop of Murphy’s Law, “If anything can go wrong, it probably will.”

Other Opportunities

Variations or combinations of the four basic strategies described previously provide a number of other ways to grow your business. Such opportunities may include franchising or licensing your product or service to others, establishing distributors, or partnering with other businesses.

Acquiring either a competitor or business in another market is a way of expanding product or service offerings and reaching current or new markets. Buying an existing business will give you instant customers and visibility. Sales typically come quickly as a great deal of time, effort, and money has already gone into the product and market development. Although it is true that problems can be inherited, an existing business should provide revenue flowing from an established clientele.

The success of purchasing a business as a growth strategy depends a great deal upon how much the buyer ends up paying for the business. A business’s true value and its future profit potential can be difficult to determine.

Understanding how to determine the valuation of your business or another business can provide critical information for yourself as well as potential strategic partners, lenders, and investors. There is more than one way to value a business; this process requires the assistance of a competent professional. With this information, you can make informed decisions about specific growth opportunities.
Use *Brainstorm and Screen Growth Opportunities* to apply the methods of identifying potential growth opportunities to your business.

**Brainstorm and Screen Growth Opportunities**

### Step 1 Brainstorm growth opportunities.
To increase creativity during the brainstorming step, withhold evaluation of ideas at this time. Generate as many ideas as you can in each category.

<table>
<thead>
<tr>
<th>a. <strong>Market Penetration (Current Product/Service, Current Market)</strong></th>
<th>How can more sales be made to current customers? How can more customers in the current market be reached?</th>
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<tbody>
<tr>
<td>b. <strong>Market Expansion (Current Product/Service, New Market)</strong></td>
<td>What new target markets exist for current offerings?</td>
</tr>
<tr>
<td>c. <strong>Line Expansion (New Product/Service, Current Market)</strong></td>
<td>What new or complementary products/services are customers interested in?</td>
</tr>
<tr>
<td>d. <strong>New Business Development (New Product/Service, New Market)</strong></td>
<td>What new products/services can be offered to new markets? Consider your knowledge and expertise in identifying these.</td>
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<tr>
<td>e. <strong>Other (Extensions of a – d)</strong></td>
<td>What extensions of the concepts above, such as licensing, partnering, or franchising, is your business ready for?</td>
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</table>
Brainstorm and Screen Growth Opportunities continued

**Step 2 Screen opportunities against your vision, mission, and goals.** Review your list with a more critical eye and consider which opportunities are consistent with your business’s vision, mission, and goals. List matching opportunities on p. 51.

**Step 3 Screen opportunities for a match with business growth indicators on pp. 38–39.** For those opportunities still remaining after Step 2, consider which ones are appropriate to your business’s financial strength and stage of growth. List these opportunities below.

**Step 4 Identify growth opportunity(ies) to research and determine market potential.** In the list of remaining opportunities, identify those for which you have sufficient interest to assess for market potential. The market research you will conduct later will enable you to evaluate these opportunities for market potential.

---

**Determine Market Potential**

Once you have established that an opportunity matches your business’s vision, goals, and financial indicators, you are ready to assess its market potential by examining specific key factors. Market research will enable you to more accurately assess the following points:

- **Ability to compete**—Which opportunity offers the potential for you to compete most effectively in the marketplace based on a price/cost advantage or market differentiator? These components of competitive advantage will be discussed in Module 3. If you will not be able to compete effectively, be wary of such an endeavor. Build on your strengths to increase the chances of future successes.

- **Duration of the opportunity**—Will the opportunity last long enough for you to seize it and reap its rewards? Duration is critical to determining attractiveness. For example, a new product or service based on a long-term trend, such as a changing demographic, has an enduring window of opportunity. One based on a fad, such as the latest fashion trend, has a limited life. Another consideration is how long you have before competition might flood the marketplace.

- **Growth potential**—In many cases, long-term growth rather than immediate rewards make one opportunity more attractive than another. An entrepreneur may decide to offer a new product in a growth area rather than pursuing sales of existing products that have minimum growth potential. Is the sales potential sufficient to make it worthwhile? Even if you can dominate a small market, it may not be worth your while.
Risks and rewards—A certain amount of risk is involved in all entrepreneurial ventures, and growth is no different. How much will the opportunity cost to pursue in terms of time, money, and physical resources? What is your potential return on your investment? Are the risks acceptable to you and your business? Do the rewards compensate for the risks?

Keep in mind that typically the risks associated with growth opportunities increase as you move away from products and markets you know into products and markets that are new to you. Costs for researching and developing new products and researching and penetrating new markets will also increase.

You will complete an evaluation of the growth opportunities for your business in Action Step 2.4 Evaluate Growth Opportunities. Later in the program in the financial modules, you will continue this evaluation by determining the financial potential of your growth strategy.

Conducting Market Research

Earlier in the module you considered ways to identify growth opportunities by scanning the internet, professional journals, talking with vendors and peers, and surveying customers. Keep in mind that market research is an ongoing process. It isn’t just interesting or “nice to know” but essential to your continued success. Because of its importance, you will now look at market research techniques and resources needed for the business planning process and preparing the business plan—skills you will need later in the program. Through market research, you will be able to make decisions based on hard data rather than relying on gut instinct.

Simply stated, market research is the process of gathering, interpreting, and reporting data to take advantage of market opportunities or solve a marketing problem.

Market Research Process

You may have realized by now that you need different types of information to make informed decisions for your business. The following steps will help you jumpstart your market research process.

Set Research Goals

The first step of the research process, setting research goals, is often overlooked; yet it is essential to the success of your research endeavor. Time spent at this step can save hours down the road by helping you determine the types of research needed. If your research goal is to evaluate a particular growth opportunity for your business, you can ask specifically about the opportunity and the variables that will determine its attractiveness. For instance, if you are considering expanding from a regional to a national market, what variables will impact the likelihood of such a strategy succeeding? Typically both internal and external variables must be examined, such as the market’s likely response to this expansion and your organization’s ability to implement such a plan.

A research goal can be framed as a statement you are seeking to prove. For example, in researching a growth opportunity—whether to expand from a regional to a national market—your research goal might be “Moving from a regional to national market will increase sales by more than 35 percent.” You would then design the research to prove (or disprove) this statement.
Gather and Analyze Data

Once you have clarified your research goal and formulated it into a statement, you are ready to identify the types of information needed to prove your research statement and collect it.

Market research includes two broad categories: primary and secondary. For your business, you will want to conduct both. You can use secondary research first to identify information or data already gathered. Secondary research can be accessed via the Internet, libraries, and trade associations. While extremely helpful, secondary research will not provide all of the information essential to the success of your business, particularly customer reactions and validation of your product or service.

Primary research is obtained by observing or communicating with customers or competitors. You will need to conduct your own primary research regardless of the quantity or quality of the secondary research you discover.

Some of your most valuable market research will be conducted close to home, within your existing business. Analyzing your existing customer base can help you determine who is buying your product or service and who is not. An analysis of your financial data will show you sales trends and growth.

For the growth opportunity that you identified in Step 4 of Brainstorm and Screen Growth Opportunities on p. 49–50, complete your own market research process.

### Market Research Process

First review the example. Then plan the market research process for the growth opportunity you are considering.

**EXAMPLE**

Engineering consulting firm, research on growth opportunity

a. Develop research statement(s). What do you wish to prove?
   
   Moving from a regional to national market will increase sales by more than 35 percent.

b. For each research statement, identify the information needed by generating a list of questions to be answered to prove or disprove the statement.

**Secondary Sources**

What are sales in the regional market? What is the sales potential in the national market? What is the strength and number of competitors in the national market? What is sales growth potential regionally and nationally? What is growth for the industry as a whole? What financial and human resources do I have to implement this expansion strategy?

**Primary Sources**

Among the target audience for the engineering consulting firm in the possible new territories, ask:

- How likely would you be to purchase consulting services from the engineering consulting firm described in the above concept statement?
- How do you typically choose an engineering consulting firm?
- Who is involved in making the decision? Who makes the actual selection?
- What is the most important factor in determining the success of an engineering consulting project? The second most important factor?
- Who are you using now as an engineering consultant?
**Market Research Process continued**

**Market Research**

a. Develop research statement(s). What do you wish to prove?

b. For your research statement, identify the information needed by generating a list of questions to be answered to prove or disprove the statement.

**Secondary Sources**

**Primary Sources**

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**Data to Collect**

In your market research to evaluate potential growth opportunities, you will need to research your customers. You must also have a clear understanding of your competitive environment. This information will help in your business planning process and is key in making informed decisions about your business.

**Customer Profile**

A customer profile provides a clear picture of the type of person or business you are currently serving or planning to serve. This information helps drive your marketing strategy, promotional design, and sales tactics. For example, a tennis racquet manufacturer who is trying to identify the type of players most likely to purchase the product will want to characterize the segments of customers in this market. This manufacturer needs to know demographics of the customers, where the customers purchase their racquets, how often they play, how often they buy a new racquet, how much they pay, what motivates them to choose one racquet over another, and much more.

Typically the customer profile will include customer demographics, buying patterns, and psychographic characteristics, which help determine why customers buy and their lifestyles preferences. For business-to-consumer markets (B2C), the standard tool to search for customer demographic data is zip codes. Industry codes (NAICS and SIC) will give you information on business-to-business (B2B) markets. In Action Step 2.2 Develop My Customer Profile you will identify your customer profile.

**Tip**

The target market is a customer group that can be reached through marketing. The customer profile is a picture of a typical member of that group.
Competitive Profile
In order to assess the sales potential of various growth opportunities, you will want to find out as much as possible about competitors. You will make a general analysis of your competition in this module and continue by identifying your competitive advantage in Module 3.

Direct Competition—Direct competition for any business includes entities that sell similar products or services in the same target market. Home Depot® and Lowe’s® are direct competitors in the home improvement market. H&R Block® and Jackson Hewitt® are direct competitors in the tax preparation market.

More so now than ever before, direct competitors are not always located in the same geographic area as a business. Many businesses are using the internet, mail order, telephone sales, or websites to sell their products or services.

Indirect Competition—Indirect competitors can be more difficult to identify. The indirect competitor is one that sells different products or services as a primary business but can also fill the need for your product or service. If your business provides marketing consulting to other small businesses, your most likely direct competitors are other marketing consulting firms. But what about specialty and print advertising businesses that consult with clients on their marketing as a part of the sales process, or a nonprofit community resource that offers marketing advice free of charge? You may have more competitors than you think.

Indirect competition can also be the customers, as they may provide the product or service themselves or eliminate it entirely when times are financially tough, especially for services such as housecleaning, lawn-care, or food preparation.

Future Competition—Entrepreneurs should always consider how much time they have before another company begins competing for their existing customers. You may have an advantage in the market today, but others will note this and counteract with a competitive strategy. You will also benefit from anticipating customers’ future needs. As time goes by, your customers’ needs may change. If your competition is more in tune with their changing needs, then they will steal your market share.

In Action Step 2.3 Analyze My Direct, Indirect, and Future Competition you will identify your competition to prepare for more detailed competitive analysis to be completed in Module 3.
Summary

You can choose from many strategies to grow a business. In this module, you examined various ways to identify growth opportunities and learned to conduct market research to assist you in the evaluation process. You evaluated key indicators within your business to determine the level and type of growth your business is prepared for and considered growth opportunities in relation to their alignment with your vision, mission, and goals. You assessed market potential to determine which growth strategy is the best fit for your business.

Key Things to Remember

- Planning for growth is a critical part of business planning and should be consistent with your business’s vision, mission, and goals.
- When evaluating how and when to grow the business, consider your business’s financial strength and stage of growth.
- Studying markets, industries, competitors, and customers helps you stay abreast of the current business climate and identify opportunities for your business’s growth.
- Put in the time you need to determine what market research is required, set research goals, and commit to gathering the relevant information.
- Analyze growth opportunities from the perspective of sales potential, duration of opportunity, risks, and your ability to compete.

Module 3 will build on the research you are conducting and the opportunities you are evaluating to develop a strategic direction for your business. You will consider your competitive advantage, business model, and exit strategy as you make strategic decisions about your business’s future.
Activity 2a: Excell Staffing Services

Analyze various growth opportunities and determine which is most appropriate for a business.

Directions

Step 1 Read the Excell Staffing Services scenario. Ian is at a decision point in his business. In the past three years since starting his engineering temporary staffing company, growth had been steady but slow. He presently has approximately twenty engineers placed in small- to medium-sized companies, typically engineering firms, during any given week. Ian focuses his marketing efforts within his local community, a Midwestern city with a population of approximately 500,000, about two hours from Chicago. It looks like a recent downturn in the local economy, however, would limit growth as some of his clients have begun to lay off engineers rather than seek short- and long-term temporary ones.

One day at the local chamber luncheon, Ian shared his frustration with Claire, an entrepreneur he has known for the past several years who has her own manufacturing representative agency. Claire commented, “When I feel that sales are too slow or that I have pretty well maximized sales with existing products and customers, I try to take on new product lines. Sometimes this really jumpstarts my sales.”

“I don’t think that would work for me,” Ian commented. Or would it? Later that evening Ian started thinking about what Claire had said. “Have I maximized my sales to existing customers? And if I have, then what?” Ian thought. “What kind of ‘new product line,’ as Claire called it, can I take on?”

Ian thought about the ten years’ experience he had as an engineer prior to starting his staffing company. Before that he had held a number of jobs in high school and college in various industries and businesses, doing anything from waiting tables and driving a fork lift to general office work. “Maybe I’m not as limited as I think,” Ian told himself. Plus he has the expertise of the members of his infrastructure to help, including his accountant, a marketing consultant, and his banker. His advisory committee also includes the owner of a small manufacturing company and a health care provider.

A quick review of the internet yielded many ideas. Staffing companies existed for every job imaginable. Ian started his list, which includes:

<table>
<thead>
<tr>
<th>Accounting/finance</th>
<th>Electronic assembly</th>
<th>Hospitality</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative/clerical</td>
<td>Executive</td>
<td>Information technology</td>
<td>Scientific</td>
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<tr>
<td>Call center staff</td>
<td>Fulfillment</td>
<td>Janitorial</td>
<td>Security</td>
</tr>
<tr>
<td>Customer service</td>
<td>Healthcare</td>
<td>Marketing</td>
<td>Warehouse</td>
</tr>
</tbody>
</table>

At the next chamber luncheon, he shared his thoughts with Claire. She was pleased that her comments seemed to have generated new possibilities. “But do you want to stay exclusively in staffing?” she asked. That was another thought to mull over.

“Maybe I’d rather help people find jobs than place people in temporary jobs.” Ian mused to himself on the drive home. “I could add an employment service component to my company and help engineers or others find jobs. I could teach them to write resumes and search for jobs.”

“I could also provide outplacement services to companies that are downsizing. Some of the companies that I now work with may be my first customers—I could do outplacement counseling for them,” Ian brainstormed. “Wow! Now I have too many possibilities.”
Activity 2a: Excell Staffing Services continued

Step 2 Apply the Growth Analysis Map. Brainstorm possible growth opportunities for Excell Staffing Services in the four broad categories identified and list below:

a. Market Penetration (Current Service / Current Market)

b. Market Expansion (Current Service / New Market)

c. Line Expansion (New Product or Service / Current Market)

d. New Business Development (New Product or Service / New Market)

e. Other (Extensions of a–d)

Step 3 Discuss your findings. Meet in small groups and discuss each category of growth opportunities. Select the one that would be best for Excell Staffing Services. Be prepared to share why you chose one option over the others. (You may need to make some assumptions to aid in decision making. If so, identify your assumptions.) Select a Reporter to write down the group’s responses and to report back.

Step 4 Review Brainstorm and Screen Growth Opportunities on pp. 49–50. In it you used a process to identify and evaluate possible growth opportunities for your own business similar to the one you just completed for Excell Staffing. Now that you have completed this activity, you may want to add to or edit your responses to the questions on pp. 49–50.
## Action Step 2.1: Assess Industry Potential

Research information to determine industry potential.

Conduct preliminary industry research which will be completed when preparing a marketing plan.

### Directions

In this action step you will conduct market research to fill your information gaps and evaluate your industry for growth and profit potential. Read the topics and suggested questions in the first column. Then, in the second column, list the information you want to find. In the third column, identify sources for this information. Refer to the sources on *Industry Research*, pp. 60–61, to get started.

In conducting your research, do not merely collect information about your industry. Draw conclusions about what the information means to you and your business. Look for patterns, see how it fits together, and integrate this information into your existing knowledge about your business.

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<tr>
<th>Questions</th>
<th>Information</th>
<th>Source(s) of information</th>
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<tr>
<td><strong>Current Size</strong></td>
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<tr>
<td>What is the current size of your industry for this product/service? What is the size at the national, regional, state, and local levels? How many dollars are spent annually and/or how many units are consumed annually?</td>
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<td></td>
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<tr>
<td><strong>Growth Potential</strong></td>
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<tr>
<td>Is the industry growing and, if so, by how much? Is it stabilizing or declining?</td>
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<td><strong>Profitability Characteristics</strong></td>
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<td>What are typical gross margins within the industry?</td>
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</table>
### Action Step 2.1: Assess Industry Potential continued

<table>
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<tr>
<th>Questions</th>
<th>Information</th>
<th>Source(s) of information</th>
</tr>
</thead>
<tbody>
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<td><strong>Industry Trends</strong></td>
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<td></td>
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<tr>
<td>What are the trends in the industry? What effect does technology have on the business?</td>
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</tbody>
</table>

Based on your research above, does your industry provide an opportunity for you to reach the sales and profit goals you seek? Explain your answer.
Industry Research
You will want to start your industry research by identifying your industry’s North American Industry Classification System (NAICS) or Standard Industrial Classification (SIC) code. To find a NAICS or SIC code, go to the U.S. Census NAICS website at www.census.gov/epcd/www/naics.html. Enter a key word into the search box on the left-hand side of the page that describes your industry or browse codes by clicking the NAICS to SIC / SIC to NAICS button.

Once you’ve located the relevant industry code(s), use the U.S. Economic Census and related reports as a resource to assist you in gathering industry statistics. You can also use these codes to access other industry information, some of which is grouped by industry type:

**Manufacturing**—Manufacturing & Distribution USA provides statistical information and leading companies in all manufacturing and wholesale industries. The Annual Survey of Manufacturers, available online at www.census.gov/mcd/asm-as1.html, gives more detailed statistics.

**Restaurants**—The National Restaurant Association publishes a number of resources that provide relevant industry data, including a Restaurant Industry Forecast and Quickservice Restaurant Trends. Get started online at restaurant.org.

**Service businesses**—The Census produces the Service Annual Survey, online at www.census.gov/econ/www/servmenu.html. Many trade magazines cover specific service industry sectors, such as ABA Banking Journal, Best’s Review of Life & Health (Insurance), and Spa Management.

**Retail**—Many trade magazines focus on retail, including Chain Store Age and Stores. Additionally, the National Retail Federation provides some timely information online at nrf.com.


**Gale Business & Company Resource Center**—This online database includes data from publications such as Market Share Reporter, Encyclopedia of American Industries, Encyclopedia of Global Industries, and other industry publications and company directories. Search for specific company information or find market share, industry overviews, company rankings, and articles on just about every industry.

**Franchises**—You can find lists of franchises for sale, franchising tips, and more at the Start-Up Journal from the Wall Street Journal. Another useful resource is Franchise Opportunities, an online resource for franchise business opportunities and information, at franchiseopportunities.com.

**Licensing resources**—One resource is the International Licensing Industry Merchandisers’ Association (LIMA), which sponsors an annual show in New York City; see their website at licensing.org. The Licensing Resource Directory, published annually by Expocon Management Associates, lists alphabetically more than 3,000 owners and categories of products and services as well as tips, support organizations, consultants, designers, and other professionals specializing in licensing. Other resources include The Licensing Letter and The Licensing Letter Resource Sourcebook from EPM Communications, which lists the top 4,000 executives involved in the licensing industry. Two other publications relating to the industry are The Licensing Report, a weekly newsletter, and The Licensing Book, a monthly magazine, from Adventure Publishing.
Additional Governmental Resources

Department of Commerce—Locate information about industry products and services, commerce.gov.

Patent and invention resources—Find patent information online through the U.S. Patent & Trademark Office, uspto.gov.

Libraries

Industry growth and trends—An easy way to find out industry growth trends is through newspaper and trade journal articles.

Dun & Bradstreet and Standard & Poor’s Company Profiles—These resources report financial information and statements from existing businesses. Dun & Bradstreet provides a number of databases, such as the Dun & Bradstreet Million Dollar Database, which lists public and private companies and their annual sales, and Dun & Bradstreet Business Information Reports, which provides information on over 11 million businesses in the United States regarding operations, profitability, and stability. Standard & Poor’s Company Profiles also has a number of resources, such as NetAdvantage, which has more in-depth financial information on larger public companies.

The Statistical Abstract of the United States—This resource provides basic information such as income levels, employment figures, industry outputs, and useful market information, and is available online at www.census.gov/compendia/statab/. Many of the charts are summaries of more detailed data; check the source listed for more information.

Encyclopedia of Associations—Trade associations often collect valuable statistics and provide networking information on the industries they represent. Use this encyclopedia to find information on more than 25,000 United States trade associations, including lists of publications available and association contact information including websites.

Encyclopedia of Business Information Sources—This encyclopedia lists resources such as trade magazines, databases, handbooks, trade associations, statistics and more for over 1100 business and financial topics. Use this guide to get started finding relevant sources for your industry and market research.

Standard & Poor’s Industry Surveys—S & P provides in-depth surveys on over fifty major industries such as apparel & footwear, biotechnology, healthcare, and retailing. The industry surveys are updated four times per year and include information on industry trends, consumers, market share, leading companies, and leading company financials.

Trade and Professional Organizations

Encyclopedia of Associations—See reference above.

American Society of Associations—Get started by searching the American Society of Association Executives Gateway to Associations – online at asaenet.org/ – for more than 6,000 local and national association websites.

Trade publications provide timely information about activities in your industry and are a great way to recognize and capitalize on emerging trends.
Action Step 2.2: Develop My Customer Profile

Identify your major customer groups, their distinguishing characteristics, and the market research needed to develop your customer profile.

Directions
Follow the steps below to develop your customer profile.

A. Identify major customer groups. Although customers come in all shapes and sizes, generally they can be grouped into broad categories that represent the majority of your buyers. List your major customer groups below and indicate whether they are other businesses (B2B) or consumers (B2C).

B. Develop customer profiles. Customers can typically be described through demographic variables (for example, age, gender, geographic location), psychographic variables (why they buy), and buying behaviors (where, when, what, and how they buy). Use the appropriate checklist to help you define a customer profile for each of your major customer groups.

Demographics (age, gender, geographic location)

<table>
<thead>
<tr>
<th>B2C Customers</th>
<th>B2B Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>Number of employees</td>
</tr>
<tr>
<td>Gender</td>
<td>Organizational structure</td>
</tr>
<tr>
<td>Profession</td>
<td>Location of headquarters</td>
</tr>
<tr>
<td>Education level</td>
<td>Types of products and services they provide</td>
</tr>
<tr>
<td>Household income level</td>
<td>Annual revenue</td>
</tr>
<tr>
<td>Marital status</td>
<td>Number, size, and location of branches</td>
</tr>
<tr>
<td>Number of children</td>
<td>Year founded</td>
</tr>
<tr>
<td>Geographic location</td>
<td>Other</td>
</tr>
</tbody>
</table>

Psychographics (why they buy)

<table>
<thead>
<tr>
<th>B2C Customers</th>
<th>B2B Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conservative</td>
<td>Market leader</td>
</tr>
<tr>
<td>Liberal</td>
<td>Innovative or cutting-edge</td>
</tr>
<tr>
<td>Conformist</td>
<td>Liberal</td>
</tr>
<tr>
<td>Experimental</td>
<td>Conservative</td>
</tr>
<tr>
<td>Environment-friendly</td>
<td>Environment-friendly</td>
</tr>
<tr>
<td>Socially conscious</td>
<td>Employee/family-friendly</td>
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<tr>
<td>Growth-oriented</td>
<td>Fast growing/adopting new ideas</td>
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<tr>
<td>Fun-loving</td>
<td>Stable/set in their ways</td>
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<tr>
<td>Cutting-edge</td>
<td>Other</td>
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<tr>
<td>Trend follower</td>
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<tr>
<td>Fashion-forward</td>
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<tr>
<td>Family-oriented</td>
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<td>Other</td>
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</table>
### Action Step 2.2: Develop My Customer Profile

<table>
<thead>
<tr>
<th>B2C Customers</th>
<th>B2B Customers</th>
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<tbody>
<tr>
<td>How many family members are typically in your customers’ households?</td>
<td>What growth stage is the company in? (start-up, growth, stable, or decline)</td>
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<tr>
<td>What hobbies and/or sports do your customers enjoy?</td>
<td>What is the type of workforce they employ? (for example, younger, education level, part-time)</td>
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<tr>
<td>What types of entertainment do they enjoy? (for example, movies, theater, opera)</td>
<td>Who is the decision maker in the business you are selling to?</td>
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<td>What publications do they subscribe to?</td>
<td>Do identifiable common characteristics of managers or executives exist?</td>
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<td>What do they do in their free time?</td>
<td>What is the company’s culture?</td>
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<td>What is the management style?</td>
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<td>What trade associations do they belong to?</td>
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<td></td>
<td>What publications do they subscribe to?</td>
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</table>
### Action Step 2.2: Develop My Customer Profile

#### Buying Behaviors (where, when, what, and how they buy)

<table>
<thead>
<tr>
<th>B2C Customers</th>
<th>B2B Customers</th>
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<tbody>
<tr>
<td>What benefit is the customer looking for?</td>
<td>What benefit is the customer looking for?</td>
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<td>How often will they purchase?</td>
<td>How often will they purchase?</td>
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<td>What is the customer’s decision-making process?</td>
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<td>What factors are most important to your customers:</td>
<td>What factors are most important to your customers:</td>
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C. **Identify research needed on major customer groups.** Additional research regarding your customers will help you determine the size of your target market, how to reach potential customers, and how to best sell your products or services. What market research would be helpful on your major customer groups? Note this information in the right-hand column of the Customer Profile Worksheet on p. 65.
### Action Step 2.2: Develop My Customer Profile continued

<table>
<thead>
<tr>
<th>Customer Profile Worksheet</th>
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<tbody>
<tr>
<td><strong>Step 1</strong></td>
</tr>
<tr>
<td>Identify major customer groups</td>
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<td><img src="image" alt="EXAMPLE" /></td>
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**B2B or B2C?**

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</table>

**D. Conduct research.** Verify the draft customer profile of each customer group above by actually conducting primary and secondary market research indicated in the last column. Refer to the sources on Customer Research, p. 66, to get started.

*EXAMPLE*

For a shuttle service to and from the airport, the main customer group is businesses whose sales force and other employees make regular business trips. The key motives for choosing a shuttle service include reliability and efficiency. They purchase frequently, one or more times a month, typically by telephone.
Customer Research
Check these resources to assist you in gathering information about your customers and developing a customer profile.

Governmental Resources
Census Bureau—The Census Bureau compiles demographics including age, race, population, median income, geographical information, and other useful information. Obtain information from the Census Bureau online at census.gov or via telephone at 301-763-INFO (ext. 4636).

Bureau of Labor Statistics Consumer Expenditures Survey—This survey provides information on the spending habits of consumers. Obtain information from the Bureau of Labor Statistics Consumer Expenditures Survey online at bls.gov/cex/home.htm or via telephone at (202) 691-6900.

Libraries
Dun & Bradstreet and Standard & Poor's Company Profiles—These publications report financial information and statements from existing businesses for B2B customer research. Dun & Bradstreet provides a number of databases, such as the Dun & Bradstreet Million Dollar Database which lists public and private companies and their annual sales. Standard & Poor’s also has a number of resources, such as NetAdvantage which has more in-depth financial information on larger public companies.

The Statistical Abstract of the United States, Encyclopedia of Associations, Encyclopedia of Business Information Sources, Standard & Poor's Industry Surveys—Listed in the Industry Potential section, these resources also provide helpful information regarding customers.

Trade and Professional Organizations
Visit or become a member of a trade organization that relates to your product, service, or target market. Associations can often provide valuable “insider information” from those who are in a similar industry, which can help you identify customers’ buying patterns, for example. Most members are more than willing to answer your questions or share their stories.

Become a member of a national organization that can provide you with information such as customer surveys, market surveys, and white papers that provide innovative solutions to customer problems and are often used to introduce technology and products. This source can be an inexpensive way to obtain very reliable research data.
### Action Step 2.3: Analyze My Direct, Indirect, and Future Competition

Consider your competition and identify what research you will need to conduct to determine if you have a competitive advantage.

**Directions**

Competition can be defined as any business or situation that takes sales away from your business. Competition can be direct or indirect. To understand your competition, you must identify it and then collect information about it. Follow the steps below.

For market research resources on your competition, refer to the sources listed on Competitive Research, p. 69.

**Identify direct competitors.** Direct competitors are businesses that sell similar products or services to the same target market. Consider companies located in the same geographic region as well as companies (such as mail order or Internet-based) that can reach your potential customers. List your direct competitors.

<table>
<thead>
<tr>
<th>Possible direct competitors</th>
<th>Information I will collect on my direct competitors</th>
<th>Research sources I will use</th>
</tr>
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**A. Discover indirect competitors.** Indirect competitors are businesses that sell products or services that fill the same need as your business. (Flowers and candy can both fill the same need for someone seeking to buy his sweetheart a gift.) List your indirect competitors. This list may be much longer than the direct competitors list. It may be necessary to discuss categories of competitors rather than to list specific company names.

<table>
<thead>
<tr>
<th>Possible indirect competitors</th>
<th>Information I will collect on my indirect competitors</th>
<th>Research sources I will use</th>
</tr>
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<tbody>
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</table>
**Action Step 2.3: Analyze My Direct, Indirect, and Future Competition** continued

B. **Recognize other forms of competition.** Sometimes customers will create the product or perform the service themselves. Other times, customers eliminate the purchase entirely when times are financially tough, also a form of indirect competition.

Could this type of competition apply to your product or service?  
- [ ] Yes  
- [ ] No

Explain:

---

C. **Consider future competition.** Frequently others note your success and counteract with a competitive strategy. How much time do you have before others begin competing for your customers? Although this type of information may be found for public companies through annual reports, press releases, and product releases, getting information about small, privately held companies is much more difficult. Reading about industry trends may help you anticipate potential competitors entering your market.

<table>
<thead>
<tr>
<th>Possible future competitors</th>
<th>Information I will collect on my future competitors</th>
<th>Research sources I will use</th>
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D. **Conduct research.** Verify competitive information by actually conducting primary and secondary market research.
Competitive Research
The sources you will use to research competitors will depend on your type of business. The Internet and the Thomas Register of American Manufacturers can be helpful resources. Information about competitors may also be available through vendors and local chamber(s) of commerce or trade associations. Following is a list of additional resources which may be helpful.

Governmental Resources
Department of Commerce—This governmental agency provides information on industries, products, or services. This information may be helpful to identify competition and/or niche opportunities. Contact the Department of Commerce to find out how to access their publications on industry, products, and services at commerce.gov.

National Association of Secretaries of State—This association, online at nass.org, provides contact information for each state’s office of business registrations. Visit individual state websites for contact information, searchable directories of state businesses, and filing information.

Libraries
Trade journals—These publications often report on industries, products, services, companies, competitors, and proposed products. Look for a journal that focuses on your industry, such as Nation’s Restaurant News, Chain Store Age, or Chemical Market Reporter. General publications focus more exclusively on entrepreneurship, such as Entrepreneur, Success, Inc., and Home Office Computing.

Small Business Sourcebook—An excellent guide for sorting through the many business references and data available, the Sourcebook profiles 224 types of business resources (such as articles, books, and trade associations) for everything from accounting services to beauty shops.

ReferenceUSA—This database of more than 12 million private and public companies nationwide can help you find potential competitors using NAICS or SIC codes, geography, size of company, and more.

The Statistical Abstract of the United States, Encyclopedia of Associations, Encyclopedia of Business Information Sources, Standard & Poor’s Industry Surveys—These resources may also provide helpful information regarding competitors.

Trade and Professional Organizations
Chamber of commerce—Join your local chamber of commerce to meet and network with competitors in your area.

Online trade organizations—Online discussion groups relating to your product or service and electronic newsletters can keep you up to date on what your competitors are doing and help you gather relevant information about your industry or target markets. Check your local newspaper for upcoming community events with local organizations.
**Action Step 2.4: Evaluate Growth Opportunities**

Evaluate the growth opportunity(ies) you have already identified.

**Directions**

Although you may not be able to answer all of the following questions with complete confidence at first, answers will become clearer as you conduct additional market research and clarify your business strategy in subsequent modules. You may want to revisit this evaluation at the end of the program to see if your answers have changed.

A. **Review your market research information.** Conduct a brief review of all the questions and checklists you completed while reading this module. Take time to review your market research results. Write down any insights you gained after collecting data about the industry, potential customers, the competition, your business, and the marketplace.

B. **Complete the Growth Opportunity matrix.** This matrix will help you determine and/or confirm which market opportunity is the best match for your business and the marketplace.

**Growth Opportunity Matrix**

Describe the opportunity/strategy you are seriously considering.

<table>
<thead>
<tr>
<th>Criterion: Vision, Mission, and Goals</th>
<th>Evaluation: Circle number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the opportunity align with my business's vision, mission, and goals?</td>
<td>1 2 3 4 5</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Criterion: Business Growth Readiness</th>
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<tbody>
<tr>
<td>Is my business ready for growth and does it have the financial strength to pursue and implement this opportunity?</td>
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</table>

<table>
<thead>
<tr>
<th>Criterion: Market Potential</th>
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<tbody>
<tr>
<td>a. In implementing this option, will my business be able to compete in the marketplace?</td>
</tr>
<tr>
<td>b. Is the window of opportunity for realizing sales and profits sufficient in length?</td>
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<tr>
<td>c. Is the growth potential sufficient to make the option worthwhile?</td>
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<tr>
<td>d. Are the risks acceptable?</td>
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</table>

In reflection, does the opportunity match my business and the marketplace?

What additional research will I need to collect?

**Note:** Repeat this evaluation for each market opportunity you are seriously considering.
A Closer Look @ Primary Research

The following are some suggestions for gathering information from your customers or potential customers. Other great sources of information are your own employees as well as suppliers and vendors. They may be able to give you insights into what sells, what doesn’t, and why.

Conducting Surveys and Questionnaires

**Step 1** Prepare a questionnaire that includes any important information the customers should know before they can formulate a response. For example, respondents may need a short description of the product or service they are evaluating prior to answering questions.

**Step 2** List the questions, providing only a multiple-choice format when possible (rather than essay responses) to make it easier to record answers. Select key questions that will give you valuable information for your research. Questions should ask about customers’ needs, their preferences on product or service features and benefits, pricing, location, marketing sources, and buying behaviors.

Use a five-point rating scale. Ask questions that can be answered along a spectrum of responses. For example, a customer’s definite affirmative response would receive a 5, a customer’s definite negative response would receive a 1, and in-between responses receive in-between ratings.

Lay out and neatly type the questionnaire. Graphics and pictures should be used if available since they will help clarify the subject.

**Step 3** Decide which method is best for collecting the data you need. If you have a small number of people to reach, perhaps twenty or fewer, you might choose to conduct surveys or interviews by phone or in person. If you want to reach more than twenty people, you may consider conducting a survey by Internet or fax. However, the sample size and complexity of the questions will determine the best method for gathering information from your target market.

If questions can be directed by how customers respond to previous ones, then surveys conducted over the Internet work well. For example, if you seek feedback on customer taste preferences, you could establish a survey site that allows customers to post comments about products, or they could respond to an online survey/questionnaire. Depending on how they respond to specific questions, the software pulls up the subsequent questions.

If reactions to a product or service should be visible, then you need in-person contact. For example, a live taste-test booth could be set up in a shopping area where customers could sample products and provide feedback to a researcher.

If conducting personal interviews, make suitable copies and put them on clipboards for respondents to complete the questionnaire; if using a mail technique, be sure to include a stamped, self addressed envelope in the mailing; if using a telephone technique, the personal interview format can be applied.

**Step 4** Determine how many completed surveys are needed to be representative of the group you are surveying. For example, if you have 5,000 customers and survey ten, that is not enough to assume the information is representative of the entire group. If you obtain completed surveys for ten out of forty customers, chances are much greater that the results are representative.
A Closer Look @ Primary Research continued

**Step 5** Summarize and evaluate the information gathered. Determine if similar responses indicate a trend within your target market. Many times survey or interview information may not be accurate because respondents are not committed to purchasing the product but merely giving their opinions. Also, since most surveys and interviews are very brief, it is not possible to collect in-depth information.

**Focus Groups**
A focus group is a simple but effective way to obtain in-depth customer information. This research technique is used to collect information from a group of people instead of using a one-to-one approach. Follow these steps to prepare for a focus group:

**Step 1** Develop questions to ask participants and an agenda for the focus group(s).

**Step 2** Invite focus group participants who have demographics and psychographics similar to potential customers.

**Step 3** Plan the logistics.
- Schedule the focus group meeting at a convenient time for participants. A typical focus group takes one to two hours.
- Find a meeting room or relaxed atmosphere to ensure an informal discussion of participants’ opinions and feelings.
- Find an unbiased, skilled moderator to lead the group. The moderator asks broad questions at the beginning and then focuses the group discussion on the specific information you want to obtain. Moderators can skillfully probe the group, stressing the importance of sharing different points of view and emphasizing that there is no right or wrong answer.

**Step 4** Use a data collection source that doesn’t interfere with the discussion. It is best to record or videotape the focus group discussion rather than taking notes. Findings can then be analyzed to interpret feedback from participants and relate it to the business.
One common denominator among successful entrepreneurs is their ability to think strategically and make critical decisions about the future direction of their business. In this module you will strengthen your ability to make strategic decisions as you work on your business strategy. This business strategy will describe how you plan to accomplish your goals and achieve your vision. What opportunities, identified in Module 2, will you incorporate in your strategy? What activities and actions will be part of your plan to grow your business?

As you work on your business strategy, you will consider your competitive advantage, business model, and exit strategy. Your competitive advantage builds on the answer to the question, “Why should customers choose my business over others?” The answer to that question may require a look at your current business model to see whether it is the best match with your vision and goals. Your exit strategy—how you plan to harvest wealth from your company—will be a factor in your business strategy. You will document your business strategy when you write an Executive Summary which can be used as a stand-alone document or as the first section of your strategic plan. Your business strategy sets the direction for your business; all of the modules that follow will ask you to evaluate aspects of your business and align them with your overall strategy.

**Key Question**

- What is my business strategy for growth?

**Action Steps**

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<th>Action Step</th>
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<tr>
<td>3.1 Define My Business Strategy</td>
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<td>3.2 Write My Executive Summary</td>
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<td>Read Module 4 Using Financial Tools</td>
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Strategy Achieves the Vision

On a bright day full of promise, a premier sculling coach took his team to a race. After weeks of dedicated practice, they lost. So the coach had them practice harder. They lost the next race. The coach used tactics to boost the team’s morale. They lost again. The coach was so frustrated that he wondered if he should look for a new career. In desperation, he had the boat removed from the water to examine it. The problem was clear. The boat was poorly constructed and was producing a strong drag on its forward movement. They had been trying to win the races in what amounted to a square boat.

Entrepreneurs are like the coach and need to pay attention to the fundamental design of their business. The boat is like a business strategy—the how to reach your vision. Everyone can be doing their best, but if your boat is not constructed properly, you won’t win many races. The right boat can carry you to the winner’s circle.

new strategy creates sales momentum

As a start-up, PeopleAnswers, Inc. focused on selling its innovative software package for assessing job applicants to recruiting firms around the country. Although initial feedback had been enthusiastic, founder Gabriel Goncalves realized he needed to change his business strategy. With the slow economy, recruiting firms weren’t getting as many assignments. More importantly, they didn’t want to handle the assessing of the candidates. They preferred that their clients undertake that task.

Goncalves’s product, a software package geared to analyzing individuals’ personalities in order to determine the likelihood of their performing well in a job, was useful not only to the recruiters but also to companies doing the hiring. In addition, companies evaluating current employees could use the program (especially if they were preparing to lay off staff), and it might even be of interest to the job seekers themselves.

Which way to turn? After much deliberation, PeopleAnswers decided to market the software to companies looking to hire. They quickly ruled out the job seekers, because they didn’t want to handle 1,000,000 accounts at $19.95 apiece. They preferred 100 accounts at $199,500. In a tight economy, they thought companies would be less likely to focus on the soft issue of evaluating current employees, and they could not get too excited about making downsizing efforts the focus of their business.

Corporate hiring managers would be particularly interested in a tool that would help them recruit candidates who could perform like the best on their staff. They would be able to pitch their software as a way for them to decrease hiring costs, increase productivity, and reduce turnover.

As part of their strategy, they decided their product would be available by means of a password on the Internet rather than as a stand-alone software package. In turn, that meant they would license their software rather than sell it. They decided to target large organizations and offer a fixed annual license for unlimited use of the software, based on the number of employees in that organization.

Now they had to get the word out. The issue became how to do that with limited resources. Their strategy was to land some name brand accounts and then leverage the good press they received. The name brand accounts took a lot of work and entrepreneurial perseverance and the press coverage was a combination of luck, contacts, and a good story. By leveraging their brand accounts and press coverage via e-mail marketing campaigns, they were able to generate the sales momentum they needed to grow the company.

PeopleAnswers also implemented a channel Value Added Reseller program, targeting organizations that offer services which complement those PeopleAnswers offers. They considered, but ultimately decided against, building a large internal sales force. Instead, they began training independent dealers to sell PeopleAnswers software on an exclusive basis around the country.
This module will help you examine your strategic direction. As you are planning your strategy, you will be asked to think about your competitive advantage, your business model, and your exit strategy. Your vision is more certain to become reality if you have a well-constructed strategy detailing how your company will achieve its goals, compete effectively in the marketplace, and evolve with market changes.

Creating a business strategy and a plan to implement it is an iterative process. You start out with certain assumptions and, through implementation, learn which of your assumptions are accurate and modify your strategy accordingly. Goncalves found that PeopleAnswers needed to adjust its strategy based on slower than expected sales to its initial target market—recruiting firms. You will find that each time you analyze your business performance and fine-tune your strategy, the closer you get to the best strategy for your business.

A business strategy provides the foundation for your entrepreneurial venture. The strategy helps you achieve your business and personal goals, define your position in the market, and meet market needs. If you devote the time to develop a well-thought-out strategy, it will provide the direction you need to build these pillars of strength and contribute to your entrepreneurial success.

**Achieve business and personal goals**—The vision describes what you want to achieve for your business and for yourself. For your entrepreneurial venture to be successful, it must meet both the business and personal goals you set in Module 1. Your business strategy should allow you to meet both sets of goals. After all, what is the point of achieving all of your business goals but feeling shortchanged on what you want the business to do for you, your family, or the community?

**Meet current and emerging market needs**—An effective business strategy helps the company meet current market needs and has the foresight to anticipate emerging or future needs. This is not always easy to do. You can get caught up in running the business and putting out daily fires. In Module 2, you explored the market’s current needs and considered how you will meet the demands of a changing market. Keep these decisions in mind as you consider how to build that market knowledge into a business strategy to help your business grow.

**Maintain competitive advantage**—Your chosen business strategy will make the most of what your company does best—its competitive advantage—and define a profitable position in the marketplace that will be sustainable over time. A company has built a competitive advantage when it accomplishes the following:

- Provides products or services deemed valuable by its customers
- Differentiates from other competitors in the market
- Exhibits expertise, processes, or formulas that are difficult for others to copy

This module will help you develop a strategy for reaching your vision and goals, which includes decisions concerning your competitive advantage, business model, and exit strategy. With your business strategy in hand, the rest of the program will help you develop your plan for implementing it.

**Tip**

Make trend watching and anticipating the needs of current and potential customers part of your strategy. Stay ahead of the wave instead of behind the 8-ball.
Competitive Advantage

In any industry, businesses create a competitive advantage through price or the market. A price or cost advantage is tied directly to production costs, efficiency, or available technology. Pricing is one of the topics in Module 5 Strengthening Your Product/Service. A competitive advantage in the market requires you to develop market differentiation—the aspect of your business that sets you apart from the competitors in your industry.

Companies that build and sustain a distinct market differentiator generally have unique attributes.

Competitive Advantage Using Market Differentiators

Each of these companies has grown by using some kind of market differentiator, such as the following:

- Unique way to meet the needs of a niche market
- Brand recognition in the market
- Proprietary or trade secrets for operations
- Customized or proprietary software or technology
- Patents and trademarks

- Unique combination of products/services
- Access to leading or scientific research
- Highly skilled and creative staff
- Reputation for quality and innovation

Companies with a price, or cost, advantage over competitors usually have internal strengths that are difficult for other competitors to replicate, including:

- Investments in production and equipment
- Expertise in designing products/services efficiently
- Access to less expensive materials
- Operational processes replicated consistently
- Outsourcing partnerships

- Efficient distribution channels
- Effective hiring practices, low turnover, and highly skilled/knowledgeable staff
- Efficient production or operational systems
- Innovative equipment or technology
- Strategic alliances that support delivery to customers

<table>
<thead>
<tr>
<th>Unique Product/Service</th>
<th>Unique Combination of Products/Services</th>
<th>Unique Way to Meet Needs of Target Group</th>
<th>Unique Method of Delivery</th>
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<tbody>
<tr>
<td><strong>Apple®</strong>&lt;br&gt;Macs, iPods, iPads, iPhones</td>
<td><strong>FedEx Kinko’s®</strong>&lt;br&gt;Suite of office products and services</td>
<td><strong>Subway®</strong>&lt;br&gt;Fast food for the health conscious</td>
<td><strong>Amazon.com®</strong>&lt;br&gt;Books, music, and much more via the web</td>
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<tr>
<td><strong>Zappos</strong>&lt;br&gt;One of the first online retailers</td>
<td><strong>Logitech®</strong>&lt;br&gt;Extensive line of computer peripherals</td>
<td><strong>Starbucks Coffee®</strong>&lt;br&gt;Relaxing hangout for coffee aficionados</td>
<td><strong>XM® Radio</strong>&lt;br&gt;Satellite radio service to subscribing customers</td>
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</table>
Six Differentiators That Build a Competitive Advantage

A true competitive advantage is one that is difficult for other competitors to copy and one that customers find valuable. Ultimately, your competitive advantage is why customers choose to do business with your company over anyone else. If customers don’t value your differentiator, then you don’t have a competitive advantage. Here are six ways your company can differentiate itself from the rest:

**Core competencies**—The core competencies you considered in Module 1 can be used to develop an edge over the competition by providing products or services that customers value over products or services your competitors offer. Auntie Anne’s® specializes in making pretzels in every way imaginable. Rather than making a variety of products, founder Anne Bieler decided to focus on a competence she mastered at the age of twelve, baking pretzels. Core competencies are the strengths that allow you to meet the needs of your customers. Keep in mind: your core competencies may change over time, depending on the demands of the marketplace and the dominant position you want to have over competitors.

**Reputation for superior products/services**—Provide the best products or services in the industry or market. Your focus on quality will give you a reputation for expertise in specific areas. For example, Nordstrom® focuses on offering customers the best possible service, selection, quality, and value. Nordstrom sets the standard for department store customer service and a guaranteed, money-back commitment to meet customers’ expectations.

**Niche market**—Offer products or services to meet the specific demands of the target market(s). A *niche market* is a distinctive group of customers within a larger market or a smaller segment of a product line. For example, ITW® (Illinois Tool Works) manufactures specialty fasteners and products that are customized for its buyers’ needs.

Tom’s of Maine® by positioning its toothpaste as a natural product, created a new category in the toothpaste market. Since no other toothpaste filled this need, the company was able to charge a premium price that consumers who buy organic or all natural products will gladly pay.

**Unique distribution channels or delivery methods**—Use a selling method that is unique to the industry or difficult for competitors to use effectively. Provide multiple products or services to the same or similar markets through an effective distribution channel.

Dell® sells computers directly to consumers and builds every computer system to order based on the customer’s specific needs. Dell uses a variety of suppliers who actually manufacture the computer components, but since Dell bypasses middlemen and retailers to sell to consumers, it maintains low overhead and passes the savings on to buyers.

Amazon.com was the first in its industry to use e-commerce to market and distribute books, music, and movies. Besides offering competitive prices, Amazon has an excellent distribution system and can get products into customers’ hands quickly. Amazon also developed strategic relationships with used booksellers to provide customers with the option of buying new or used books.

**Organizational efficiency**—Look for less expensive materials and more efficient equipment. Streamline your processes and find ways to make products or deliver services more efficiently. Outsource to efficient and highly skilled suppliers. Hire staff with expertise that can improve operations and efficiency levels. For example, Southwest Airlines® continues to be one the few profitable airlines because of its ability to provide excellent service, budget prices for fares, and quick turnaround on secondary routes. Southwest Airlines started a trend for cost-conscious, low-frills air transportation.

**Tip**

Know what is important to your prospective and current customers. From time-to-time, ask them why they buy from you or other competitors and what factors influence their buying decisions.
Unique technology and innovative products or services—Use unique, innovative, and leading technology to market, sell, and serve target markets. Consider using the Internet to offer products or services to local, regional, national, or global customers. Invest in technology to manufacture products, manage operations, or track customer information.

Apple does not produce as many products as Hewlett Packard® or Samsung®. But what sets Apple apart from its competitors is that it creates innovative products that initially are unique for the industry. Apple’s first success was its user-friendly computer icons—even three-year-olds could use the computer. With the introduction of the iPad, Apple again provided a unique product to meet the diverse needs of the market.

Tip

Copying a competitor’s competitive advantage is a mistake. Capitalize on your strengths or unique innovations so that customers prefer to do business with you. What works best for another company may not work for you.

Competitive Advantage

What are my core competencies? What do I do better than any of my competitors?

Are my products or services the best in the industry or market? If so, why? If not, why not?

What specific target, or niche, market(s) could I serve better than anyone else?

How effective is my distribution channel or delivery method?

How can I improve my organizational efficiency?

What unique technology and innovative products can I develop?
Before deciding on your business strategy, take the time to understand the competition. Analyzing the competitive environment and understanding how competitors differentiate from one another will enable you to develop your own tactics and counter-tactics. Your market research from Module 2 should help you with this analysis, especially your responses to Action Step 2.3 Analyze My Direct, Indirect, and Future Competitors.

**Analyze the Competitive Environment**

By researching competitors and collecting information, you have already begun to study the competitive environment and have identified the other business entities that compete with you for the same customers. If you need help in determining who will be your best customers, read A Closer Look @ Defining Your Target Market, pp. 104-106.

Every competitor has strengths and weaknesses. Your competitors’ weaknesses may become the potential advantage you use to position your business effectively. Many larger competitors are not able to make decisions, allocate resources, and respond to changing market needs as quickly as smaller ones. Because of this weakness, entrepreneurs can often gain market advantage until the larger companies respond.

On the other hand, entrepreneurs have a hard time competing with the financial resources of larger competitors. For example, a small, local beverage manufacturer may not offer as many flavors or new products as the larger soft drink companies. The smaller manufacturer may need to focus on unique flavors and depend on local strategic alliances with restaurants to keep its market share.

Entrepreneurs should explore and understand key information about every significant competitor that poses a potential threat. Identify which companies will present the most aggressive competition and anticipate what they will likely do if you change your business strategy. Some competitors might react very aggressively to any challenge to their market position. Other competitors may take a more tolerant view of competitors in the industry.

Using the information you collected from your market research in Module 2 and your answers to Competitive Advantage on p. 78, complete Competitive Analysis on p. 80–81. Compare your company with competitors to understand how you can compete successfully in the market. Analyzing the strengths and weaknesses of your competitors will help you determine your most effective business strategy.

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**Tip**

Thriving businesses sometimes have difficulty recognizing the need to change in order to stay ahead of the competition. Successful entrepreneurs plan for change.
## Competitive Analysis

**Step 1 Compare your company with its competitors.** Start with your own company and evaluate how you use each of the differentiators to gain a competitive advantage in the market. Then, choose up to four direct competitors and evaluate how they use the same differentiators. If you do not yet have enough information to evaluate your competitors, do some research. For example, talk to suppliers or conduct focus groups or interviews with the competitors’ customers. For more information on surveys and focus groups, see A Closer Look @ Primary Research on pp. 71–72 in Module 2.

<table>
<thead>
<tr>
<th>Differentiators that Build Competitive Advantage</th>
<th>Your Company</th>
<th>Competitor A</th>
<th>Competitor B</th>
<th>Competitor C</th>
<th>Competitor D</th>
</tr>
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<tbody>
<tr>
<td>What core competencies does the company possess?</td>
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<tr>
<td>What qualities, characteristics, or capabilities are its strengths?</td>
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<td>Which products or services are perceived by the customer as superior to others in the market or industry?</td>
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<tr>
<td>Which target market or niche does the company serve better than anyone else?</td>
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<tr>
<td>Does the company have a unique distribution channel or delivery method?</td>
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<td>Has the company mastered organizational efficiency? Does it offer products or services at a better price, more effectively, or through a highly talented staff?</td>
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<tr>
<td>Has the company developed technology or innovative products or services unique in the market?</td>
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### Weaknesses

- What weaknesses exist in the product or service, marketing, or organization?
- Other weaknesses?
Competitive Analysis continued

Step 2 Analyze your competitive advantage. Based on this analysis of your competitors, answer the following questions about your competitive advantage:

Who are my stronger competitors? Why?

How do I compare?

What is my competitive advantage?

Business Models

As part of the planning process, it is time to evaluate your business model to ensure that the current model will support your plans for growth. If your business strategy changes, you may need to modify your business model to align with it.

A business model is the method by which an organization uses its resources to deliver value to customers while maximizing profits and growth for itself. The model provides a structure or framework for delivering products or services to an intended audience. The business model includes these elements:

- Type of customers to serve
- Ways customers use the product/service
- Distribution
- Promotional strategy
- Operational tasks to be performed
- Resource requirements
- How profit and revenue is generated

Two businesses that sell the same product or service can have quite different business models. For example, both Zappos and DSW sell shoes and accessories. Zappos receives orders via the telephone or online, receives payment from the consumer and ships the order directly to the consumer. DSW is primarily a retail operation, selling various brands of shoes and accessories. The choice of business model has a profound effect upon all aspects of their business.

Tip

A well developed business model can help you sustain a competitive advantage in the market.
Types of Business Models
Some of the common business models are highlighted below, although many entrepreneurs develop hybrids that incorporate features of several different models rather than just one or the other.

Bricks and mortar—The oldest and most basic business model is the storefront where companies maintain a physical location and offer products or services to customers. Customers buy on location. In recent years, retailers have expanded their bricks and mortar model to include an online presence. This practice, called the clicks-and-bricks model, allows customers to buy online and pick up at local stores or have products shipped directly to them.

Subscription—A business model originally developed for magazine and record clubs is now finding many new applications. The subscription business model allows a company to generate recurring revenues, usually on a monthly or yearly basis. Other industries that have adopted this model include cable and phone companies, newspapers, Internet providers, software providers, and health clubs. This model generates a constant stream of revenue and provides convenience for customers who buy once and receive products or services for a period of time.

Bait and Hook—Years ago, Gillette developed a model to hook customers with the purchase of an initial product—their safety razor first manufactured in 1903. Customers would then be hooked into purchasing supplemental products, such as disposable razor blades. This model is implemented with products such as cell phones and airtime, printers and ink cartridges, and cameras, film, and prints.

Multi-level marketing—Also referred to as the network marketing model, independent distributors buy products from a parent company, sell products to consumers, and create a downline (or network) of other distributors who do the same. The independent distributors receive a profit generated from their own sales and sales of their downlines. Mary Kay®, Melaleuca®, and Longaberger® are multi-level marketing companies.

Direct Sales—The direct sales business model eliminates the middleman and increases the sale-to-delivery speed of a company’s products to consumers. Popularized by Dell, this model capitalizes on customers who buy directly from the manufacturer. Since no additional margins are paid to middlemen, the cost of sales is less, and customers buy at reduced prices. For example, airlines often give a small discount to customers who book tickets on their websites. Some manufacturers may prefer, however, to use middlemen to streamline the sales process, share the costs for local marketing, and reduce costs by consolidating goods and services for distribution.

Auction—This model provides a process of buying and selling goods by offering them up for bid. The traditional auction-house business model is usually associated with antiques and collectibles such as stamps, coins, classic cars, and fine art. While this business model is very old, the Internet has created an online auction version. Auction sites eBay and Zaaarly allow people from all over the world to buy and sell all kinds of goods and services, generating countless new business opportunities for entrepreneurs.

Service—The service industry is a large category of our economy and presents the most complex and challenging business models. The service sector consists of such industries as insurance, tourism, banking, education, franchises, restaurants, transportation, healthcare, consulting, investment, and legal services, among others. The problem that many service providers face is how to deliver quality services
efficiently and effectively every time. A typical service business model may focus on increasing customer satisfaction, which leads to loyalty, which leads to profitability. The increase in profitability is related to customer retention. It’s typically less expensive to keep existing customers than to acquire new ones.

**Collective business system**—This model offers businesses, tradespersons, or professionals in similar or related fields opportunities to pool resources, share information, and gain benefits by paying fees to belong. Trade associations, cooperatives, and franchises are based on this model. The premise of this model is that its members with common interests can support one another to successfully compete in the marketplace.

- **Trade associations**—Members pay annual and user fees to market, network, access information and education, and purchase products and services through group purchasing plans. The association may also collect rebates or commissions from purchasing programs.

- **Cooperatives**—These entities are similar to trade associations, but members have an equity interest by owning a portion of the cooperative. Members participate in group purchasing plans, buy or lease commercial space, and share in the risks and profits of conducting business. Members receive profits or dividends from sales.

- **Franchises**—Borrowing concepts from the manufacturing sector, franchises perfect branding, production, procurement, and operational procedures so that they can be replicated in different geographical locations. Members buy the rights to operate a franchise in a geographical location from the franchiser, or parent company. In addition to the initial franchise fee, members of franchises buy products or services and pay a percentage of their sales to the franchiser.

**Online delivery**—The Internet has given rise to new variations of business models. Internet models allow companies to sell their own products or services, sell others’ products or services, or promote and connect buyers and sellers. Here is a quick glimpse at a few Internet models:

- **Brokerage**—A broker provides a service by bringing buyers and sellers together for a transaction fee. Examples of the brokerage model include Orbitz®, Priceline®, eBay, Paypal®, Amazon.com, and Shopping.com®.

- **Advertising**—A website provides content services and makes its money by selling advertising. The advertising revenue is in direct proportion to the volume of viewing. Yahoo!®, Monster.com®, Google®, and Marketwatch® are examples of this model.

- **Infomediary**—An independent entity analyzes Internet consumption habit data and sells it to firms for use in target marketing. Likewise, they analyze markets for consumers. Edmunds® and Double-Click® are examples of this model.

- **Information**—A website creates a depository of articles, publications, videos, or other media and sells them to distributors or end-users who want to buy the information. Hoovers®, Dun and Bradstreet®, and Knowledge Storm are examples of this business model.

The success of your company is directly related to how well your business model matches your customers’ expectations. The CEO Refresher’s *Establishing a Continuing Business Model Innovation Process* by Donald Mitchell and Carol Coles states that successful high-growth companies revise their business models according to customer preference as often as every two to four years.

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**Tip**

A well considered business model gives you a competitive position—especially if the model is unique or well executed. Adapt to stay in the game.
change with the times

Olin B. King founded Space Craft, Inc., in Huntsville, Alabama. King started his business in the basement of his home in 1961 with two friends whose goal was to design and build satellites. They had built only three before that program was transferred to NASA from the U.S. Army. Later they set out to manufacture subsystems for the Apollo mission, completing fifteen systems before the Apollo program came to a halt.

Back to square one, SCI began to manufacture subsystems for F4 jets for the Department of Defense, building thousands before it found itself, once again, searching for a new market need to fill. In the late 1970s and early 1980s, SCI made computers for IBM and evolved into a Fortune 300 company.

In just a few years, SCI grew from a handful of people to thousands of employees working in plants all over the world. Some industry analysts dubbed Mr. King the “Father of Contract Manufacturing.”

Mr. King will tell you it wasn’t easy; in fact, he found he had to reinvent his company and his business model a number of times. Although SCI began as an engineering services business, it continued to adapt until it evolved into a contract manufacturing business model.

In 2001, when SCI Systems, Inc., was acquired by Sanmina® for $6 billion, SCI was a publicly-traded company operating forty-nine facilities in nineteen countries and employing more than 35,000 people. Analysts projected this merger would create one of the most respected and successful companies in the $130 billion global electronics contract manufacturing industry.

Business Model

Which of the following business models have possibilities for meeting your vision and goals for growth?

- Bricks and mortar
- Auction
- Subscription
- Service
- Bait and hook
- Collective business system: Trade association, Cooperative, Franchise
- Multi-level
- Online delivery: Brokerage, Advertising, Infomediary, Information
- Direct Sales
- Other:

Aligning the Business Model and the Vision

Use the questions below to align your business model with your vision and goals. What components of my current model would I keep and what would I change?

Why would I make these changes and how would they align with my vision or my competitive advantage?
In addition to aligning your business model with your vision, your business strategy will be somewhat determined by how you plan to remove yourself from the business. Some entrepreneurs want the business to continue to exist without them for the benefit of their employees, some of whom may be their own family members. Other entrepreneurs have personal goals that include maximizing monetary return at their departure. Forward-thinking entrepreneurs will consider an exit strategy as part of their overall business strategy.

Exit Strategies

You may say to yourself, “Why would I design an exit strategy when I still enjoy being in this business?” Think of it this way: your business is an asset in which you have invested money. It has a revenue stream that supports your salary and possibly a sizable distribution of yearly profit. It should be increasing in value so that when the time comes, you will be able to harvest additional wealth.

Planning an exit strategy is the most commonly overlooked consideration of a business strategy, yet the exit strategy plays a key role in determining the strategic direction for the company. By not planning an exit strategy beforehand, business owners, their heirs, or their successors may find that the options in the future are limited.

Some entrepreneurs think of their exit strategy as the means by which the business transitions to the next major stage. From this perspective, the entrepreneurs do not necessarily leave the business, but their role changes significantly.

Years before exiting her business, Jennifer Lawton was planning ahead. “I began to see my exit strategy less as a termination and more as a logical part of the high goals I had set for both my company and myself, stated the owner of Just Books, Inc.”

“I may pursue an acquisition, take the company public, merge with another concern, methodically increase sales to a higher level, or shoot for rapid 200 percent growth. In achieving any of these goals, I will have, in fact, ‘exited.’ My company will have moved from one phase to the next, its ‘exit’ from one level becoming its ‘entrance’ to the next. The reality is that unless you define that end or change, your business may change in a way that wasn’t in your plan.”

Choose an exit strategy that aligns with your business and personal goals. “You should be thinking about your exit strategy the day you start your business,” says attorney Garrett Sutton, author of How to Buy and Sell a Business. “By keeping the issue of exiting in mind as you build your business, you will have the flexibility to handle the exact strategy at the appropriate time.”

To prevent your business from taking a path other than the one you intended, you can integrate an exit strategy into your business’s vision, goals, and strategy. Just because you define your exit strategy now doesn’t mean you have to execute it anytime soon. Some entrepreneurs use their exit strategy three, five, or twenty years later. As the owner, you should determine the expected outcome, parameters, and results before you exercise the strategy.
Benefits of an Exit Strategy

Besides having peace of mind that you can exit the business profitably, other benefits of having an exit strategy in place include:

- Protecting the value of the business you have built.
- Creating a smooth transition to your management team or family members.
- Generating a potential income for retirement or disability.
- Enhancing the future worth of your business.
- Reducing or deferring the potential tax impact on your estate, spouse, or family.
- Creating a strategic direction for your business’s growth.

Types of Exit Strategies

A successful business builds wealth for its owners by accumulating assets and building future profit potential. The most common favorable exit strategies are to sell the business, sell the assets of the business, merge it with another business, or sell shares in the business to the public at large. Unfortunately those entrepreneurs who do not plan an exit strategy will one day exit from their businesses unprepared. Some entrepreneurs exit the business for reasons other than wealth, retirement, or the desire to pursue other goals. Death, disability, family circumstances, and divorce from partners sometimes lead to an early exit. Without an exit plan, entrepreneurs who want a favorable outcome for themselves, their heirs, or their employees may find that their exit is other than what they wanted it to be.

Mo Siegel, founder of Celestial Seasonings® based in Boulder, Colorado, faced some challenges when planning to exit his company. Siegel had grown Celestial Seasonings to become the largest herbal tea manufacturer. Siegel purposefully created an entrepreneurial culture that encouraged new ideas for tea flavors from employees, established a fun and family-like work environment, and was rated one of the most socially responsible companies in the United States.

When Kraft® bought Celestial Seasonings in 1984, Siegel watched his company’s culture change significantly. Many of the staff that Siegel had personally recruited left. The quality of life and passion that he had created for so many people slowly disappeared. Even though the company met all of its business goals, Siegel felt his exit had not accomplished what he wanted for himself, his staff, or the community.

In 1988, when Kraft was negotiating to sell Celestial Seasonings to Lipton®, Siegel decided to buy it back from the corporate giant.

In 2000, Siegel merged Celestial Seasonings with Hain Pure Foods® to form The Hain Celestial Group. He had found a company who shared Celestial Seasonings’ vision, not only for the business but for its people, and knew he could finally retire to pursue another personal dream—hiking the last set of 14,000-foot Colorado mountains he had yet to climb. To ensure he had made the right decision for his company and staff, he stayed on for two years to oversee the transition between the companies.

Every exit strategy has advantages and disadvantages. The chart on p. 87 highlights both and may provide you with some considerations you have not thought of before. These exit strategies can take a business to its next stage. As the business transitions to the next stage, you may end your involvement or remain with the business in a new role.
Types of Exit Strategies | Description | Advantages | Disadvantages
--- | --- | --- | ---
Merger with Another Company | Company joins with an existing company. | Owner may receive cash and/or stock, resources of both companies are combined, and some of the management may remain constant. | New owners or managers may have different philosophies or ways of doing business, existing staff may have less control, and blending the two cultures may be difficult. |
Acquisition by Another Company | Company is bought out by another existing entity. | Owner receives cash or stock for the sale and management contract is negotiable for the owner to stay on during transition. | Fit is not always appropriate for the business or employees, and the corporate identity or brand may diminish. |
Sale of the Company | Company is sold to individual(s). | Owner may receive cash immediately or over time. | May be difficult to find the right buyer at the right price and changes in ownership may be difficult for employees. |
Franchise of the Company | The business concept is replicated and the company expands locally, regionally, nationally, or internationally. | Owner receives cash for each franchise, current corporate management is maintained, and the enterprise sees an opportunity for large-scale growth. | Process may be difficult and time-consuming, and the business concept may not be appropriate for franchising. |
Employee Stock Ownership Plan (ESOP) | Employees receive shares or stock of the company over time. | Key employees are rewarded for their contributions, receive incentives for staying with the company for a number of years, and share in the profits of the company they have helped to grow. | Owner can borrow funds from the plan as a loan to the company, employees may lose their shares if they leave the company, and if the value of the company or company stock goes down, the employees share in the burden. |
Initial Public Offering (IPO) | Shares of the company are sold to the public on a stock exchange. | Shares convert to cash for investors, major shareholders control the company, and investors see potentially high returns. | Company needs high growth to generate earnings and investors’ interest, process is costly, and the outcome is uncertain. |

Plan With the End in Mind
It is never too early or too late to decide how you want to exit from the business. Consider which exit strategies are most appropriate for you and your business. Talk with your attorney and accountant about the legal and financial implications involved. The more you understand your options and how they meet your short and long-term goals, the more comfortable you will feel about the type of exit strategy you choose.

Exit Strategy
Which of the following exit strategies best serves your personal and business goals?

- Merger with another company
- Acquisition by another company
- Sale of the company
- Franchise of the company
- Employee stock ownership plan (ESOP)
- Initial public offering (IPO)
- Other:
When my partner and I launched NetCreations, an email marketing firm, my dream was to run my little company for the rest of my life,” says Rosalind Resnick. “Anyone who wanted to take it away from me would have to pry my cold, dead fingers from my desk.”

Yet, Resnick and her partner sold NetCreations to a European conglomerate for $111 million. Looking back on the collapse of the dot-com market, Resnick counts herself fortunate to have gotten out before it was too late.

The moral? “Start thinking about potential buyers before the ink is dry on your business plan,” advises Resnick, now CEO of Axxess Business Centers, Inc.® Build relationships with those companies so you’ll be on their radar screens when it’s time to sell or seek a strategic partner. “It’s also important to figure out what these companies want—a proprietary technology, a product line extension, an entry into a niche market—so that you can shape your company accordingly,” Resnick adds.

**Define Your Business Strategy**

A business strategy creates a strategic direction for the company, establishing the company’s focus. The strategic direction represents a commitment to concentrate and specialize in what will help the company to achieve its vision. The companies that fare the best are those that maintain their focus.

Consider the analysis, market research, and opportunities you explored in Modules 1 and 2 and use them to complete Ideas for a Business Strategy to help you prepare to write a business strategy.

**Ideas for a Business Strategy**

1. **How will the business and personal goals I set in Module 1 help achieve my vision for the business?**

2. **How can I build and maintain a competitive advantage in the market?**

3. **How will I continue to meet current and emerging needs of the market?**

4. **What steps should be taken to regain or maintain focus for my business?**
Defining a Business Strategy
How you define your business strategy will determine the direction of your business and what it will look like in the future. By defining your business strategy clearly, you can develop your business or growth plan to achieve your business and personal goals.

Analyzing your responses to Ideas for a Business Strategy will help you develop a business strategy that works for your business. Remember, you cannot be all things to all customers. You do not have to be the market leader to compete successfully, but you do need to focus on your company’s strengths to find a way to differentiate from other competitors.

Once defined, your business strategy sets priorities for the company and management team and helps you attract and retain the talented workers you need. Although each department in your company may focus on different priorities to accomplish specific tasks, these priorities should not conflict with the overall strategic direction of the company.

Your business strategy can be defined in either several paragraphs or be written as a set of strategic statements. It is a summary of how the company will achieve its goals, meet the expectations of its customers, and sustain a competitive advantage in the marketplace. Your business strategy should answer these questions:

- Why is the company in business?
- What are we best at doing?
- Which customers should we continue to serve or start serving?
- Which products/services should we stop offering, continue to offer, or start offering?
- Why have we decided on these strategic directions?

The following examples describe two different companies and their business strategies:

EXAMPLE
Heartland Training Solutions is a consulting company that provides performance improvement strategies, assessments, and training programs to mid-sized businesses. Heartland has successfully worked with a variety of service businesses on an innovative client retention process. Some of the most positive feedback has come from accounting firms and financial planners who have used these services. Like many consulting companies, Heartland’s current revenues are tied to the number of hours the consultants can work, and the majority of its clients are located in a four-state area. The Heartland team wants to grow the business. After conducting a SWOT analysis and brainstorming their three-year vision, they developed the following goals and strategy to accomplish them.

Goals
- Enhance the value of the Heartland Training Solutions brand.
- Develop a revenue stream independent of consulting time that will provide 50 percent of Heartland’s sales revenue within three years.
- Increase the assets of the business so that in the next five years, Heartland could be sold to another company or individual.

Strategy
Heartland Training Solutions will offer performance improvement strategies, assessments, training programs, and tools to help mid-sized businesses build sustainable futures, increase productivity, and develop staff and customer loyalty. In addition to continuing its regional consulting services, Heartland will:

Tip
A business strategy incorporates business and personal goals into a competitive advantage that will successfully carry the business into the future.
• Develop a software program based on Heartland’s successful client retention process.
• Create a turnkey training program that can be used to help potential customers achieve the greatest benefits from the client retention software.
• Broaden Heartland’s distribution activities to market the new client retention software and training program to mid-sized accounting firms and financial planners nationwide.
• Implement a marketing plan to position Heartland as the expert in client retention for accountants and financial planners.

EXAMPLE

O-Foods offers a line of organic foods that range from cereal and soups to cheese and chicken. These products are currently sold at three company stores, and those products that can be easily shipped are also sold through the O-Foods website. In addition to the O-Foods branded products, they also carry other organic products. Each of the company stores is located in a town with a major university; both students and working adults interested in a healthy lifestyle are their target customers. O-Foods attracts and retains a talented staff who provide product information along with a high level of service to its customers—creating a strong competitive advantage. The following goals and strategy were developed based on their SWOT analysis and three-year vision.

Goals

• Develop incentives to maintain high employee retention with a turnover rate of less than 20 percent annually for those at or above the assistant manager level and less than 30 percent for all other employees.
• Build the O-Foods brand.
• Increase profits by 15 percent each year for the next three years.

Strategy

O-Foods will provide its customers with the freshest and finest organic food available. O-Foods’ team ensures each customer has an outstanding shopping experience by providing a high level of service and product information. O-Foods will:

• Implement an employee stock ownership program for those employees who have worked for the business for a minimum of one year.
• Develop an employee training program to further enhance all employees’ product knowledge and customer service skills.
• Create a unified look for the stores, the website, and product packaging.
• Design a marketing plan to increase purchases by current customers and attract new customers within the existing target markets.
• Increase operational efficiencies.
• Improve shipping capability so that perishable products can be ordered from the website and shipped anywhere in the United States.

Action Step 3.1 Define My Business Strategy will lead you through the process of determining and describing your overall business strategy. Then you can capture the big picture for your business in Action Step 3.2 Write My Executive Summary. This draft of your Executive Summary is an overview of your plan for your business. After you work through the rest of the modules, you will want to adjust your Executive Summary to reflect any changes you’ve decided to make.
Use Your Strategy

Once you have outlined your business strategy, you will continue the planning process to determine how to implement the strategy. Module 4 immerses you into aspects of financial planning by taking a look at your historical financial data and projecting your future financial situation. In Module 5, you will align your products or services and pricing with your business strategy. In Module 6, you will develop a marketing plan to promote, sell, and distribute your products or services. Module 7 will help you refine your management team to implement the business strategy while Module 8 focuses on the processes needed for strategic operations. Module 9 will help you finalize your budget, including the expected profitability from implementing your business strategy and marketing plan; and Module 10 provides success tips to keep your business on track with your plan.

Evaluating the Business Strategy

Throughout the planning process, your business strategy should be evaluated. Each component of your business strategy—including your competitive advantage, business model, and exit strategy—should always align with your overall plan for growth. Re-evaluating these components during the planning process will help keep your business strategy aligned with your plan.

Review your business strategy and business performance on an ongoing basis as you implement the plan. The navigational tools you currently have and the ones you develop in this program (such as the use of financial documents, job descriptions, and worksheets) can provide ways to compare the company’s actual performance to its planned performance in specific areas. You may choose to review your business strategy annually by evaluating how well the company has sustained its competitive advantage, its business model, and its movement toward the planned exit strategy.

You may be familiar with the saying, “You can’t manage what you can’t measure.” This definitely applies to knowing whether your business strategy is producing desired results. Use Evaluate My Strategy to help determine how well your current strategy is meeting your expectations.

<table>
<thead>
<tr>
<th>Evaluate My Strategy</th>
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<tbody>
<tr>
<td><strong>Business Strategy and My Goals</strong></td>
</tr>
<tr>
<td>Has the strategy helped me achieve my personal goals? If so, how has the strategy helped to achieve those goals? If not, why aren’t my personal goals being met?</td>
</tr>
<tr>
<td>Has my current strategy helped me achieve my business goals? If so, how has the strategy helped to achieve those goals? If not, why aren’t my business goals being met?</td>
</tr>
<tr>
<td>How can I improve my current business strategy to achieve my personal and business goals?</td>
</tr>
</tbody>
</table>
Evaluate My Strategy continued

**Business Strategy and Market Needs**
How does my current strategy help address the changes in population, customer behavior, and demographic trends?

How does my current strategy help manage the changes in my industry?

Do my products/services continue to meet current and evolving market needs? Is the need for my products/services growing, on a plateau, or declining?

How can I adjust my business strategy to meet market needs more effectively?

**Business Strategy and Competitive Advantage**
How does my current strategy differentiate my business from the top competitors in the market I serve?

What strategies do my top three competitors use?

Should I adjust my business strategy to maintain a competitive advantage? If so, how should I adjust it to remain competitive?

**Refining Your Business Strategy**
Designing a business strategy is not a one-time job. Significant changes in the market may create a need to alter your business strategy in order to reach your growth goals. Your strategy, therefore, must be continually refined as new information becomes available. The quicker you anticipate these changes in your market, the better off your business will be.

By establishing a routine way to monitor your business strategy—let’s call it a business barometer—you can define strategic choices for your business based on the newest research available.

**Tip**
The business strategy should be refined on a regular basis, at least annually, to incorporate changes that keep your business on its growth track.
The following steps will create a business barometer that can alert you to changes in the landscape and the need to re-position your business for a sustainable future:

**Step 1 Determine current and emerging market needs.** Make a list of macro and micro trends—those outside of your industry and those that are specific to your industry—that are occurring in the marketplace. Be as specific as possible.

<table>
<thead>
<tr>
<th>EXAMPLE</th>
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<tbody>
<tr>
<td><strong>Macro trends</strong>—72 million baby boomers reaching retirement from 2007-2027</td>
</tr>
<tr>
<td><strong>Micro trends</strong>—Elder care facilities have nursing shortages due to fewer entering the field, Medicaid decreases</td>
</tr>
</tbody>
</table>

**Step 2 Identify possible impact to your business.** Define which trends may directly or indirectly impact your business or its ability to compete. Be as specific as possible.

<table>
<thead>
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<th>EXAMPLE</th>
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<tbody>
<tr>
<td>Elder care facilities—More baby boomers interested in senior services, more home and community-based models for providing senior care, private pay for services not reimbursed by the government</td>
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</table>
Step 3 Consider your response to market changes. Determine how you would respond to market changes and ensure that your company can continue to compete. Be as specific as possible.

**EXAMPLE**
Elder care facilities—Invest in technology to do more with fewer resources; expand senior care services without "walls"; develop strategic alliances with competitors and complementary services.

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Step 4 Refine your business strategy to position the company for success. Evaluate your current strategy and those of your competitors. Refine your strategy to use your company's strengths, meet the needs of your market, and achieve your personal and business goals.

**EXAMPLE**
Our elder care facility, like our competitors, struggles with the nursing shortage and the high costs of caring for our residents. Expanding our services to include different levels of care (adding assisted living and adult day care services) will target customers who require less care (less need for nurses and lower costs) and fits well with our strengths. This will also create a source of residents for our skilled-level care as the new customers advance in age. For all services, increasing the use of computer monitoring and communicating with the residents will increase responsiveness to residents while reducing the demands on the nursing staff....
Step 5 Determine ongoing factors that affect the future forecast and how to monitor them.
Identify factors that would measure internal and external changes and where you might find this information. Be as specific as possible.

**EXAMPLE**
Elder care facilities research sources: Industry trade association—trade journals, newsletters, and shows; national newspapers and magazines; financial statement guides, such as D & B and RMA

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**Decision Making**
The decisions you will be making about the strategic direction of your business lead to more decisions. Good decisions result from critical thinking—the ability to focus your thinking to get the results you want—a key entrepreneurial skill.

Whether you are defining your strategy or simply figuring out how to solve a routine problem, keep these questions in mind:

- What do you know about the situation that explains what is happening?
- What patterns do you see? What inconsistencies?
- Are you looking at a symptom? Is something else creating these results?
- What can you do to assist the situation?
- What would happen if…?
- Can you propose an alternative solution?
- How would you prioritize your time and actions?
- How would you explain…?
- What data could you use to reach a conclusion?
- What assumptions have you made?
- What are expected outcomes? What’s the worst that could happen? The best?

To succeed as an entrepreneur, remember to guard against making critical decisions based solely on emotion without considering relevant information. You’ll want to be able to analyze the situation, make the decision, and take action with confidence in your decision-making and planning abilities. In the subsequent modules, you will analyze and evaluate how your strategy will affect your business and determine the actions needed to implement your strategy.
taking action

Steve Stephenson identified a promising business opportunity: by investing about $100,000 in cutting-edge technology, he could provide his clients with revolutionary new services.

But the timing wasn’t great. Stephenson had just purchased a building and orchestrated the merger of two companies to form Lykins-Signtek Inc., a firm based in Naples, Florida, that works with residential and commercial developers to design street signs, mailboxes, and other specialized items. Facing tight cash flow and seeking to stabilize the freshly merged companies, Stephenson hesitated to buy the new technology. In fact, he waited six months before finally deciding to take the plunge.

In retrospect, Stephenson concluded that the new equipment would have paid for itself over that six-month period by helping him attract more clients and broaden his range of services. Instead, his dithering cost him potential revenue. “I over analyzed, and then I procrastinated,” he says. “Now I know that instead of beating a dead horse, you ride it. You make a decision and then ask, ‘What next?’”

He now conducts due diligence, collects relevant information, and makes decisions promptly. As an example, Stephenson boldly purchased another building to house his fast-growing company. He didn’t waver or repeatedly question whether to proceed. Today, he’s more decisive in hiring people, buying vehicles, and making other major investments in his company.

“Now when I have the information in front of me, I act,” he says. Stephenson credits FastTrac with making him more decisive and also sharpening his ability to plan. One of the most valuable tools he acquired is learning to evaluate the actual cost of sales and growth to his bottom line.

He’s currently assessing several scenarios to expand his business, such as opening new branches or buying another company. By projecting the financial impact of each scenario, he can separate emotional drivers from more substantive, strategic factors that guide his decision. “What kills most businesses is under capitalization,” he says. “So I’m asking, ‘If we close this deal, how will this impact my sales and profitability? How much capital will we need?’”

Stephenson knows now to answer these questions up front so he can have a plan in place. Stephenson’s decisiveness has led to better results. His company’s revenues have increased nearly 20 percent a year over the past few years, and annual sales exceed $5 million.

Writing an Executive Summary

Your strategy sets the direction for your business and becomes the cornerstone of the planning process. In Action Step 3.2, you will write a draft of your Executive Summary, which is an overview of your company and its strategic direction. You can use your Executive Summary as a standalone document or as the first section of your business plan.

The action steps in FastTrac® GrowthVenture™ will guide you through the development of your plan. After you finish each module, take the time to complete each action step to record the results of your research and analysis, your decisions, and the actions you want to take to achieve your vision and goals.
Summary

Defining a business strategy when you are repositioning for growth can be just as difficult as it was the first time you designed your business. The business strategy should meet both your personal and business goals, develop a sustainable competitive advantage for your company, and meet current and emerging market needs. In addition, your exit strategy and business model should align with the overall business strategy. This alignment will provide the foundation to help the company achieve its vision and for you to have the company of your dreams.

Key Things to Remember

- Your business strategy helps you realize your vision.
- Your business strategy focuses on achieving personal and business goals, maintaining a competitive advantage, and meeting current and emerging market needs.
- You can maintain a competitive advantage by focusing on your strengths, differentiating from competitors, and meeting market needs better than others.
- Plan your exit long before you need it.
- An exit strategy help you grow your business the way you intend.
- Refine your business model to meet your business strategies and address market needs effectively.
- The Executive Summary describes your business, its market and customers, company goals, and how it will meet them.

Module 4 addresses your financial situation, both historical and future. You will look at your financial goals, understand the benefits of using a budget, align your budget with your business vision and goals, and learn to use your financial statements to make financial decisions. Most importantly, you will begin to see how every functional aspect of your business has financial implications, so that you can integrate financial planning into your overall business strategy.
Activity 3a: Personal Best Health and Fitness

Identify ways that a business can sustain a competitive advantage.

Directions
Read the scenario for Personal Best Health and Fitness and answer the questions that follow.

Personal Best Health and Fitness has just celebrated its sixth anniversary in business. Co-owners Nina and Carlos are reviewing the changes that have taken place since they opened for business.

When Personal Best Health and Fitness opened its first location, the nearest exercise facility was ten miles away. Several of the community centers offered a gym and exercise classes. One of them had installed exercise equipment at its facility, but it was not comparable to Personal Best. Even though Nina and Carlos thought of these facilities as their competitors, they knew that the others did not offer the same level of service that Personal Best’s staff ensured. None of these sites provided the one-on-one coaching and customized fitness plan development and monitoring that Personal Best offered.

Six years later, the landscape is much different. Personal Best has a total of three locations in the metropolitan area—the original one in the downtown business district and two in suburban areas. Two other health and fitness facilities have recently opened near Personal Best locations. One of them is part of a national chain and is the first location in the area for the chain. In other suburbs throughout the metropolitan area, four other health and fitness facilities have opened, which decreases the number of customers willing to drive any distance to work out.

Nina and Carlos considered what built their competitive advantage over the last few years. They invested in state-of-the-art equipment available when opening each location. Although they have had some turnover with the staff, Nina and Carlos’s managers have been with them since they opened each location. The managers are dedicated to the business and consistently provide exceptional customer service. Every week Nina and Carlos receive handwritten notes thanking them for the great job their staff does, and these new facilities have not stripped them of Personal Best’s loyal customers.

Now the business is six years old with substantially more competition. Nina and Carlos need to explore ways to remain the market leader and find ways to stay ahead of competitors.
Activity 3a: Personal Best Health and Fitness continued

Discussion Questions
A. What are some of the business’s core competencies, and how can they be used to sustain a competitive advantage?

B. What other areas of expertise or quality products or services should the business offer to sustain a competitive advantage?

C. What target or unique niche can the business reach to sustain a competitive advantage?

D. How could the business use a unique distribution or delivery method to sustain a competitive advantage?

E. How could the business master operational efficiency to sustain a competitive advantage?

F. How can the business use technology or innovation to sustain its competitive advantage?
**Action Step 3.1: Determine My Business Strategy**

Determine and describe your overall business strategy.

**Directions**
A business strategy should detail how you will achieve your mission, vision, and goals, differentiate your company from its competitors, and meet current and emerging market needs. The business strategy you develop in this Action Step will be useful in completing Action Step 3.2 Write My Executive Summary.

A. **Use the results of your responses** to questions and checklists, activities, and action steps completed in the first three modules to complete this action step. Discuss possible overall business strategies with other entrepreneurs and advisers.

1. Why is the company in business? (Review Action Step 1.2 Define My Three-Year Vision on pp. 29–30.)

2. What are our core competencies—those things we are really good at doing? (Review Competitive Advantage on pp. 80–81.)

3. Which customers should I stop, continue, and start serving as a refinement of my focus? (Review Action Step 2.2 Develop My Customer Profile on pp. 62–65.)

4. Which products/services should I cease, continue, or start offering, and why? (Review Action Step 1.1 Conduct a SWOT Analysis on pp. 27–28 and Action Step 2.4 Evaluate Growth Opportunities on p. 70.)

5. Why have I decided on this strategic direction? (Review Action Step 2.3 Analyze Direct, Indirect, and Future Competitors on pp. 67–68.)
Action Step 3.1: Determine My Business Strategy continued

B. Formulate these answers into a concise paragraph that outlines your business strategy. See examples on pp. 89–90.

C. Answer the following questions to test the fit between the strategy and your business. Yes indicates your business strategy is a good match.

- Are my business and personal goals reflected in the strategy? □ Yes □ No
- Is the strategy sustainable into the future? □ Yes □ No
- Does the strategy define our position in the market? □ Yes □ No
Action Step 3.2: Write My Executive Summary

Develop your draft Executive Summary to provide an overview of your business plan.

Directions
An Executive Summary provides an overview of the company. It should be brief—less than three pages—but contain sufficient detail to adequately describe the company. Most entrepreneurs write a draft Executive Summary when they start their Business Plan. After finalizing the plan, they will rewrite the Executive Summary to reflect any changes made.

A. Review the business planning template. For this action step, use the Business Plan Template at fasttrac.org/resources. Read the instructions on page 1 of the template then move to the Executive Summary to insert your information. For additional tips, read A Closer Look ® Using the Business Plan Template on p. 103.

Each section of the template contains headings with questions in blue text, which will not appear when you print the document. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. You should incorporate answers to all of the questions that apply.

B. Respond to the questions and statements below. Turn your responses into complete sentences and paragraphs to finish the first draft of your Executive Summary. If you cannot answer a question completely, answer as well as you can or make a note to do further research and determine the answer later in the program.

Executive Summary Questions

<table>
<thead>
<tr>
<th>History</th>
</tr>
</thead>
<tbody>
<tr>
<td>When and why was the company formed?</td>
</tr>
<tr>
<td>What is the marketing history of the products and services?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>What business is your venture in, and what is its current stage of development?</td>
</tr>
<tr>
<td>What is unique about the product/service, and what proprietary rights does the business have?</td>
</tr>
<tr>
<td>Briefly describe your business model and strategy.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>What form of organization does the business operate under, and why?</td>
</tr>
<tr>
<td>Who are the key management team members, and what skills do they have to help the business?</td>
</tr>
<tr>
<td>Who are the key support groups for your management team, including accountants, attorneys, consultants, board of directors, and advisory board members?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is the market like in terms of the industry, the customer, customer needs, product benefits, the venture's target markets, and the market-penetration plan?</td>
</tr>
<tr>
<td>Who are the major competitors, and what are their strengths and weaknesses?</td>
</tr>
<tr>
<td>Include specific facts and figures from your market research.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>How much money does the venture need for product development, marketing, and operations?</td>
</tr>
<tr>
<td>Highlight how much money is needed to grow the business and how it will be spent.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is the business’s performance to date?</td>
</tr>
<tr>
<td>What are the projections for sales and net profit?</td>
</tr>
<tr>
<td>What sources of financing have been, and will be, sought?</td>
</tr>
<tr>
<td>How much money has been invested in the business to date, and where did it come from?</td>
</tr>
<tr>
<td>What is your exit strategy?</td>
</tr>
</tbody>
</table>
A Closer Look @ Using the Business Plan Template

The FastTrac® GrowthVenture™ program includes electronic templates to give you a place to record your planning decisions or to provide a jumpstart in producing your Business Plan. The templates save you time by assisting with generating, formatting, organizing, and presenting information. You will start using the Microsoft® Word-based Business Plan Template for Action Step 3.2 Write My Executive Summary and continue using it as you progress through the rest of the modules. The Excel®-based Financial Template will walk you through several worksheets and then automatically generate financial statements to include in your Business Plan. Instructions for using the Financial Template appears in Module 4, A Closer Look @ Using the Financial Template. You will begin entering information into that template in Module 4.

The Executive Summary is the first section of your Business Plan you will write. Whether you plan to complete a written Business Plan or only intend to use the Business Plan Template as a planning tool, writing the Executive Summary will help you take a bird’s eye view of your company from which to begin your planning process. Throughout the process of using the Business Plan Template, you can continually update previously completed sections. You will probably find that you need to update the Executive Summary later in the program as additional information becomes available.

You will access the Business Plan Template at to fasttrac.org/resources. Read the instructions on p. 1 of the template. Then move to the Executive Summary in the template to insert your information. The instructions are reprinted here for your convenience.

Instructions
1. ALL BLUE Text is HIDDEN. IT WILL NOT PRINT. If you CANNOT SEE the BLUE Text, on a PC click on the “¶” button on the tool bar, or search Help for Hidden Text to see how to enable Hidden Text for your version of MSWord.
2. Enter your own information when prompted, such as InsertTextHere.
3. Change the copyright line in the footers to include your company name.
4. This text box is not hidden and will be printed. Therefore, you should delete this text box before printing out your final business plan.
5. Links in the Table of Contents to each of the action steps show when Hidden Text is enabled. Clicking on these links will bring you to the section of the business plan for each action step. When you update the Table of Contents these links disappear.

Each section of the template contains headings with questions to prompt you to consider the type of information to include under each heading. The questions are also listed in each action step for easy reference. After you enter your answers into the template and print them out, the questions will not appear on the hard copy. You will want to incorporate enough of the question into your answer so that the reader understands what is being answered.

Table of Contents
The Business Plan Template will insert page numbers on the Table of Contents automatically, but they will need to be updated as you add to your plan. Use your mouse to highlight the page number or select the section of the Table of Contents you want to update and then press F9 to update the numbers.
A Closer Look @ Defining Your Target Market

Entrepreneurs may be on different ends of the continuum when it comes to knowing their target markets. At one end stand entrepreneurs with products or services that will sell to easily identified target customers, making their market planning much easier. At the other end are entrepreneurs who want to sell their products or services to the masses. Their target customers are not as apparent. If a target group of customers is not selectively identified, reaching those customers becomes difficult.

The most successful entrepreneurs recognize that only a limited number of people in a general market will buy their products or services. These entrepreneurs have identified a group of potential buyers and adjust or “target” their marketing efforts and resources toward them. Although it’s possible to sell products or services to everyone in a given market, savvy entrepreneurs know that design, pricing, positioning, and promotion is easier, more effective, and less costly when the target market is smaller and better defined.

Remember, that the term target market is used because it represents a specific group of customers you aim to reach. Consider your target market as focused on a smaller, more profitable customer group within your total market. Keep in mind that for target marketing to be successful, the following objectives must be met:

- You can reach the target market with your available resources.
- The market is large enough to provide a sufficient customer base and growth opportunity.
- Selling to this target market is profitable for your business.

Within every industry smaller segments make up the entire market available for you to offer your products or services. To create market strategies and realistic sales projections, divide the market into workable segments. This practice allows you to focus on more defined subsets of target customers who are “most likely” to buy from you. Here are some examples of target markets:

- An auto repair shop only provides services to owners of Toyota, Subaru, and Honda cars.
- A travel agent focuses on corporate or commercial clients with repeat business.
- A general contractor produces a line of residential doors.
- A training consultant offers teambuilding and customer service programs to nonprofit organizations.

You have several market segments that could be served with your company’s products or services. A market segment is any smaller, identifiable group within the larger market. All of your potential customers could be divided into smaller, workable markets. These smaller market segments may be distinguished by demographic, psychographic, or behavioral variables. Market segments can also be differentiated by usage, frequency of purchases, or the benefits received from using your products or services.

Tip
Consider which market segments you have been serving in the past and whether you want to continue focusing on them. You may decide to increase your focus in a specific market segment because of your refined competitive advantage or to concentrate on a segment with better profitability or more potential for growth.
A Closer Look @ Defining Your Target Market continued

Market segments are distinguished by what customers share in common. For example, a travel agent could differentiate her market segments as depicted by the chart below:

<table>
<thead>
<tr>
<th>Demographic</th>
<th>Market Segment 1 Consumer</th>
<th>Market Segment 2 Consumer</th>
<th>Market Segment 3 Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age, Sex, Family size, Family life cycle stage, (Industry, company size for B2B)</td>
<td>• Married</td>
<td>• Married or single</td>
<td>• 500+ employees</td>
</tr>
<tr>
<td></td>
<td>• Professionals</td>
<td>• Professionals</td>
<td>• $5M revenue/yr</td>
</tr>
<tr>
<td></td>
<td>• Children</td>
<td>• No children</td>
<td>• Diverse industries</td>
</tr>
<tr>
<td></td>
<td>• Income $100K +</td>
<td>• Income $100K +</td>
<td>• 500 companies in area</td>
</tr>
<tr>
<td></td>
<td>• Own home</td>
<td>• Own home</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• 25,000 families</td>
<td>• 15,000 professionals</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Geographic</th>
<th>Market Segment 1 Consumer</th>
<th>Market Segment 2 Consumer</th>
<th>Market Segment 3 Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region, County size, Climate</td>
<td>• Jefferson County</td>
<td>• Jefferson County</td>
<td>• Jefferson County</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Psychographic</th>
<th>Market Segment 1 Consumer</th>
<th>Market Segment 2 Consumer</th>
<th>Market Segment 3 Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social class, Lifestyle, Personality</td>
<td>• Liberal</td>
<td>• Liberal</td>
<td>• Employee/ customer-oriented</td>
</tr>
<tr>
<td></td>
<td>• Trendy</td>
<td>• Trendy</td>
<td>• Innovative</td>
</tr>
<tr>
<td></td>
<td>• Travel</td>
<td>• Innovative</td>
<td>•</td>
</tr>
<tr>
<td></td>
<td>• Family-oriented</td>
<td>• Travel</td>
<td>• Innovative</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Behavioral</th>
<th>Market Segment 1 Consumer</th>
<th>Market Segment 2 Consumer</th>
<th>Market Segment 3 Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occasions, Benefit, Loyalty</td>
<td>• Quality-conscious</td>
<td>• Quality-conscious</td>
<td>• Quality-conscious</td>
</tr>
<tr>
<td></td>
<td>• Service-conscious</td>
<td>• Service-conscious</td>
<td>• Service-conscious</td>
</tr>
<tr>
<td></td>
<td>• Convenience</td>
<td>• Convenience</td>
<td>• Outsourcing suppliers</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Usage and Usage rate</th>
<th>Market Segment 1 Consumer</th>
<th>Market Segment 2 Consumer</th>
<th>Market Segment 3 Business</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Book travel 2 to 3 times/year</td>
<td>• Book travel 4 to 6 times/year</td>
<td>• Book travel for employees, contractors</td>
</tr>
<tr>
<td></td>
<td>• Travel packages</td>
<td>• Travel packages</td>
<td>• Travel packages</td>
</tr>
</tbody>
</table>

Each market segment values quality and service. The consumer segment of professionals with children may be more price-conscious than the professionals without children because the travel costs would be for four people per trip rather than for one or two people. The business segment involves booking travel for many employees, so the companies in this market may also be price-conscious.

The travel agent could define her customers as professionals in Jefferson County between the ages of 35 and 55 with household incomes of $100K or more/year, who travel frequently and who appreciate the quality and customized service of working with a travel professional to manage all their arrangements. The travel agent could determine if her target market would be all of Jefferson County or if she would define her market as a subset of this group. If she decides to reach them by direct mail, she could define her target market by selecting specific zip codes in Jefferson County. She would focus on reaching this target market for a specific period of time. Later, she may decide to target additional zip codes in the county.

A sample market segmentation matrix illustrates the golf ball market. It focuses on four potential markets. Each of these markets can then be classified by its demands. For example, the high handicap golfer might be most interested in a durable golf ball with a low cost while the corporate market might want a ball with a recognizable brand name.
The makers of a new golf ball would study the matrix carefully before concluding that the professional golfer would be the least likely to accept their product and the recreational player would be the most likely. Thus the manufacturer would target the recreational player.

**Niche markets**—Although you may want to sell your product or service to the largest possible market, it isn’t always the quickest path to growth and profitability. You will find difficulty marketing to a large number of potential customers. It takes greater resources of time, money, and people to sell to a larger audience than a smaller one.

Many entrepreneurs have found it more cost-effective to focus on specialized or niche markets. Consider the following advantages and disadvantages:

**Advantages**
- Fewer competitors
- Market may be underserved
- Possible to charge a higher price
- Customized offering
- Easier to find those interested in niche products/services

**Disadvantages**
- Smaller target market
- Turn away customers who don’t fit niche
- Marketing messages must be focused on niche prospects
- Niche customers must have higher transactional value or be repeat buyers

If the travel agent wanted to focus on a niche market, she could focus on adventure travel for professionals, including cruises, safaris, and exotic destinations. Although this niche market is smaller and more specialized, her customers will generally go on two- or three-week vacations and spend more for customized arrangements.

**Future Markets**—Whether your goal is growth or stability, you also want to consider future markets and opportunities. Every product or service has its life cycle, some shorter than others, depending on how fast changes in customer needs or the market occur. You can develop future markets by adding a product or service, improving a current product or service, or by selling to a new market with an existing or new product or service. Your search for future markets should be driven by customer demand. Ask these questions to consider future markets for your business:
- Does a group of currently underserved customers exist in the market?
- What other new and emerging group of customers will need to be addressed over the next few years?
- Is there a market for my products/services outside of the industry or cluster groups that I serve now?
In the first three modules, you focused on what you want your business to become and, through research and analysis, made strategic decisions to help you achieve it. Now it’s time to understand how all the parts of your business can work together to support your overall vision. Through the business planning process, you will examine each functional area in your business—its products or services, market, management, operations, and finances—and create a plan to guide you as you grow your business.

Module 4 focuses on the financial aspects of your business. Your existing business and new research will provide you with the information you need to complete a preliminary three-year forecast of profits. Then you will use the Financial Template, or another budgeting tool, to develop a three-year operating budget that supports your vision and strategy. This budget will be updated as you continue through the planning process. After each module, you will review and refine your budget to incorporate your most recent information. In Module 9, you will finalize your budget and analyze it for profitability, financial performance, and cash flow based on industry financial standards. To improve your ability to read and analyze projected financial statements, you may want to read A Closer Look @ Financial Statements at the end of this module.

**Key Questions**

- How do I build a budget that supports my vision and strategies?
- How do I know if my budget is accurate?
- How do I use my financial statements to make financial decisions?

**Action Steps**

<table>
<thead>
<tr>
<th>Action Steps</th>
<th>Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1 Develop a Preliminary Forecast</td>
<td></td>
</tr>
<tr>
<td>4.2 Use the Financial Template</td>
<td></td>
</tr>
<tr>
<td>Read Module 5 Strengthening the Product/Service</td>
<td></td>
</tr>
</tbody>
</table>
Financial Planning

What if your business were stock, real estate, or another investment? You would expect a certain return from that investment, wouldn’t you? You would expect the investment to increase in value and to generate a revenue stream. You would also want the best investment counsel on how to get the best return. Planning for financial success is a key role for you as an entrepreneur because your business is likely one of the biggest investments of time and money you will ever make.

You can count on getting advice from others, but the final decisions are yours to make. Your role as the financial decision-maker doesn’t require you to get training as a certified public accountant. You do, though, need to be comfortable dealing with financial information. Through practice and experience you will know and understand the concepts critical to your business’s success. The readings called A Closer Look included at the end of this module may be particularly helpful. Many financial concepts are reinforced in them. Take A Closer Look @:

- Using the Financial Template, pp. 138–143.
- Financial Statements, pp. 144–152.
- See also fasttrac.org/resources.

This module launches your financial planning by building a three-year budget. Your budget will include realistic financial goals. Going through the budgeting process will help you determine the financial implications associated with your business’s vision and strategy. You will continue to use this budget throughout the planning modules. Then in Module 9, you will fine tune your budget by analyzing projected financial statements and improving financial performance.

Business planning is not entirely sequential. Periodic adjustments will be necessary as a result of decisions you will make after you have already analyzed each functional area of your business. Just as the movement in one interlocking gear affects the other gears, plans for one functional area of your business will affect all other areas. During planning and implementation, each area of the business must work together. As each module in the program helps you define your plan, you will want to verify that your decisions in each area of business align with all the other areas of the business. This approach leads to a dynamic plan that you will continue to update with new information from each functional area. Two electronic templates are included in this program to streamline your planning work: the Business Plan Template you began using in Module 3 and the Financial Template which you will use in this module.
Budgeting Strategies

When you hear the words budget, forecasts, or projections, you may see numbers flashing through your head, papers piling up, or formulas dancing in an electronic spreadsheet. In fact, creating a budget may involve all of these. The concept of budgeting is very simple. You have been budgeting money your whole life. Your first experience with budgeting was probably as a child when you planned a way to save enough money to buy your first bicycle, video game system, or roller blades.

A budget is an estimate of future numbers based on information you already know. Budgets estimate the profits, financial performance, and cash flow of a business for a particular period of time. Having and using a budget can help you:

- Evaluate operational efficiency.
- Monitor the financial health of your business.
- Assess managerial decisions.
- Plan the business’s financial future.
- Create a business that meets your financial goals.

The business planning process begins with budgets because every decision you make throughout this process—every change, every goal—affects financial outcomes. Budgeting is not an afterthought. Your budget is a reflection of the goals and strategies you have for each area of your business. The figures you budget for sales and expenses will help you chart your financial performance and compare your business’s actual performance against your goals.

Financial strategies flow from your company’s vision, mission, and business strategy. For example, when you develop a business strategy to grow your business within a specific market, you create certain financial expectations. You will probably forecast an increase in sales. In addition, your strategies may include increases in marketing expenses, payroll to produce the product/service, and capital equipment purchases. Developing a budget will help you plan for the costs of implementing these strategies.

Tips

Budgeting, forecasting, and projecting mean fundamentally the same thing—estimating future amounts based on information you already know.

Signs of Inadequate Budget and Controls

Do you use a budget for daily decision making or does the budget sit on the computer waiting to be revised for the next calendar year? If your business has any of the following symptoms, it may reflect a need for a budget and procedures to use the budget effectively. Check those that apply to your business:

- Sales are sluggish or declining.
- The business is losing market share.
- Data to evaluate employee or departmental performance are inadequate.
- Company debts are excessive.
- Cash flow needs and related borrowing are unpredictable.
- People, materials, equipment, or facilities are not always used efficiently.
- Profits are declining.
Like many entrepreneurs, W. Michael Scott’s financial goals for Financial Management Solutions, Inc. (FMSI) were vague when he launched his company—he just wanted to be solvent. Yet as FMSI matured, specific financial goals began to emerge along with the need for a more formal budgeting process. FMSI hit its first financial milestone of $1 million in annual revenue a few years after opening. Even so, a formal budgeting process didn’t surface for several more years.

That might sound surprising, especially for someone like Scott, who has a degree in business administration and established a successful fifteen-year track record in the banking industry before launching FMSI. Based in Alpharetta, Georgia, FMSI provides software that helps banks and financial institutions schedule tellers more efficiently and track productivity.

Establishing a formal budget for FMSI stemmed partly from growth. “When we were smaller, the numbers were in my head but not on paper,” Scott explains. “As other people came into the company, we had to become more sophisticated in documenting our financials.”

With no formal training on budget preparation, Scott developed his own financial tools, including an intensive spreadsheet with 103 line items that captures revenue and expenses in every area of the company. “Once we got the format down, budgeting became much easier,” Scott says.

Budgeting is not black and white, Scott stresses: “It’s an ongoing effort we revisit monthly because things change in our business.”

Accurate budgeting comes with experience, he adds: “To put something on paper you need to know what your environment is—which is difficult if you’re just starting out. It’s good to get coaching from other folks. If you form a board of advisers, try to get someone who might be a good resource at budgeting.”

Entrepreneurs and business managers use budgets to set financial goals and then to review actual performance against these goals. This regular review of the budget helps entrepreneurs get the business back on track without additional loss of time or money. Sometimes budgets are prepared annually and not reviewed until the next budget cycle. This annual look at the budget is very ineffective in helping you reach your financial goals. It is like planning this season’s crops, planting the seeds, and then coming back at the end of the season to harvest what is there. Just as a farmer must fertilize, protect, and cultivate the crops, you need to attend and adjust the budget throughout the budget cycle.

Although some people consider the budget a simple list of planned expenses, useful budgets forecast profitability (sales and expenses) as well as the cash and capital equipment needed to support sales.

After completing this program, your budget will include estimates for these accounts:

- Sales
- Marketing
- Production
- Inventory
- Payroll
- Operating Expenses
- Fixed Asset Purchases
- Cash needed and potential sources

These estimates will be projected on the following financial statements:

- Three-year projected Income Statements
- Three-year projected Balance Sheets
- Three-year projected Cash Flow Reports

For More Information on financial terms and concepts read A Closer Look @ Financial Statements on pp. 144–152.
pumping up profits

Michael Scott’s budget reflects FMSI’s aggressive sales growth and the costs associated with that strategy. He uses the budget to set specific goals for profits and then charts actual performance against the forecast. His financial strategy centers on increasing profits, not just sales. Because many of FMSI’s expenses are fixed, sales growth—both expanding existing accounts and wooing new clients—has the greatest impact on profits. In the past four years, FMSI’s annual revenue hovered between $2.5 and $3 million, which Michael Scott wants to double to about $6 million.

Scott believes that kind of growth is possible due to FMSI’s new product, Sales Management System™, which will enable the company to expand beyond banking to other industries, such as retail. He knows that the goal is bold. But he also feels that setting a big, daring goal helps employees stretch. “It gives your staff something to shoot for,” Scott says. “Start by saying something like, ‘Wouldn’t it be great if we could achieve X?’ Then people start thinking about ways to achieve X. Ideas come out of the woodwork, and plans begin to evolve to meet the goal.”

Information technology has been a boon for FMSI. “In other industries, expanding sales might increase costs significantly,” explains Scott. “But in our business, we’ve been able to add a lot of technology that has enabled us to take on more clients without adding a lot of staff.” Increasing sales without increasing expenses is a sure way to improve profits.

Steps to Budgeting

The steps to preparing a budget include:

1. **Gather and analyze information**—Using your newly developed vision and business strategy, historical financial statements, and research, estimate the company’s potential annual profits by preparing a preliminary forecast.

2. **Build the final budget**—Forecast monthly budget figures and financial statements for three years using decisions made and information gathered throughout the planning process.

3. **Monitor the budget**—Evaluate the variance between actual results and budgeted amounts on a regular basis. Make prompt and appropriate adjustments to improve performance.

Gather and Analyze Information

The information you gather relating to the vision and business strategy, historical financial data, and financial research should be analyzed to estimate the company’s profitability potential and to test your preliminary forecasts.

Reviewing Your Business Strategy

The goals and strategies for each functional area of business must be visible in the budget. A goal, for instance, that sets a certain level of profits will not only affect the sales budget, but also the costs associated with supporting a higher level of sales. When Michael Scott sets sales growth projections for FMSI, he understands that achieving sales growth will typically require more marketing muscle. During his budgeting process, Scott includes a separate plan for trade shows, detailing all costs associated with exhibiting—and what month he expects to pay those bills. In this way, the costs of each event can be planned for and then evaluated against the associated return on their marketing investment.
Gathering Historical Information

The first place to look when projecting future financial information is at your own historical financial statements. Since history often repeats itself, you can rely on these statements to help build and validate your budget. Even if you plan significant changes, the information from past financial successes, and even failures, can provide a starting point for your estimates. Since the most helpful information is the most recent information, it is best to have the three most current years of useful, accurate historical data.

Collecting useful historical financial data is not always easy. You may not trust the historical financial information available, or you may not have historical figures that support the business functions you are budgeting for. Before you proceed in this module, analyze your situation in Useful Historical Financial Information.

If you are able to check each of the boxes in Useful Historical Financial Information, you can comfortably rely on historical data as a basis to prepare the budget. If not, your historical information may not provide you with the most accurate basis to prepare the budget. Consider how you can use the data and what information might be misleading. For example, if you have start-up information included in your last three years of financial data, you may only use the year(s) of historical data that most reasonably reflects the future direction of the company. You can always use the other information on an account-by-account basis to pinpoint specific costs, such as telephone or rent.

<table>
<thead>
<tr>
<th>Useful Historical Financial Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before you base your future financial plans on your most current three years of historical financial data, check to see that the following is true:</td>
</tr>
<tr>
<td>☐ Financial statements were prepared on a regular basis.</td>
</tr>
<tr>
<td>☐ Financial statements were prepared or reviewed by a competent accountant.</td>
</tr>
<tr>
<td>☐ The business strategies for the last three years were similar to the future strategies.</td>
</tr>
<tr>
<td>☐ No one-time, large expenses or sales were recorded in the last three years that would skew the financial information.</td>
</tr>
<tr>
<td>☐ The accounting system is trustworthy and has been the same for at least the last three years.</td>
</tr>
<tr>
<td>☐ None of the last three years of financial data is considered part of the company’s original start-up phase.</td>
</tr>
</tbody>
</table>

Tip

Any amounts that may be incorrect or misleading should not be used to guide the future financial plans of the company.

Researching Other Businesses

Financial research can help you adjust your historical data to include new aspects of your vision and business strategy. The changes you will make to the budget based on historical data, should be verified by researched facts.

Many trade associations provide industry information that can be built into financial assumptions. Additional industry information appears in the databases of business magazines and journals at most libraries. Under the industry classification codes, the North American Industrial Classification System (NAICS) or Standard Industrial Classification (SIC), articles about existing businesses may mention information about profits, expenses, or other financial data.

Tip

Building financial projections without adequately researched financial assumptions is like building a house without a foundation.
Studies of financial statements from similar companies may also provide valuable information. The Securities and Exchange Commission (SEC) has financial information about publicly traded companies online. Also, several publishers collect information from companies and compile it by industry. Using industry classification codes, you can review the financial information of competitors within your industry. Information is organized by the size of the company and includes data concerning sales, expenses, assets, liabilities, equity, and financial ratios. These financial statement studies are available at most libraries. The main publishers of these studies produce the following resources:

- **RMA Annual Statement Studies**—Includes seventeen sections arranged by primary NAICS or SIC code. They contain composite company financial data supplied by Risk Management Association’s member institutions.

- **Industry Norms and Key Business Ratios, Dun and Bradstreet**—Includes financial information based on financial statements of various companies arranged by SIC code.

**Analyzing the Information**

After gathering historical and researched financial information, you should prepare a preliminary forecast. This important aspect of the first step to budgeting takes a big picture look at the primary components of profitability—Sales, Cost of Goods Sold, and Operating Expenses. Taking this step prior to developing the detailed line-by-line budget can save a great deal of time and effort. Consider the preparation that a farmer goes through before planting crops. The farmer tests the field’s ability to support the crops by taking soil samples to identify the existing nutrients. Like this farmer, you will want to test how well your existing financial resources support your proposed business strategy. By preparing a preliminary forecast before developing the detailed budget, you can gauge the potential profitability inherent in your strategy.

### Preparing the Preliminary Forecast

To prepare a preliminary forecast, identify the specific strategies within your business vision that will affect profitability. Consider changes in the major components of profitability—Sales, Cost of Goods Sold, and Operating Expenses. Most entrepreneurs begin the preliminary forecast by estimating sales, because the sales growth goal has many implications for the rest of the profit components. For example, a marketing consulting business may estimate a 15 percent growth in sales based on their current business strategy. They will then identify the expenses necessary to support this goal. If the marketing consulting business is already at capacity, a 15 percent increase in sales may require a considerably higher increase in payroll costs to hire new staff. The preliminary forecast will help test the feasibility of this sales figure by taking a big picture look at profitability.

**HOME+MEDICAL SUPPLY STORE**

<table>
<thead>
<tr>
<th>Year-End Preliminary Forecast</th>
<th>2012 Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>726,700</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>453,605</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>$273,095</td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td>$185,820</td>
</tr>
<tr>
<td>Operating Income</td>
<td>$87,275</td>
</tr>
</tbody>
</table>
Forecasting sales—Rather than picking a random sales growth figure as a goal, you will want to look at your new sales goals from different angles to assure an attainable figure. Start with the growth opportunities you identified from researching and analyzing your industry in Modules 2 and 3. Then follow up with a more detailed approach, specifically related to your own business strategy. This process gives your company a fresh look at the possible sales levels during the next few budget years, often with some needed changes or added resources.

1. **Look at your opportunities**—First, estimate the total amount of sales you expect in your business. This approach relies on information about the competitors and industry obtained through research and experience. From your research you should be able to come up with relatively accurate estimates of your competitors’ annual sales and the amount of sales expected in your industry. Use this information to estimate a range of forecasted sales for your business. For example, an entrepreneur wishing to grow her retail business, found the following information through research:
   - Based on association publications, the average annual sales for her type of business is $2,000,000.
   - A specific competitor in a similar-sized market sells approximately $20,000 each week, except for 10 weeks around the holidays when the sales exceed $60,000 each week, which totals $1,440,000/year ($20,000 X 42 weeks + $60,000 X 10 weeks).

Using this information and her own past experience, this entrepreneur estimates her sales at $1,700,000.

2. **Look at the detail**—Looking at your opportunities focuses on competitors’ successes and your business’s vision. Looking at the detail brings the realities of your business’s existing resources and capacity into focus. Start by quantifying the number of sales transactions you expect over a specified period. For example, a restaurant may expect sixty customers on an average day. The restaurant owner then needs to calculate the average price of each meal to be sold. If the average price per meal is expected to be $15, then the annual sales volume would be $328,500 (60 customers x $15 x 365 days). For a more accurate estimation, the restaurateur should take into consideration various factors such as the difference in the average price of lunch versus dinner, the number of lunch versus dinner customers, increases in customer counts on weekends, as well as the number of customers during different times of the year.

After estimating sales by looking at the detail, compare these budget amounts to the total generated by looking at opportunities. They will likely be similar, but not identical. Select sales goals that are reasonable but will stretch the company and its resources.

**Forecasting Cost of Goods Sold and Operating Expenses**—After forecasting Sales, you are ready to estimate Cost of Goods Sold and Operating Expenses. Your historical financial information is a great place to start. This information will show you the costs your business has incurred to produce the products or services it has sold. For example, Cost of Goods Sold for a landscaping company may have remained at a steady 40 percent of Sales for the last several years. Even as Sales increase, it would be reasonable to assume that future Cost of Goods Sold will be around the same rate. Estimating a lower percentage could be reasonable if you implement specific strategies, such as purchasing larger quantities to receive larger discounts, which you would expect to lower the Cost of Goods Sold as a percentage of Sales.
Although not as directly related to Sales as Cost of Goods Sold, Operating Expenses usually have a similar relationship. When sales increase, the expenses necessary to operate the business are also likely to increase. As you estimate Operating Expenses, reviewing your historical data by looking at Operating Expenses as a percentage of Sales can tell you more than just looking at dollar amounts. For example, comparing last year’s marketing expense of $4,500 to this year’s $7,800 doesn’t help you project next year’s amount as much as knowing that each year came in at about 2 percent of Sales.

In addition to using your historical information, you can also use researched information to estimate Cost of Goods Sold or Operating Expenses that may change due to your new business strategy.

**Improving Profitability**

The first test when reviewing the preliminary forecast is to review each of the components of profitability—Sales, Cost of Goods Sold, and Operating Expenses—to find ways to improve profits. Entrepreneurs sometimes adjust the budgeted number of sales or the sales price to get to the level of profits they seek. In theory, the amount of products or services that a company is able to sell is largely determined by market demand. And selling prices are determined by what the market is willing to pay. Therefore, your own decisions about pricing are limited to the ceiling price, or the highest price that customers are willing to pay.

Since you have more control over costs, consider the other components of profitability—Cost of Goods Sold and Operating Expenses—to improve profits. In every job, the supervisor can make a strong attempt to get the work accomplished as cheaply as possible, given accepted quality levels and delivery schedules. Therefore, controlling Cost of Goods Sold and Operating Expenses are valuable outcomes when setting profit projections.

One way to keep costs down is to question your expenses regularly, even if they appear to be fixed. Michael Scott of FMSI initiated several changes that helped beef up the bottom line. For example, he reduced telecommunications and health insurance expenses by switching providers. And by outsourcing telemarketing efforts, Scott is saving about $20,000 per year.

**Testing for Reasonableness**

The second test is to look at the reasonableness of your preliminary forecast. Your goals should be challenging yet attainable. Look for changes that deviate from historical performance. Is it realistic to assume that these changes will take place? What improvements in the business structure or operations will support this change? If you determine that major deviations from past performance are accurately represented in the budget, be prepared to explain why with supporting research.
EXAMPLE

**Gathering and Analyzing Budget Information**

Consider the case of the Home+Medical Supply Store who went through the budgeting process using the steps in this program. Observe how their goals, business strategy, and historical information are integrated into the budgeting process and the preliminary forecast. The management of Home+Medical Supply Store gathered and analyzed budget data through the following process:

- Review the company’s SWOT analysis, vision, goals, strategy, and historical financial information.
- Determine the major changes to profits based on the business strategy.
- Estimate the company’s profitability potential with a preliminary forecast.

**Step 1 Gather Information.** Compile information about your vision and business strategy.

**SWOT Analysis**

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• An informational website provides details of the medical supplies available for use by local physicians’ offices.</td>
<td>• Potential for an e-commerce storefront offering certain medical products</td>
</tr>
<tr>
<td>• Owners have a great relationship with area physicians that encourages referrals.</td>
<td>• Plenty of room to expand into non-physician recommended products, such as fitness products</td>
</tr>
<tr>
<td>• Current location is fantastic for out-patient customers.</td>
<td>• New construction of medical office buildings nearby</td>
</tr>
<tr>
<td>• Management is experienced in retail and customer service.</td>
<td></td>
</tr>
<tr>
<td>• Cash flow has been consistent and steady to support growth.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>• No marketing or promotional efforts have been used.</td>
<td>• Increased competition by large discount store chains</td>
</tr>
<tr>
<td>• Medical supply staff is inexperienced (less than 3 years).</td>
<td>• Trends towards Internet and direct mail medical products</td>
</tr>
<tr>
<td>• No established employee training program</td>
<td>• Potential increased regulatory demands on medical products</td>
</tr>
<tr>
<td>• Ability to borrow funds unknown</td>
<td></td>
</tr>
</tbody>
</table>

**Vision and Goals**

The owners brainstormed their three year vision for Home+Medical Supply Store. Based on this vision along with input from their key employees, they developed the following goals:

- Generate a consistent 10% rate of sales growth per year.
- By 2013, expand the business to include direct referrals from three additional major medical office buildings on the north side.
- In 2014, add a second store to serve the south side.

**Strategy**

To achieve their vision and goals, they decided to focus on increasing sales by penetrating the current north side market, expanding the website to allow online purchases, and opening a south side store. They will:

- Hire a merchandising/marketing consultant to provide experienced advice.
- Increase marketing and promotional efforts towards customers.
- Enhance informational website and add e-commerce storefront sales.
- Develop training program for all employees.
- Continue operating effectively and efficiently with current staff until second store opens in 2014.
- Growth will be financed through the operations of the business.
EXAMPLE

Gathering and Analyzing Budget Information

In reviewing the historical income statements, the owners of Home+Medical Supply were able to see signs of their past business strategy in the numbers.

---

**HOME+MEDICAL SUPPLY STORE**

**Year-End Historical Income Statements**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Medical Supply Sales</strong></td>
<td>$350,000</td>
<td>$376,000</td>
<td>$415,000</td>
</tr>
<tr>
<td><strong>Nutritional Products Sales</strong></td>
<td>113,000</td>
<td>123,000</td>
<td>132,000</td>
</tr>
<tr>
<td><strong>Internet/Mail Order Sales</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Net Sales (less returns &amp; allowances)</strong></td>
<td>463,000</td>
<td>499,000</td>
<td>547,000</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>303,000</td>
<td>325,000</td>
<td>357,000</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td><strong>160,000</strong></td>
<td><strong>174,000</strong></td>
<td><strong>190,000</strong></td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bad Debt Expense</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>12,500</td>
<td>13,480</td>
<td>9,450</td>
</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Insurance</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Licenses &amp; Fees</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Marketing &amp; Promotion</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Meals &amp; Entertainment</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Office Expense</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>1,300 0%</td>
<td>1,350 0%</td>
<td>1,500 0%</td>
</tr>
<tr>
<td>Outside Services</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Payroll Expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; Wages</td>
<td>85,000 18%</td>
<td>90,000 18%</td>
<td>94,500 17%</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>10,000 2%</td>
<td>10,500 2%</td>
<td>11,000 2%</td>
</tr>
<tr>
<td>Benefits</td>
<td>7,000 2%</td>
<td>7,500 2%</td>
<td>7,900 1%</td>
</tr>
<tr>
<td>Professional Fees</td>
<td>2,400 1%</td>
<td>3,000 1%</td>
<td>3,200 1%</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Rent</td>
<td>24,000 5%</td>
<td>24,720 5%</td>
<td>25,462 5%</td>
</tr>
<tr>
<td>Repairs &amp; Maintenance</td>
<td>1,200 0%</td>
<td>1,600 0%</td>
<td>1,250 0%</td>
</tr>
<tr>
<td>Shipping &amp; Delivery</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Telephone</td>
<td>1,250 0%</td>
<td>1,500 0%</td>
<td>1,680 0%</td>
</tr>
<tr>
<td>Training &amp; Development</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Travel</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Utilities</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Vehicle</td>
<td>2,500 1%</td>
<td>3,000 1%</td>
<td>3,750 1%</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td><strong>147,150</strong></td>
<td><strong>156,650</strong></td>
<td><strong>159,692</strong></td>
</tr>
<tr>
<td>Operating Income</td>
<td><strong>12,850</strong></td>
<td><strong>17,350</strong></td>
<td><strong>30,308</strong></td>
</tr>
<tr>
<td>Interest Expense</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other Income (for example, interest, royalties)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Income Before Taxes</td>
<td><strong>12,850</strong></td>
<td><strong>17,350</strong></td>
<td><strong>30,308</strong></td>
</tr>
<tr>
<td>Income Taxes (if C Corp)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Net Income</td>
<td><strong>$12,850</strong></td>
<td><strong>$17,350</strong></td>
<td><strong>$30,308</strong></td>
</tr>
</tbody>
</table>
EXAMPLE

Gathering and Analyzing Budget Information continued

Step 2 Estimate profitability. Management analyzed the SWOT analysis and historical financial information they gathered to determine the impact on the budget and develop a preliminary forecast.

A. Identify the impact on the budget. The following financial strategies stem from the vision and business strategy. The management used this information to determine the major changes that would affect the primary components of profitability—Sales, Cost of Goods Sold, and Operating Expenses.

Major Changes Affecting Profits

<table>
<thead>
<tr>
<th>Sales or Expense Category</th>
<th>Change Expected</th>
<th>Source of Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Wages, Benefits, &amp; Taxes</td>
<td>Minimal increase of 5% for raises</td>
<td>Historical data</td>
</tr>
<tr>
<td>Other Operating Expenses -- Training</td>
<td>Increase by approx. $5,000</td>
<td>Initial discussion with G&amp;G Training Corp</td>
</tr>
<tr>
<td>Other Operating Expenses -- Promotion</td>
<td>Increase by approx. $2,500</td>
<td>Bid for promotional services from Hacking &amp; Brewer</td>
</tr>
<tr>
<td>Internet Expenses</td>
<td>Need an up-to-date computer ($2,000), e-commerce storefront software ($750), monthly support and consulting ($150), and hosting ($50), website development contracted ($7,500)</td>
<td>Initial discussion with e-commerce storefront services</td>
</tr>
<tr>
<td>Sales</td>
<td>10% sales growth + $125,000 Internet sales</td>
<td>Historical data</td>
</tr>
<tr>
<td>Other Operating Expenses -- Professional Services</td>
<td>Change to $2,500</td>
<td>Initial discussion with attorney</td>
</tr>
<tr>
<td>Other Operating Expenses</td>
<td>3% increase overall</td>
<td>Industry data provided by the Association for Medical Supply Retailers</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>Cost of Goods Sold for Internet sales will only be 50% due to decreased carrying and merchandising costs</td>
<td>Historical data</td>
</tr>
</tbody>
</table>

B. Develop a preliminary forecast. When you look at the preliminary forecast for Home+Medical Supply Store, you can see the overall goals of the company reflected in the budget. Significant growth is budgeted for Sales and Internet expenses. You can also see that the company plans to spend additional funds in Operating Expenses to support the added Sales goals.

C. Review the preliminary forecast for reasonableness. The owners of Home+Medical Supply Store will be asking themselves questions about the reasonableness of the preliminary forecast. Answers will be researched and built into the final detailed budget.

| HOME+MEDICAL SUPPLY STORE Year-End Preliminary Forecast |
|-----------------|-----------------|-----------------|
|                  | 2012 Budget     | 2013 Budget     | 2014 Budget     |
| Sales            | $726,700        | 100%            | $799,370        | 100%            | $879,307        | 100%            |
| Cost of Goods Sold | 453,605        | 62%            | 495,609        | 62%            | 545,170        | 62%            |
| Gross Margin     | 273,095        | 38%            | 303,761        | 38%            | 334,137        | 38%            |
| Operating Expenses |                  |                |                  |                |                |                |
| Depreciation & Amortization | 9,450          | 1%             | 9,450          | 1%             | 9,450          | 1%             |
| Payroll Expenses  | 119,070        | 16%            | 125,024        | 16%            | 131,275        | 15%            |
| Rent             | 26,225         | 4%             | 27,012         | 3%             | 27,823         | 3%             |
| Other – Ecommerce | 10,650         | 2%             | 7,500          | 1%             | 7,725          | 1%             |
| Other – Operating | 20,425         | 3%             | 21,038         | 3%             | 21,669         | 3%             |
| Total Operating Expenses | 185,820       | 26%            | 190,024        | 24%            | 197,942        | 23%            |
| Operating Income  | $ 87,275       | 12%            | $113,737       | 14%            | $136,195       | 15%            |

Can sales really grow over 30% from 2011? Is this jump supported by adequate marketing efforts? Will we be purchasing any equipment that will affect depreciation expense? Since the five-year lease will expire in 2013, should we expect a larger increase in this expense? Can we really operate with the same number of employees three years from now? Do assumptions need to include second store on the south side?
Using the Home+Medical Supply Store, pp. 116–118, as an example, consider how you would integrate your vision, goals, strategy, and historical information into the budgeting process and a preliminary forecast.

### Expected Major Changes to Profits

Based on my business’s vision and strategy, my preliminary forecast should reflect the following changes in the major components of profitability—Sales, Cost of Goods Sold, and Operating Expenses.

<table>
<thead>
<tr>
<th>Sales or Expense Category</th>
<th>Change Expected</th>
<th>Source of Information</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tbody>
</table>
Build the Budget

The second step in the budgeting process is to build the final budget. With your preliminary forecast in hand, you are ready to start preparing the detailed budget. Before you begin, be sure to involve the right people in the budgeting process, not only key people within your company, but external advisers and mentors, as well.

check the numbers

“Just about every aspect of your business affects your budget—and cash flow,” says FMSI’s W. Michael Scott.

At FMSI, three people are actively involved in the budgeting process: Scott, his director of sales, and his chief financial officer who is also responsible for operations. “This team reflects our key divisions—sales, client services, and operations,” Scott says. “If we had more department heads, then we would probably have more people involved in the process.”

Each quarter, the three executives sit down and pore over the annual budget. Taking accounting reports from every area of the company, they review revenue and expenses—everything from capital expenditures to year-end bonuses and quarterly tax payments. Current numbers are compared to earlier forecasts, and they try to pinpoint the cause of any variances.

“Sometimes it’s timing that throws the budget off,” Scott says. “Perhaps a new client didn’t come through as expected. Or printing costs for marketing brochures may have hit in February instead of March. Learning when things are going to happen is important.”

Forecasting revenue accurately is a particular challenge for FMSI. “In our industry, a lot of mergers affect us. Some of our clients will be bought this year and we don’t know which ones,” Scott explains.

All financial results are shared with Scott’s partner who sits on FMSI’s executive committee. Each quarter, Scott has a “state-of-the-union” meeting with employees to give them a general report of the company’s health.

A formal budget is a powerful tool to manage growth and make decisions, Scott says: “It’s a roadmap we use and check ourselves against every month. It’s like being on a car rally and going through checkpoints. You may have gone too fast or too slow during some intervals and need to adjust on the next leg to get back on track and meet the end objective.”

The budgeting process gives participating managers a broader perspective. “The department heads have to think about their environment, what they want to accomplish, and how much that will cost,” Scott says. “They can see that the company doesn’t have unlimited funds, so choices of what to do are give and take.”

FMSI’s budget also serves as a call to action. “It gives us an idea of what we need to accomplish on the sales side to fund everything,” Scott explains. “That enables us to see the financial effects of not closing a sale and provides a greater sense of urgency to do so.”
Building the Budget Using Historical Data

As you build your detailed budget, your historical data will be the most helpful information. Resist the urge, however, to merely increase all amounts by a set percentage. Think about your goals and how these goals will affect the sales and expenses of the business.

Use the following steps as a guideline to build your budget:

1. **Review your preliminary forecast.** Confirm that your business’s vision and strategies have been integrated into this first budget attempt.

2. **Review last year’s budget categories** (revenue and expense), considering the changes necessary to reflect the current business strategy and financial goals.

3. **Build monthly sales forecasts** based on the annual amounts on the preliminary forecast. Consider past monthly sales figures, trends, economic, and competitive factors.

4. **Enter the forecasts** into a budget spreadsheet.

5. **Review the budget** for overall reasonableness. Is the budget attainable?

Building the Budget Using Ratios

Using ratios from historical or industry data can be very helpful in building the budget. You can use ratios as a basis for budgeting, to establish credibility in the budget, and to check the budget for reasonableness.

Your historical Income Statements will show that each expense can be presented as a percentage of sales. These percentages stay very similar from year to year as they are based on your strategy for business operations. For example, on p. 117, Home+Medical Supply Store reports annual increases in sales of 7.8 percent to 9.6 percent. Still, their historical Cost of Goods Sold remained a steady 65 percent every year. You can use percentages in the budgeting process to estimate future dollars to be spent for each expense as it relates to sales. For example, a kitchen remodeling business could use its actual past advertising costs as an estimate for future budgets. It may make more sense, however, to use a percentage that relates to sales. Therefore, as sales increase, the advertising budget will increase as well. If the kitchen remodeling company has historically spent 7 percent of their sales on advertising, it is reasonable to assume that this same percentage would continue. This percentage may be increased if it follows a new strategy that includes increased marketing and advertising efforts.

**Using ratios to establish credibility in the budget**—Because ratios reflect a relationship between two or more account categories, they can be very helpful to establish credibility in the budget. For example, a budget for a health food store that has reported a Net Income Margin of 10 percent of sales for the last few years can generally assume that the Net Income Margin should stay about the same for the budget year. If one of the goals is to increase the Net Income Margin to 12 percent, the budget should reflect the strategies involved in creating this change.

**Using ratios to check the budget for reasonableness**—Ratios can also help to check the budget for reasonableness. If a mechanical auto repair shop, in efforts to improve its bottom line, budgeted a Gross Margin of 75 percent on labor and a Gross Margin on parts of 50 percent, there should be some justification as to why these budgets are realistic when other businesses in the industry average only 56 percent and 38 percent, respectively.

Tip

The preliminary forecast is an annual look at profits for the next three years. The detailed budget will include expected monthly sales, expenses, and cash flow amounts for the same three years.

Tip

It is okay to have a budget that will be a challenge to meet, but don’t set numbers that are impossible to reach.
Building the Budget Without Historical Data

If you do not have reliable historical information, or your business is making dramatic changes to the overall business strategy, you may have to begin your budgeting process without the aid of historical data. Without detailed past history for guidance, you will need to rely on researched information. The best way to develop the new budget is to follow a consistent plan using these steps as a guide:

1. **Review the company’s vision and business strategy**, and identify specific financial strategies that should be visible in the budget, including sales forecasts.
2. **Estimate direct costs** associated with providing the quantity of products/services expected to be produced, delivered, and sold, including payroll, materials, and other direct costs.
3. **Estimate other operating costs** based upon the quantity of products/services, including indirect costs such as administration, marketing, and other expenses.
4. **Develop a preliminary forecast** to discuss with management and team members.
5. **Finalize the detailed budget**. Review the final budget for reasonableness. A budget that is a challenge to meet can be very motivating, if it is attainable.

Using the Financial Template to Develop a Three-Year Budget

When developing a budget for a business, it is important to use a computer spreadsheet program, such as Microsoft® Excel®, to collect the information and generate reports. Because you will alter your budget many times before it is finalized, you will need the flexibility to change numbers without having to manually recalculate budget totals.

An Excel-based spreadsheet is provided with this program at fasttrac.org/resources for your convenience in developing these budgets. The benefits of using the Financial Template rather than other budgeting programs are two-fold. First, as the primary budgeting tool associated with this program, you will have specific instructions on completing your budget as it relates to this program and each functional area of the planning process, such as marketing and management.

Second, the Financial Template creates all the statements you’ll use to make daily financial decisions. After entering your monthly budget figures into the appropriate worksheets, the template will automatically generate three-year projected annual Income Statements, Balance Sheets, and monthly Cash Flow Reports. Few budgeting programs extend the financial information into such a useful format.

Each worksheet has steps to help you input your financial estimates in the appropriate cells. You will use the information you have accumulated from your historical data, your company’s vision and business strategy, and researched data to complete the Financial Template. After you have entered all appropriate financial information into the template, you will be able to review your business’s profitability on the projected Income Statements. You will also have projected Balance Sheets and monthly Cash Flow Reports to review, which will be the focus of Module 9.

The use of the Financial Template to build the budget will begin with Action Step 4.2. Before you are ready to begin Action Step 4.2, you will want to read the Introduction worksheet in the Microsoft Excel template and A Closer Look @ Using the Financial Template on pp. 138–143. These will give you additional guidance on how to use the Financial Template.

---

**Tip**

Don’t be too optimistic in the budgeting process. Be conservative by underestimating sales and overestimating expenses.
Building a Tailored Budget

Templates, such as the Financial Template that accompanies this program, are designed to work for the vast majority of businesses. You may find that your business needs more specificity than a template can provide. In this case, you may choose to develop your own budgeting spreadsheet, or rely on an industry-specific financial and budgeting software program. You may find that the Financial Template proves to be a great planning tool, but for daily variance analysis you may require more information.

If you are seeking specific information from your budgeting system, you may consider tailoring a budgeting program or spreadsheet to meet your own needs. For some businesses, it makes sense to build a budget that highlights certain aspects of business operations by breaking down the expenses into separate components. For example, your company may need to be able to review fixed and variable expenses to make financial decisions.

If you are seeking specific information from your budgeting system, you may consider tailoring a budgeting program or spreadsheet to meet your own needs. For some businesses, it makes sense to build a budget that highlights certain aspects of business operations by breaking down the expenses into separate components. For example, your company may need to be able to review fixed and variable expenses to make financial decisions.

Fixed expenses are generally not affected by the level of sales. These expenses, such as rent, insurance, property taxes, and office employee expenses, generally stay the same. Variable expenses vary depending upon the level of sales. The largest variable expense is for the cost to produce the products/services. Other variable expenses include selling costs, advertising, and delivery. Separating these expenses aids in profit analysis, such as break-even analysis.

Tip
Develop a budgeting system that meets your needs, not the needs of your accountant.

custom-fit your budget

Ty Foose, of Monolithic Sculptures, Inc., in Boulder, Colorado, developed his own system to monitor budgets on a daily basis. Monolithic Sculptures, designs and manufactures interactive sculptures and climbing structures for retail clients and fitness centers. He needed an individualized way to estimate and record costs for each project.

In response, Foose created two tools, beginning with an Excel spreadsheet to capture costs. This project cost worksheet, referred to as a “spend-o-meter” by Foose, tracks everything from how much material is used in various phases of a project to hotel expenses when staff members travel for an installation.

Using the spend-o-meter to collect information, Foose devised another tool, a formula for fast, accurate estimates—no simple task when sculptures can vary from fifty to several hundred dollars per square foot. The spend-o-meter identifies fifteen key factors influencing costs, so when Foose discusses a new project with a client, he assigns a score to each factor. For example, if a sculpture requires cutting-edge fabrication techniques, it scores higher on engineering difficulty than a more routine project.

Together, the fifteen factors yield an average level of complexity and detail, which are plugged into an equation along with a base price. In just a few minutes, Foose can produce an estimated quote that is within four or five points of his target gross margins.

This project estimator and the spend-o-meter work in tandem to help Foose identify changes and take corrective action. For example, if projects begin to run over-budget, Foose can quickly determine the cause—such as an increase in raw materials—and make adjustments to the estimator's base price.
## Creating a Detailed Budget

The managers of Home+Medical reviewed their preliminary forecast, paying particular attention to the questions that tested the budget for reasonableness. Then they entered detailed forecasts for sales, expenses, and capital expenditures into the budget spreadsheet. Notice the changes they made to this final budget after the preliminary forecast was reviewed.

### HOME+MEDICAL SUPPLY STORE

### Year-End Income Statements (Projected)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Sales (less returns &amp; allowances)</strong></td>
<td>$726,700 (100%)</td>
<td>$799,370 (100%)</td>
<td>$879,307 (100%)</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>453,605 (62%)</td>
<td>495,609 (62%)</td>
<td>545,170 (62%)</td>
</tr>
<tr>
<td><strong>Gross Income</strong></td>
<td>273,095 (38%)</td>
<td>303,761 (38%)</td>
<td>334,137 (38%)</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>2,000 (0%)</td>
<td>2,250 (0%)</td>
<td>2,500 (0%)</td>
</tr>
<tr>
<td>Bad Debt Expense</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>10,117 (1%)</td>
<td>10,117 (1%)</td>
<td>10,117 (1%)</td>
</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Insurance</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Licenses &amp; Fees</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Marketing &amp; Promotion</td>
<td>1,500 (0%)</td>
<td>1,500 (0%)</td>
<td>1,750 (0%)</td>
</tr>
<tr>
<td>Meals &amp; Entertainment</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Office Expense</td>
<td>1,000 (0%)</td>
<td>1,000 (0%)</td>
<td>1,250 (0%)</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>1,545 (0%)</td>
<td>1,950 (0%)</td>
<td>2,100 (0%)</td>
</tr>
<tr>
<td>Outside Services</td>
<td>2,000 (0%)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Payroll Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; Wages</td>
<td>99,225 (15%)</td>
<td>135,000 (17%)</td>
<td>141,750 (16%)</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>11,550 (2%)</td>
<td>15,750 (2%)</td>
<td>16,500 (2%)</td>
</tr>
<tr>
<td>Benefits</td>
<td>8,295 (1%)</td>
<td>11,350 (1%)</td>
<td>12,000 (1%)</td>
</tr>
<tr>
<td>Professional Fees</td>
<td>2,500 (0%)</td>
<td>2,950 (0%)</td>
<td>3,100 (0%)</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Rent</td>
<td>26,225 (4%)</td>
<td>36,000 (5%)</td>
<td>37,080 (4%)</td>
</tr>
<tr>
<td>Repairs &amp; Maintenance</td>
<td>1,288 (0%)</td>
<td>1,500 (0%)</td>
<td>1,575 (0%)</td>
</tr>
<tr>
<td>Shipping &amp; Delivery</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Telephone</td>
<td>1,730 (0%)</td>
<td>1,900 (0%)</td>
<td>2,250 (0%)</td>
</tr>
<tr>
<td>Training &amp; Development</td>
<td>4,750 (1%)</td>
<td>5,250 (1%)</td>
<td>5,500 (1%)</td>
</tr>
<tr>
<td>Travel</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Utilities</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Vehicle</td>
<td>3,863 (1%)</td>
<td>4,000 (1%)</td>
<td>4,250 (0%)</td>
</tr>
<tr>
<td>Other - E-commerce software</td>
<td>699 (0%)</td>
<td>- (0%)</td>
<td>- (0%)</td>
</tr>
<tr>
<td>Other - Internet support and hosting</td>
<td>2,400 (0%)</td>
<td>2,600 (0%)</td>
<td>2,800 (0%)</td>
</tr>
<tr>
<td>Other - E-commerce consulting</td>
<td>7,500 (1%)</td>
<td>2,500 (0%)</td>
<td>1,500 (0%)</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>188,187 (26%)</td>
<td>235,617 (29%)</td>
<td>246,022 (28%)</td>
</tr>
<tr>
<td><strong>Operating Income</strong></td>
<td>84,908 (12%)</td>
<td>68,144 (9%)</td>
<td>88,115 (10%)</td>
</tr>
<tr>
<td><strong>Interest Expense</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Other Income (for example, interest, royalties)</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Income Before Taxes</strong></td>
<td>84,908 (12%)</td>
<td>68,144 (9%)</td>
<td>88,115 (10%)</td>
</tr>
<tr>
<td><strong>Income Taxes (if C Corp)</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$84,908 (12%)</td>
<td>$68,144 (9%)</td>
<td>$88,115 (10%)</td>
</tr>
</tbody>
</table>
Monitor the Budget

Budgets help you set financial goals. They also provide a way to review actual performance against these goals. Because a budget is an estimate of future numbers based on information already known, your business’s actual performance should be similar to the budgeted amounts. Actual performance, however, will never be exactly the same as the budget. It will come close, fall short, or exceed the budget. Your job is to monitor the budget to answer the following questions:

- How close did the business come to the budgeted figures?
- What adjustments, if any, should be made to the current year’s budget?
- What adjustments, if any, should be made to budgets in future years?
- What changes, if any, should be implemented to improve performance?

The budget should be monitored on a regular basis throughout the year: quarterly, monthly, or even weekly. Consistently reviewing the budget will help you identify problems before they cost the business too much time or money. How often you review the budget depends upon your confidence in the figures and the risk associated with not meeting the budget. For example, if you must meet a certain budget in order to meet your loan obligations, the risk of falling short is high. You should review the budget often in order to assure that the business is on track.

You might also consider adjusting the current year’s budget at various intervals throughout the year. Many businesses will re-evaluate their budgets halfway through the year. This way they can assess the actual results for the first half of the year and adjust the budget for the second half of the year so that the budget more accurately represents real expectations.

Tip

Compare actual financial figures to your budget at least monthly. You may need to adjust the budget during the year to reflect new information.

Before her exit, Carol Frank, founder of Avian Adventures® in Dallas, Texas, held a quarterly retreat for all her management team members. At this function, the team reviewed budget variances between estimated amounts and the actual quarterly figures. Based on this analysis, the team reviewed and adjusted the budget for the rest of the year, making it a useful budget.

Falling Short of Budgeted Figures

When your business is not able to meet budgeted figures, start by reviewing the business strategy that formed the basis for the budget. Some aspect of implementing your business strategy did not happen as expected. Did you misunderstand the market? Did you have too little information? What do you know now that will change the budget in the future? Can you still plan for profitable performance based on this business strategy?

You also need to take a hard look at the budget figures, paying close attention to the major components of profitability—Sales, Cost of Goods Sold, and Operating Expenses. Maybe you met your Sales goals and understood the Cost of Goods Sold, but misjudged Operating Expenses. Evaluate the changes you must make to future budgets to include this new knowledge.

Tip

Pay attention to unpleasant financial information. It is better to know your business’s financial soft spots than to risk your personal financial well-being on inaccurate information.
Exceeding Budgeted Figures

Entrepreneurs would much prefer to exceed the budget rather than fall short. A considerable variation between forecasted amounts and actual amounts, however, places some doubt in the budgeting process, even when it is in your favor. Exceeding the budget by a great deal implies that the budget was either too easy or inaccurate. In either case, you will want to review each of the major components of profitability to determine where the variations occurred. When you discover the reasons for your discrepancies, form a more accurate future budget that will be more helpful in guiding your financial plans.

Summary

In this module, we started the business planning process by focusing on the financial aspects of your business. Financial planning starts with information gathered from the existing business as well as new research. This information is used to develop a preliminary three-year forecast of profits that becomes the basis for the detailed budget you build to support your vision and strategy.

Key Things to Remember

- Having and using a budget can help grow your business to meet your financial goals. In addition, the budget can help you improve your company’s operational efficiency, make better managerial decisions, and develop the overall health of the business.
- Useful budgets forecast profitability (sales and expenses) as well as the cash and capital equipment needed to support sales.
- A preliminary forecast that starts with your business’s vision and strategy, provides a big picture look at profitability, which becomes the basis for the detailed budget.
- The detailed budget includes projected financial statements that, when analyzed, will help you make effective, profitable financial decisions.

Module 5 Refining the Product/Service will focus on key aspects of your product or service and its competitive advantage. Evaluating pricing, protecting intellectual property, and complying with governmental regulations are all part of the business planning process in Module 5. As you develop your Product/Service Plan, you will update the preliminary budget you developed in Action Steps 4.1 and 4.2.
Activity 4a: Preliminary Forecast

Practice identifying the budget implications of strategic decisions resulting from a SWOT analysis by reporting changes expected in Sales, Cost of Goods Sold, Gross Margin, Operating Expenses, and Net Income. Build a preliminary forecast.

Directions
Step 1 Gather information. According to the first step of the budgeting process, the management team of Clean Corp has gathered the following information—SWOT analysis, goals based on their vision, business strategy, and historical financial statements.

SWOT Analysis—Clean Corp is a 12-year-old company supplying premium quality textiles for rent, including uniforms, coats and aprons, gloves, towels, linens, towels, mops and shop towels to commercial and industrial customers. The textiles are regularly picked up, cleaned, and delivered back to the customer.

<table>
<thead>
<tr>
<th>SWOT Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strengths</strong></td>
</tr>
</tbody>
</table>
| Strong customer loyalty = high retention  
Two primary targets, manufacturers and restaurants, represent 80% of revenue. (The 20% is represented by healthcare and others.)  
They still have growth capacity in their existing plant.  
Clean Corp is best-known for customer service. |
| **Opportunities** |
| The local population is aging, which has increased the healthcare and nursing home industries.  
Two new restaurant chains are entering the market and have indicated that they will contract with Clean Corp. |
| **Weaknesses** |
| High costs of laundering.  
Large inventory of textiles and numerous target markets lowers efficiency and profitability.  
Clean Corp has always been tight on cash, probably due to continued growth. |
| **Threats** |
| Manufacturing industry is in a decline in Clean Corp’s delivery service area.  
Many competitors specialize by offering a limited inventory of linens to targeted markets with specific needs. This strategy drives their price lower than Clean Corp. |

Vision and Goals
The management team brainstormed their three-year vision for Clean Corp. Based on their vision, they developed three main goals:
- Become the largest regional provider of clean textiles by the year 2014.
- Continue dedication to customer service: achieve an average rating of 4.5 or higher based on a 5-point scale for all customer satisfaction surveys.
- Generate strong growth over the next few years with Net Income Margins over 4%.

Business Strategy
Their strategy is to concentrate on increasing sales to the restaurant and healthcare markets, decreasing dependents on the manufacturing segment. In addition they will:
- Continue to provide customer service training to all current and new employees.
- Improve delivery efficiency by reworking routes and by adding vehicles when needed.
- Invest in more efficient laundering equipment that will keep utilities at current levels and require less frequent inventory replacement thus lowering COGS.
## Activity 4a: Preliminary Forecast

### CLEAN CORP

Year-End Historical Income Statement

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Sales</strong></td>
<td>$1,667,800</td>
<td>100.00%</td>
<td>$1,717,834</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold - Linen Disposal</strong></td>
<td>1,184,138</td>
<td>71.0%</td>
<td>1,236,840</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>483,662</td>
<td>29.0%</td>
<td>480,994</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bad Debt Expense</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>8,000</td>
<td>0.48%</td>
<td>8,000</td>
</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Insurance</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Licenses &amp; Fees</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Marketing &amp; Promotion</td>
<td>50,034</td>
<td>3.00%</td>
<td>51,535</td>
</tr>
<tr>
<td>Meals &amp; Entertainment</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Office Expense</td>
<td>1,668</td>
<td>0.10%</td>
<td>1,718</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>2,168</td>
<td>0.13%</td>
<td>2,233</td>
</tr>
<tr>
<td><strong>Payroll Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; Wages</td>
<td>253,000</td>
<td>15.17%</td>
<td>260,590</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>32,890</td>
<td>1.97%</td>
<td>33,877</td>
</tr>
<tr>
<td>Benefits</td>
<td>32,890</td>
<td>1.97%</td>
<td>33,877</td>
</tr>
<tr>
<td>Professional Fees</td>
<td>6,671</td>
<td>0.40%</td>
<td>6,871</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Rent</td>
<td>26,000</td>
<td>1.56%</td>
<td>26,000</td>
</tr>
<tr>
<td>Repairs &amp; Maintenance</td>
<td>16,678</td>
<td>1.00%</td>
<td>17,178</td>
</tr>
<tr>
<td>Shipping &amp; Delivery</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Telephone</td>
<td>3,336</td>
<td>0.20%</td>
<td>3,436</td>
</tr>
<tr>
<td>Training &amp; Development</td>
<td>6,671</td>
<td>0.40%</td>
<td>6,871</td>
</tr>
<tr>
<td>Travel</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Utilities</td>
<td>-</td>
<td>-</td>
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</tr>
<tr>
<td>Vehicle</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>440,006</td>
<td>26.38%</td>
<td>452,186</td>
</tr>
<tr>
<td><strong>Operating Income</strong></td>
<td>43,656</td>
<td>2.62%</td>
<td>28,807</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>5,508</td>
<td>0.33%</td>
<td>4,399</td>
</tr>
<tr>
<td>Other Income (for example, interest, royalties)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Income Before Taxes</strong></td>
<td>38,148</td>
<td>2.29%</td>
<td>24,408</td>
</tr>
<tr>
<td>Income Taxes (if C Corp)</td>
<td>11,444</td>
<td>0.69%</td>
<td>7,323</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$26,704</td>
<td>1.60%</td>
<td>$17,086</td>
</tr>
</tbody>
</table>
Activity 4a: Preliminary Forecast

Step 2 Estimate profitability. After gathering the necessary information, the second step in the budgeting process is to estimate the big picture profitability. First, identify the implications to the budget based on the strategies on p. 127. Second, develop a preliminary forecast to reveal overall profitability.

A. Identify the impact on the budget. Based on the SWOT analysis and strategies for Clean Corp, what revenue and expense categories are affected? Will these figures change based on the new strategies? Use the table below to write the categories of expenses that will change based on Clean Corp’s strategies. Note whether the change is expected to be an increase or decrease. Also, identify a likely source that Clean Corp might use to estimate the new budget figures. Budget figures will be estimated next.

<table>
<thead>
<tr>
<th>Revenue or Expense Category</th>
<th>Change Expected</th>
<th>Source of Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXAMPLE</td>
<td>Staff training</td>
<td>No change continued expense as a percentage of sales</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Activity 4a: Preliminary Forecast

B. **Develop a preliminary forecast.** To build the preliminary forecast, review historical figures for Sales, Cost of Goods Sold, and Operating Expenses on p. 128. Concentrate on the big picture of profitability, including total Sales, Cost of Goods Sold, and Operating Expenses as listed below. A more detailed line-by-line budget will be completed by the management of Clean Corp after this preliminary attempt.

**Directions**

**Step 1 Gather information.** According to the first step of the budgeting process, management gathered their SWOT analysis, vision business strategy, and historical financial statements.

**Step 2 Estimate profitability.** After gathering the necessary information, the second step in the budgeting process is to estimate the big picture profitability. Management came up with the following assumptions based on their expected new contracts and cost-saving initiatives.
- Sales will increase at 20% per year over the next three years.
- COGS will be held at 71% (includes delivery, inventory, direct selling costs etc.)
- Straight line depreciation amount will remain steady over next 3 years.
- Payroll including taxes and benefits will be reduced to 17% of net sales.
- In Year 1 – there is a 3% rent increase for the next 3 yr period.
- All other expenses will hold at 5% of net sales.

---

<table>
<thead>
<tr>
<th>CLEAN CORP Year-End Preliminary Forecast</th>
<th>2012 Budget</th>
<th>2013 Budget</th>
<th>2014 Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$__________</td>
<td>$__________</td>
<td>$__________</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>Payroll Expenses</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>Rent</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>Other – Operating</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>Operating Income</td>
<td>$__________</td>
<td>$__________</td>
<td>$__________</td>
</tr>
</tbody>
</table>

---

C. **Review the preliminary forecast for reasonableness.** Review the big picture forecast to identify areas of concern that should be addressed during the detailed line-by-line budgeting process. Record them here.

1. 
2. 
3. 

---
Activity 4b: Projected Income Statements

Practice reading Income Statements for understanding, reviewing them for goals and strategies that relate to a company’s vision and business strategy. Also, review reports for reasonableness and attainability.

Directions
The projected Income Statement of a company tells a story about the goals and strategies of the business and how these strategies relate to profitability. The management of Clean Corp prepared the Three-Year Projected Income Statement on p. 133 using additional research and analysis after the preliminary forecast was completed in Activity 4a. You will likely see several differences between the preliminary forecast and this final detailed budget.

The Balance Sheet and Cash Flow Report also tell an important part of a business’s financial story. These statements will be read in Module 9.

Step 1 Review the bottom line. What do the Net Income and Net Income Margin tell you about Clean Corp’s goals and strategies? Are Clean Corp’s profit projections reasonable compared to public corporations in this industry that report a Net Income Margin of 4.2 percent?

Step 2 Review the components of profitability—Sales. What do the forecasted sales tell you about the company’s goals and strategies? Why might the projections have changed from the preliminary budget to the more detailed one on p. 133?
Activity 4b: Projected Income Statements continued

Step 3 Review the components of profitability—Cost of Goods Sold. Clean Corp’s historical COGS were higher than the industry average of 71%, what might be some reasons for that? Why does the preliminary budget differ from the more detailed budget on p. 133?

Step 4 Review the components of profitability—Operating Expenses. Review the budgeted Operating Expenses to identify support for the new business strategy. What changes can you see from the preliminary forecast to the detailed budget? Why do you think these changes were made?
### Activity 4b: Projected Income Statements (continued)

**CLEAN CORP**

**Three-Year Income Statements (Projected)**

<table>
<thead>
<tr>
<th></th>
<th>2012 Budget</th>
<th>2013 Budget</th>
<th>2014 Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Sales (less returns &amp; allowances)</strong></td>
<td>$1,936,858 100.00%</td>
<td>$2,169,281 100.00%</td>
<td>$2,603,137 100.00%</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>1,394,538 72.00%</td>
<td>1,551,036 71.50%</td>
<td>1,848,227 71.00%</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>542,320 28.00%</td>
<td>618,245 28.50%</td>
<td>754,910 29.00%</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Advertising</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Bad Debt Expense</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Bank Charges</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Depreciation &amp; Amortization</strong></td>
<td>10,000 0.41%</td>
<td>10,000 0.37%</td>
<td>10,000 0.31%</td>
</tr>
<tr>
<td><strong>Dues &amp; Subscriptions</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Insurance</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Licenses &amp; Fees</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Marketing &amp; Promotion</strong></td>
<td>58,106 3.00%</td>
<td>65,078 3.00%</td>
<td>78,094 3.00%</td>
</tr>
<tr>
<td><strong>Meals &amp; Entertainment</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Miscellaneous</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Office Expense</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Office Supplies</strong></td>
<td>1,937 0.10%</td>
<td>2,169 0.10%</td>
<td>2,603 0.10%</td>
</tr>
<tr>
<td><strong>Outside Services</strong></td>
<td>2,518 0.13%</td>
<td>2,820 0.13%</td>
<td>3,384 0.13%</td>
</tr>
<tr>
<td><strong>Payroll Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Salaries &amp; Wages</strong></td>
<td>253,000 13.06%</td>
<td>260,590 12.01%</td>
<td>338,408 13.00%</td>
</tr>
<tr>
<td><strong>Payroll Taxes</strong></td>
<td>32,890 1.70%</td>
<td>33,877 1.56%</td>
<td>43,993 1.69%</td>
</tr>
<tr>
<td><strong>Benefits</strong></td>
<td>32,890 1.70%</td>
<td>33,877 1.56%</td>
<td>43,993 1.69%</td>
</tr>
<tr>
<td><strong>Professional Fees</strong></td>
<td>7,747 0.40%</td>
<td>8,677 0.40%</td>
<td>10,413 0.40%</td>
</tr>
<tr>
<td><strong>Property Taxes</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Rent</strong></td>
<td>28,653 1.48%</td>
<td>28,653 1.32%</td>
<td>28,653 1.10%</td>
</tr>
<tr>
<td><strong>Repairs &amp; Maintenance</strong></td>
<td>19,369 1.00%</td>
<td>21,693 1.00%</td>
<td>26,031 1.00%</td>
</tr>
<tr>
<td><strong>Shipping &amp; Delivery</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Telephone</strong></td>
<td>3,874 0.20%</td>
<td>4,339 0.20%</td>
<td>5,206 0.20%</td>
</tr>
<tr>
<td><strong>Training &amp; Development</strong></td>
<td>7,747 0.40%</td>
<td>8,677 0.40%</td>
<td>10,413 0.40%</td>
</tr>
<tr>
<td><strong>Travel</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Utilities</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Vehicle</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>458,731 23.68%</td>
<td>480,450 22.15%</td>
<td>601,191 23.09%</td>
</tr>
<tr>
<td><strong>Operating Income</strong></td>
<td>83,389 4.32%</td>
<td>137,795 6.35%</td>
<td>153,719 5.91%</td>
</tr>
<tr>
<td><strong>Interest Expense</strong></td>
<td>5,508 0.28%</td>
<td>4,399 0.20%</td>
<td>3,234 0.12%</td>
</tr>
<tr>
<td><strong>Other Income (for example, interest, royalties)</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Income Before Taxes</strong></td>
<td>78,081 4.03%</td>
<td>133,396 6.15%</td>
<td>150,485 5.78%</td>
</tr>
<tr>
<td><strong>Income Taxes (if C Corp)</strong></td>
<td>24,024 1.24%</td>
<td>40,619 1.87%</td>
<td>45,745 1.76%</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$ 54,057 2.79%</td>
<td>92,777 4.28%</td>
<td>104,740 4.02%</td>
</tr>
</tbody>
</table>
**Action Step 4.1: Develop a Projected Budget**

**Directions**

**Step 1 Gather information.** According to the first step of the budgeting process, you will gather your SWOT analysis, vision, business strategy, and historical financial statements.

**Step 2 Estimate profitability.** After gathering the necessary information, the second step in the budgeting process is to estimate the big picture profitability. First, identify the implications to the budget based on the strategies you gathered in Step 1. Refer to Expected Major Changes to Profits on p. 119 for your notes about changes you expect in the primary profitability components—Sales, Cost of Goods Sold, and Operating Expenses. Then, develop a preliminary forecast to reveal overall profitability.

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales</th>
<th>Cost of Goods Sold</th>
<th>Gross Margin</th>
<th>Operating Expenses</th>
<th>Total Operating Expenses</th>
<th>Operating Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$0 0%</td>
<td>$0 0%</td>
<td>$0 0%</td>
<td>$0 0%</td>
<td>$0 0%</td>
<td>$0 0%</td>
</tr>
<tr>
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<td></td>
</tr>
</tbody>
</table>
Action Step 4.1: Develop a Projected Budget continued

Step 3  Review the preliminary forecast for reasonableness. Identify areas of concerns that should be addressed or researched further. Keep in mind that interest payments on debt are deducted after Operating Income is figured-so if you have debts-overall profitability will be lower.

1.

2.

3.

4.
Action Step 4.2: Use the Financial Template

Use the Financial Template to enter historical data and complete the necessary worksheets to create projected financial statements.

Directions
Follow the steps below to set up the Financial Template for the budgeting process, which will continue throughout this program. More detailed information about using the Financial Template appears in A Closer Look @ Using the Financial Template on pp. 138–143.

A. Get familiar with the template. Open the Excel-based template and explore the worksheets. The following frequently asked questions will help guide you:

What do I do first?
When you initially access the file, Excel may prompt you to “Enable Macros.” You must enable macros to use the printing options. Then, save the template to your own disk or hard drive to allow you to keep a fresh version of the template if you want to start over or create another plan.

What’s in the template?
The template consists of worksheets (where you enter data) and projected financial statements (automatically generated by the template). The worksheets are presented in a logical sequence for budgeting financial information. Your budgeted financial statements will automatically be assembled as you enter information into these worksheets.

How do I get started?
Read the Introduction Worksheet and then step through the worksheets included in the Financial Template. Notice that each worksheet includes its own instructions on how to enter information.

NOTE: The Financial Template is not designed for columns or rows to be added or deleted. By doing so, you run the risk of losing or corrupting the preset calculations, which are linked to other sections of the Financial Template.

B. Gather your financial information and enter data. Gather the information you have already collected, researched, and analyzed related to your Financial Plan to complete all but the last two of the following Financial Template worksheets. Guidance concerning each worksheet is available in A Closer Look @ Using the Financial Template on pp. 138–143.

Financial Template Worksheets

- **Introduction Worksheet** provides valuable information on features of the Financial Template.
- **Company Information Worksheet** asks you to set up your company information and record your company's current financial position.
- **Existing Company Set-Up Worksheet** allows you to report historical financial information for your business, which will be used to create forecasted balances for assets, liabilities, and equity.
- **Start-Up Company Set-Up Worksheet** (if applicable) asks how much money you and your investors will initially put into the company, as well as the amount you plan to borrow and the expenditures you expect to make before you open the doors.
- **Sales Worksheet** will include your estimated monthly sales for three years.
- **Inventory Worksheet** (if applicable) provides steps to build your inventory budget.
- **Operating Expenses Worksheet** records all the different expenses required to operate the business.
- **Capital Budget Worksheet** will be completed in Module 9, Action Step 9.1, pp. 369–370.
- **Equity & Debt Worksheet** will be completed in Module 9, Action Step 9.1, pp. 369–370.
Action Step 4.2: Use the Financial Template  continued

C. Review the financial statements for accuracy. After you have completed Action Steps 4.1 and 4.2, your preliminary budget is complete. To create a budget you can trust to help you chart a course for daily financial decision making, print off and review the following financial statements generated from the information you entered:
- Monthly Income Statement
- Monthly Cash Flow Report
- Year-End Income Statement
- Year-End Balance Sheet
- Financial Analysis/Ratios

At this time, concentrate on the Income Statement. The Balance Sheet and Cash Flow Report will be explored in greater detail in Module 9.

First, perform a cursory review of the Income Statement to see if you made any errors entering your estimates. Your preliminary forecast is a good indication of profitability and should be compared to the Year-End Income Statement generated from the template. If you see differences between the preliminary forecast and the template’s Income Statement, you will need to review each line item carefully. Do the individual sales and expense estimates reflect what you expected? Are any of them considerably higher or lower? Look back on the appropriate worksheets to verify any figures in question.

Second, check the accuracy of the financial statements by answering these questions:

1. According to your Income Statement, are the business profits on the bottom line adequate? How does it compare to the industry?
   - Yes. The level of profits reported is adequate and reasonable for a company in my industry.
   - No. The business is not as profitable as I would like or as is possible within the industry.
   A business cannot continue to operate with insufficient profits. Profits are the key source of cash to fund operations and growth. If your business is not as profitable as its potential, identify the reasons why. What changes could be made within this three-year budgeting cycle to improve profits?

2. According to your Income Statement, is your Cost of Goods Sold or Cost of Sales as lean as possible? How does it compare to the industry percentage?
   - Yes. The costs to produce the product/service are tightly controlled and similar to or lower than the industry.
   - No. Costs are not as low as the industry or need to be controlled in order to reduce them.
   Cost of Goods Sold (service-based companies call it Cost of Sales), reflects inventory that has been sold. The Cost of Goods Sold is usually easier to track in product-based companies. Still, every business invests money into the products/services it sells. Since the overall goal is profitability, even if you do not sell products you should evaluate the amount of time and resources used to provide your services. This is the biggest expense in most businesses. What changes can you make to reduce costs?

3. According to your Income Statement, are your Operating Expenses controlled? How do they compare to the industry?
   - Yes. The costs to operate the business are tightly controlled and similar to or lower than the industry.
   - No. Costs are not as low as the industry or need to be controlled in order to reduce them.
   Another way to make improvements to the profitability of the business is to reduce expenses. To know which expenses may be inflated, compare your expenses to other businesses in your industry as a percentage of Sales. How can you reduce expenses?
A Closer Look @ Using the Financial Template

A Microsoft Excel template is provided with this program to save hours of time in creating a budget for your Business Plan. When you initially access the file from fasttrac.org/resources, Excel may prompt you to “Enable Macros.” You must enable macros to use the full features of the template.

The template consists of worksheets (where you enter data) and forecasted financial statements and ratio analysis (both automatically generated by the template). You may choose to include the worksheets in the Appendix of your plan. The financial statements and ratio analysis are part of the financial section of the Business Plan.

NOTE: The Financial Template is not designed for columns or rows to be added or deleted. By doing so, you run the risk of losing or corrupting the preset calculations, which have been established in other sections of the Financial Template. Throughout the template only enter positive numbers (without commas). The only exception is if you have an established company with a loss in your Retained Earnings account. That number must be entered as a negative on the Historical Balance Sheet on the Existing Company Set-Up Worksheet.

Features of the Financial Template

Many features have been built into the template to make it easy to use:

1. Worksheets are presented in a logical sequence for projecting financial information. You should step through the worksheets in the order they are presented. You can always go back and make adjustments or change assumptions as you see how the plan works out.

2. Tips/comments are included throughout the template to provide additional information on the template or the budgeting process. Placing your cursor on any cell that has a red triangle will access these tips/comments.

3. Printing your instructions, worksheets, and financial information is easy with the print buttons provided on each worksheet. The Print Options Worksheet lists all printing options included within the template. Be sure to “Enable Macros” upon entering the template to use the print buttons.

4. Additional functions are provided on the Financial Template for your convenience:
   - **Amortization Schedule**—This function figures your principal and interest payments on your loans.
   - **Print Options**—With one click, print out your choice of instructions, worksheets, or financial statements.

Steps in Using the Financial Template

The following steps for using the Financial Template are detailed below:

Step 1 Download and save the template.
Step 2 Set up the template.
Step 3 Enter your budget information.
Step 4 Print the financial statements.
A Closer Look @ Using the Financial Template continued

Step 1 Download and save the template. When you first open the Financial Template at fasttrac.org/resources, we recommend you enable macros and save the file to your hard drive. Then save the file again using another name. Renaming the file will allow you to keep a fresh version of the template if you want to create another plan.

- Open the Financial Template.
- From the File menu, select Save As…
- Save the document as MyFinancials.xls on your own disk or hard drive.
- Continue to save the document as you make changes to it. Store a backup copy in a safe place.

Step 2 Set up the template. After reading the Introduction Worksheet, complete the following worksheets to set up the template prior to entering your budget information.

- **Company Information Worksheet**
  
  The Company Information Worksheet sets up your template by asking five questions about your business. Be sure to answer every question because the answers will help tailor the template to your specific business operations. For example, if you answer yes to the question in Step 4, “Is your business solely a service provider? (Yes or No),” the Inventory Worksheet will not become part of your template, since service providers generally do not need to budget for inventory.

  In response to your answer to the question in Step 3, “Is your company a start-up (no historical financial data to enter)? (Yes or No),” the template will prompt you to use one of the following set-up worksheets. If you enter no the Existing Company Set-Up Worksheet will be available on the Financial Template. If you enter yes the Start-Up Company Set-Up Worksheet will be available. Until you answer this question, neither worksheet is available on the Financial Template.

- **Existing Company Set-Up Worksheet**
  
  In the Existing Company Set-Up Worksheet, you will enter your most recent Balance Sheet figures in the Historical Balance Sheet. These figures will be used as a basis to project ongoing financial reports. To build reliable financial projections, start with numbers you trust are correct.

  **The Balance Sheet**
  
  The Balance Sheet requests information in the following categories:

  **Cash**—Enter the dollar amount for cash and other equivalents from your current Balance Sheet. Other equivalents may include savings accounts, money market accounts, petty cash fund, or various checking accounts.

  **Accounts Receivable**—Enter the dollar amount owed to the company for previously sold products and services.

  **Inventory**—Enter the dollar amount of inventory that reflects previous purchases of products and raw materials. If you are a manufacturing business, enter the dollar amount of inventory that reflects previously incurred expenses for Cost of Goods Sold (labor) and Cost of Goods Sold (overhead).

  **Security Deposits**—Enter the dollar amount paid out for security deposits. Security deposits are not typical costs; they are considered assets because they retain value.

  **Other Current Assets**—Enter the dollar amount of any other current assets. A current asset is something of value that you expect to turn into cash within one year.
A Closer Look @ Using the Financial Template continued

**Property, Plant, & Equipment**—Enter the amount of each asset category in the related account and enter the amount of total accumulated depreciation in the corresponding depreciation account.

**Non-Current Asset**—Enter the amount of non-current assets that are not reported in Property, Plant, & Equipment. A non-current asset is something of value that you do not expect to turn into cash within one year.

**Accounts Payable (Suppliers)**—Enter the amount of money owed to suppliers.

**Line of Credit**—Enter the principal balance due on an existing line of credit. Do not enter the available balance.

**Other Current Liabilities**—Enter the dollar amount owed for current liabilities. A current liability is an obligation that is expected to be paid within one year.

**Loans**—Enter the principal balance of loans outstanding.

**Real Estate Loans**—Enter the principal balance owed on real estate loans.

**Other Non-Current Liabilities**—Enter the dollar amount owed for non-current liabilities. A non-current liability is an obligation that is expected to be paid more than one year from now.

**Owner's Equity**—If the company is a sole proprietorship or partnership, enter the amount of equity previously invested in the company. If the company is an LLC, LLP, S Corp, or C Corp, enter the amount of equity invested.

**Retained Earnings**—Enter the amount of profits that have been retained in the business. Enter a negative number for a loss.

**Owner's & Investor's Draws**—Enter the amount of equity that has been withdrawn from the company for owner's or investor's withdrawals. This account is not to be used by C corporations.

**Payoff Schedule**

Existing businesses may need to complete a payoff schedule located at the bottom of the Existing Company Set-Up Worksheet. The purpose of the payoff schedule is to record the collection or payment of cash that changes a balance in assets or liabilities. Identify the situations that apply to the following accounts on your Balance Sheet:

**Other Current Assets or Non-Current Assets**—If you will be receiving cash payments to reduce a balance in Other Current Assets or Other Non-Current Assets, record those payments in the appropriate months. If the balance is a prepayment amount that you expect to remain consistent from year to year, such as insurance, you do not need to enter anything. The balance will be carried forward to future years in the Year-End Balance Sheet.

**Accounts Payable**—If you have a balance in your Accounts Payable account, enter your payments towards these obligations in the appropriate months. For future periods, it is assumed that Operating Expenses are paid with cash and Inventory Purchases may be cash or credit. If you do not enter a payment schedule for existing Accounts Payable, the balance will be carried forward indefinitely.

**Other Current Liabilities or Non-Current Liabilities**—If you will be making payments toward Other Current Liabilities or Non-Current Liabilities, enter those payments in the appropriate months. If the balance is an accrual that you expect to remain from year to year, (such as Accrued Payroll) you do not need to enter anything.
A Closer Look @ Using the Financial Template continued

Note: Payments on your Line of Credit, Long-Term, or Real Estate Loans should NOT be entered in the payoff schedule. Use the Equity & Debt Worksheet to record payment of principal and interest relating to these loans.

Start-Up Company Set-Up Worksheet
If you enter yes to the question in Step 3 on the Company Information Worksheet, the Start-Up Company Set-Up Worksheet will become part of your personalized Financial Template. Detailed instructions in the worksheet will direct you through the process of entering start-up estimates.

If you are starting a business, complete the Start-Up Company Set-Up Worksheet based on the financial information you have collected through research. You will be asked how much money you and your investors will initially put into the company, as well as the amount you plan to borrow and the expenditures you expect to make before you open the doors.

Step 3 Enter your budget information. The next five worksheets—Sales, Inventory, Operating Expenses, Capital Budget, Equity & Debt—ask you to record budget decisions for the next three years. The Financial Template utilizes the information you enter on these worksheets to automatically generate the financial statements you need to include in the Business Plan.

The following detailed instructions for each budgeting worksheet should guide you.

Sales Worksheet
On this worksheet you will record the monthly sales you expect to receive for the first three years in the planning period. To get an accurate picture of your sales forecasts and how your sales affect your cash flow, you will be asked these questions:

1. What percentage of sales is made to customers paying cash (credit cards included)?
2. How long on average does it take to collect credit sales?
3. What percentage of credit sales is considered bad debts (invoices that are uncollectible)?
4. What percentage of credit sales is estimated for returns and allowances (products returned for one reason or another)?

Start entering sales amounts in the first month you expect to receive sales. You can customize the worksheet by entering product/service names in the areas provided. If you sell many products or services, group them into categories for your sales estimates.

In addition to monthly sales, you may receive money from activities unrelated to your primary business activity. The template provides a category called Other Income for you to enter these amounts.

An important part of this worksheet is the section for your assumptions. Base each sales assumption on researched facts or historical information and be as clear and thorough as possible. This information will help you remember the details supporting the numbers and will help readers of your plan understand the basis for your estimates. For example, an assumption for Returns and Allowances might read, “Estimated at .25% based on industry averages for boutique operations.” The source of the industry statistic should be included directly after the assumption. The space to enter these assumptions is limited, so be concise. You may choose to provide additional worksheets in the Appendix of the plan to further explain your assumptions.
A Closer Look @ Using the Financial Template continued

- **Inventory Worksheet (if applicable)**
  
  If you answer *no* to the question in Step 4 on the Company Information Worksheet, “Is your business solely a service provider? (Yes or No),” this worksheet will become part of your personalized Financial Template. All product-based businesses, such as retailers and manufacturers, should complete this worksheet to build an inventory budget. Service businesses that sell products should also complete it.

  To accurately budget for inventory needs, you will be asked these questions:

  1. What percentage of sales comes from products?
  2. What percentage of sales is the average Cost of Goods Sold for your products?
  3. How much inventory or raw materials will you be purchasing? Will you be buying some of this on credit? What is the average number of months you are allowed before payment is due?
  4. Do you produce inventory in your own plant? What are your production expenses?

  The categories on the Inventory Worksheet cover common expenses. Use the Other Production Expenses category if your expenses do not fit into those listed.

  For each inventory or raw material amount, you will write an assumption about how that estimate was determined. Base each assumption on facts researched and be as clear and thorough as possible. For example, the inventory/raw material purchases of $15,000 for a winery may include the assumption, “15 tons of grapes at $800 per ton and $3,000 inventory to stock gift shop.”

- **Operating Expenses Worksheet**

  On this worksheet you will enter the monthly amount you expect to pay for operating expenses, such as non-production payroll, marketing, and rent expenses. Your historical financial data and additional information researched will be helpful in completing this worksheet. Because it is easy to overlook some expenses, you will be reminded throughout this program to evaluate the expenses for each functional area of business. If you have expenses that do not fit the listed categories, you can rename the “Other” categories at the end of the list.

  Write an assumption about how each estimate was determined. For example, a company that publishes a small magazine included this assumption for salaries, “Designer @ $1750/mo beg. in Aug; Editor @ $60K/yr beg. Sept; Promotions Mgr @ $30K, Ad Director @ $1K/mo + 15% comm., Publisher @ $60K/yr.”

- **Capital Budget Worksheet**

  On the Capital Budget Worksheet you will enter all cash expenditures that are not considered expenses and are not deducted from revenue to determine profitability. These non-expense cash expenditures, which have a significant impact on your cash flow, include the following:

  **Capital Expenditures**
  - Computer Equipment
  - Equipment & Machinery
  - Furniture & Fixtures
  - Leasehold Improvements
  - Vehicles
  - Building
  - Land

  **Other Expenditures**
  - Prepaid Expenses
  - Security Deposits
  - Payouts to Owners and Investors

  **Payouts to Owners and Investors**
  Equity distributions, or payouts to owners and investors, are called by different names, depending on the legal structure of the business. In sole proprietorships, the owner can receive a check at any time for compensation, called an owner’s draw. Corporations call payouts to owners a dividend. Limited liability companies call it a distribution. It can also be called a payout or draw. No matter what it is called, it amounts to a reduction in equity.
A Closer Look @ Using the Financial Template continued

The different sections of the Capital Budget Worksheet will guide you through the process of recording the cash you expect to spend for non-expense cash expenditures. The instructions for each section in the template will help you determine which sections pertain to your business. Through this process you will identify:

- Depreciation on existing capital assets (for example, equipment, furniture, vehicles)
- Depreciation on future capital purchases
- Other capital expenditures (for example, owner’s draws, dividend payments)

Equity & Debt Worksheet

On the Equity & Debt Worksheet enter the cash you receive for items other than revenue, including equity investments and loan proceeds. This worksheet is divided into several sections that represent the type of funding—equity or debt—you will likely seek. Evaluate the questions in each section of the worksheet to determine if you will seek that form of funding. If they apply, you will record the equity investment, new loans received, and loan payments on existing and new loans. You will be asked these questions:

1. How much of your own cash and/or other investors’ cash will be sought as equity?
2. Do you have an existing loan on real estate (building, land) or are you planning to seek a real estate loan during the planning period?
3. Do you have an existing business loan or are you going to acquire a business loan for start-up, operations or growth of the business?
4. Do you have an existing line of credit (a short-term loan used to cover cash shortfalls as they occur) or are you planning to get a line of credit?

An analysis tool—Section E Cash Position—is provided that shows the current cash balances based on all the spending and sales forecasts as well as borrowing and equity investments you have budgeted to this point in the process. You will be prompted to evaluate the cash balance to determine if it is sufficient to support the start-up, daily operations, and growth of your company. Several options are provided for you to consider if you still find the business needs additional cash to support operations.

Step 4 Print the financial statements. Use the Print Options Worksheet to print the Financial Statements to include in the Business Plan:

- Monthly Income Statement
- Monthly Cash Flow Report
- Year-End Income Statement
- Year-End Balance Sheet
- Financial Analysis/Ratios
- Existing Company Set-Up Worksheet’s Historical Balance Sheet or Start-Up Company Set-Up Worksheet’s Start-Up Funding & Expenditures Worksheet
- Sales Worksheet
- Inventory Worksheet
- Operating Expenses Worksheet
- Capital Budget Worksheet
- Equity & Debt Worksheet
- Amortization Schedule
A Closer Look @ Financial Statements

The Language of Business
Accounting and financial concepts may be as alien to you as a foreign language. Still, the ability to understand and communicate financial information is critical to every entrepreneur. To succeed at business, you need to learn the language of business, which will enable you to understand the financial reports and information generated from your business and to communicate this information to others.

The Accounting System
Financial transactions occur every day in business. Each time a bill is paid or a sale is made, a financial transaction takes place. These financial transactions can’t be interpreted unless they are arranged into a useful format. The transactions must be recorded in a way that easily provides the information an entrepreneur needs to make good financial decisions. The accounting system provides this organization.

The accounting system takes business transactions and categorizes them into accounts, such as Utility Expense, Consulting Revenue, and Bank Loans. Accounts are grouped into categories and then arranged into several reports, mainly the Income Statement, Balance Sheet, and Cash Flow Report or Cash Flow Statement.

Accounting Language
When beginning to learn a new language, it is always helpful to learn a few basic rules—pronunciation, grammar, and syntax, for example. This information provides a basis of understanding about language. Accounting systems are built on rules as well. You need to understand the two basic methods of accounting that businesses use, since specific rules are associated with each. They are the **accrual basis** and **cash basis** methods of accounting. Based on the accounting method you choose, your financial reports will communicate a different message.

**Accrual Basis Accounting**—Most businesses use the accrual basis accounting method, which reports income at the time it is earned and expenses when they are incurred, without regard to when the cash changes hands. This method presents a very accurate financial position. For example, if insurance is paid every six months, it is recorded as a prepaid asset on the Balance Sheet at the time it is paid. Each month, a portion of the insurance will be recorded on the Income Statement to represent the portion of insurance associated with that specific month.

**Cash Basis Accounting**—Some businesses use the cash basis accounting method, which records revenue when cash is received and expenses when bills are paid. This method is very simple to use, but doesn’t provide the most accurate financial picture, because income may not be appropriately matched with related expenses. Looking at the insurance example, every six months a payment to the insurance company is reported in the month it is paid, but it represents half the yearly insurance due. This allocation may be true from a cash perspective, but does not show an accurate account of expenses as they relate to monthly revenue.
A Closer Look @  Financial Statements  continued

Reporting Cash vs. Profits—Although the Income Statement reports the profitability of the business, Net Income doesn’t always indicate positive cash flows for the following reasons:

• When using the accrual basis accounting method, the Income Statement reflects income earned and expenses incurred, without regard to whether the cash changed hands.
• Non-cash expenses such as depreciation and amortization are included in the Income Statement.
• Cash outflows for debt repayments, purchases of inventory, and payments to the owners of the business (dividends or draws) and cash inflows from borrowings from banks and other lenders do not show up on your Income Statement.

These discrepancies between what is shown on the Income Statement and what is actually flowing into and out of your business make it critical for you to understand all three financial statements—Income Statement, Balance Sheet, and Cash Flow Report.

Income Statement

The Income Statement shows the net income or loss that the business has experienced over a period of time. It is your company’s financial grade card. The time period could be a day, week, month, quarter, or year. This report helps you determine if your business is making or losing profits. The Income Statement displays the revenue (sales) earned by your company and the expenses it incurred to generate those revenues. Then it reports Net Income based on those revenues and expenses for the intended period of time.

Income Statement Categories

Revenue—Revenue (or Sales) can be described as money earned from conducting the business’s activities. It is sometimes called Net Sales on the Income Statement.

Expenses—Expenses are costs associated with supporting the business’s activities. The expenses that appear on the Income Statement are generally the same expenses that the Internal Revenue Service allows as deductions for income tax purposes. In addition, the Income Statement may include some non-cash expenses such as depreciation or amortization.

Net Income—The ultimate goal of any business is to produce a positive net income or profit over the long haul.

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>Sample %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (Sales)</td>
<td>100%</td>
</tr>
<tr>
<td>- Cost of Goods Sold</td>
<td>75%</td>
</tr>
<tr>
<td>= Gross Margin</td>
<td>25%</td>
</tr>
<tr>
<td>- Operating Expenses</td>
<td>15%</td>
</tr>
<tr>
<td>= Operating Income</td>
<td>10%</td>
</tr>
<tr>
<td>- Non-Operating Expenses</td>
<td>7%</td>
</tr>
<tr>
<td>= Net Income</td>
<td>3%</td>
</tr>
</tbody>
</table>
## A Closer Look @ Financial Statements continued

The Backyard Solutions Income Statement demonstrates the format used by the Financial Template. Use this sample to review the headings, sub-headings, and accounts below that appear on a detailed Income Statement.

### Line Item Descriptions

**Net Sales** includes all sales reduced by any discounts or returns.

**Cost of Goods Sold** includes all the costs of inventory sold, including production labor, materials, and overhead. This amount is subtracted from the Inventory account on the Balance Sheet.

**Gross Margin**, or Gross Profit, is the first cut. Can the company's sales price cover all of the costs to manufacture the items being sold?

**Operating Expenses** lists the total of expenses incurred to operate the business. Non-operating expenses, such as interest expenses, are excluded.

**Advertising** includes any costs directly related to advertising products/services to potential customers.

**Bad Debt Expense** is used to write off invoices to customers who are not expected to pay.

**Bank Charges** includes any cost of banking for a checking account, merchant account, or other fees.

**Depreciation & Amortization** is used to allocate the expense of fixed and intangible assets over a certain number of years.

**Dues & Subscriptions** includes costs of trade magazines or periodicals and membership dues to organizations.

**Insurance** includes the cost of purchasing general liability or other insurance.

**Licenses & Fees** includes any costs incurred for occupational licenses, fees, or other licensing registrations.

### Backyard Solutions Year-End Income Statement (Projected)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales (less returns &amp; allowances)</td>
<td>$775,175</td>
<td>100.0%</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>542,623</td>
<td>70.0%</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>232,552</td>
<td>30.0%</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bad Debt Expense</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>14,095</td>
<td>1.8%</td>
</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
<td>220</td>
<td>0.0%</td>
</tr>
<tr>
<td>Insurance</td>
<td>2,700</td>
<td>0.3%</td>
</tr>
<tr>
<td>Licenses &amp; Fees</td>
<td>215</td>
<td>0.0%</td>
</tr>
<tr>
<td>Marketing &amp; Promotion</td>
<td>11,300</td>
<td>1.5%</td>
</tr>
<tr>
<td>Meals &amp; Entertainment</td>
<td>1,000</td>
<td>0.1%</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>1,200</td>
<td>0.2%</td>
</tr>
<tr>
<td>Office Expense</td>
<td>1,800</td>
<td>0.2%</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Outside Services</td>
<td>1,640</td>
<td>0.2%</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>171,370</td>
<td>22.1%</td>
</tr>
<tr>
<td><strong>Operating Income</strong></td>
<td>61,182</td>
<td>7.9%</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>3,477</td>
<td>0.4%</td>
</tr>
<tr>
<td>Other Interest, Royalties</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Income Before Taxes</strong></td>
<td>57,705</td>
<td>7.4%</td>
</tr>
<tr>
<td>Income Taxes (If C Corp)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$57,705</td>
<td>7.4%</td>
</tr>
</tbody>
</table>

The Net Income reports the company's profit or loss. Profits represent an increase in the value of the business to the owner(s). Therefore, this amount will show up as Retained Earnings in the equity section of the Balance Sheet.
A Closer Look @ Financial Statements continued

**Marketing & Promotion** includes any costs related to marketing to customers or helping establish the business’s image.

**Meals & Entertainment** includes the costs incurred for networking meals and other meetings with potential customers and advisers.

**Miscellaneous** includes expenses that do not fit into any other category.

**Office Expense** includes the expenses to run the office, including postage but not office supplies.

**Office Supplies** includes the supplies you purchase for office needs, not including products that will be resold to customers.

**Outside Services** includes money paid for outside consultants, sub-contractors, and other vendors.

**Payroll – Salaries, Taxes, & Benefits** includes the entrepreneur’s salary, benefits, and company-paid taxes and the salary, benefits, and taxes of all employees. Sole proprietors record their “salary” as an owner’s draw.

**Professional Fees** includes costs to hire a professional to help with different areas of a business, such as management consultants, lawyers, accountants, and other professionals.

**Property Taxes** includes taxes paid on the property owned by the business. It does not include income taxes. Income taxes are not an operating expense of the business.

**Rent** includes the specific costs of renting the business facility including common area maintenance costs.

**Repairs & Maintenance** includes all costs to maintain computers, equipment, and other capital purchases.

**Shipping & Delivery** includes costs associated with shipping or delivering products/services.

**Telephone** includes costs associated with local service, long distance, and mobile phone service, if applicable.

**Training & Development** includes costs for employee training and development.

**Travel** includes costs for traveling for business purposes to training sessions, out-of-town association meetings, or other business-related events.

**Utilities** includes costs of utilities, such as electricity, water, and gas.

**Vehicle** includes actual costs incurred for company-owned vehicles or mileage reimbursement if the vehicle is not company-owned.

**Leased Equipment** includes lease payments for equipment. The management of Backyard Solutions added this title by replacing one of the Other categories in the Financial Template. Three Other categories are included on the Financial Template so users can add additional account categories. This company has used one of these for Leased Equipment.

**Operating Income**, also known as Earnings Before Interest and Taxes (EBIT), is the income generated from conducting business. (Gross Margin less Total Operating Expenses.)

**Interest Expense** is the interest portion of the loan payments made during the year.

**Other Income** is income received from activities other than the normal business operations, such as non-operating rent income.

**Income Before Taxes** is a Net Profit calculation that is often used to compare one company against another since this figure has not been reduced by income taxes paid.

**Income Taxes (if C Corp)** is calculated on this report to help identify the real bottom line. With sole proprietorships, partnerships, S corporations, and LLCs, the income taxes are passed through to the owners, so they would not be included here.

**Net Income**, also known as Net Profit, is the earnings after taxes are paid—the “bottom line.” When measured as a percentage, this item is referred to as Net Margin, Net Income Margin, or Net Profit Margin.
A Closer Look @ Financial Statements continued

Balance Sheet
The accounting equation is an accounting rule that provides the foundation for the Balance Sheet. It states that the value of a company’s assets must equal the value of the rights of the creditors (liabilities) plus the rights of the owners (equity). Therefore, even though they are considered company assets, both owners and outsiders may have rights to those assets.

The Accounting Equation
\[ A = L + E \]

Assets = Liabilities + Equity

At any point in time, a Balance Sheet can be produced to report the value in the following account categories:

**Assets**—Assets can be described as things in your business with value, such as cash, equipment, inventory, and investments. In the same way you might own your car or house, these items are owned by the business. The business may not have the sole rights to these assets, however, just as you may share the rights to your car or house with the bank that lent you money.

On the Balance Sheet, assets are divided into Current Assets and Non-Current Assets. Current Assets include cash or assets that can or will be turned into cash within one year. Examples include Cash, Accounts Receivable, and Inventory. All assets that are not expected to be converted into cash within one year are considered Non-Current Assets. These accounts include Fixed Assets, such as Land, Facilities, Equipment, and Vehicles. Other Non-Current Assets include Long-Term Notes Receivable and Intangible Assets such as Goodwill, Patents, and Copyrights.

**Liabilities**—Liabilities describe others’ rights to the value in the business, such as banks that have loaned the business money and vendors who have allowed the business extended payments. This amount can be compared to the amount of money you still owe on your house or car, which are personal liabilities. You will see Liabilities divided into Current Liabilities and Non-Current Liabilities. Current Liabilities include those liabilities you expect to pay within the next year, such as Accounts Payable. Since lines of credit typically have a renewal provision included in the loan agreement, they are also usually classified as current. Long-Term Liabilities include Notes Payable, such as loans from banks or other financial institutions with payment terms over several years.
A Closer Look @ Financial Statements continued

**Equity**—Owner’s Equity is the difference between Assets and Liabilities. It shows the owner’s rights to the value of the company. Depending on the structure of the company, this number could reflect what you as the sole proprietor own in the company or what you and the other stockholders or shareholders own if your company has multiple owners.

One equity account that seems to stump many business owners is called Retained Earnings. This account represents the amount of cumulative earnings or Net Income that has not been paid out to owners in dividends or owner’s draw. The amount in Retained Earnings, however, may not always be equal to the amount of cash the business has on hand. This discrepancy occurs because you may re-invest the earnings of the business in new equipment or even a new building. You may also make a strategic decision to increase the operations of the business and, therefore, need to purchase more inventory. The Retained Earnings account may also show a negative number if the business has not been profitable or the business owners have taken out more money than the business has generated in income.

The Balance Sheet on p. 150 reflects the format of the Financial Template. Use this example to review the accounts on a detailed Balance Sheet.
A Closer Look  Financial Statements continued

Account Descriptions

**Cash & Equivalents** is the amount of cash the company has in the bank at this time.

**Accounts Receivable** is the amount of money owed to the company from its customers.

**Inventory** is the amount of merchandise or finished goods the company has on hand ready to sell to customers.

**Security Deposits** includes money paid as a deposit for services, such as utilities and rent. These payments are considered assets because they have value.

**Other Current Assets** is a category to accumulate any other assets that could be turned into cash within a year and do not fit into any other category.

**Property, Plant, & Equipment** includes all tangible assets in the business that have ongoing value.

**Accumulated Depreciation** includes the total of each year’s allocation of the purchase price of an asset.

**Other Non-Current Assets** is a category to accumulate any other assets that will not be turned into cash within a year and do not fit into any other category.

**Accounts Payable** includes the money the company owes for expenses incurred on credit, generally due in 30 to 60 days.

**Line of Credit** is for short-term financing, usually granted by a bank up to a predetermined limit.

**Other Current Liabilities** is a category to accumulate any other liabilities that will be paid within the year and do not fit into any other category.

**Loans** includes the amount of money the company has borrowed and owes to banks or others.

**Mortgages** includes amounts owed on loans for real property, usually reserved for real estate loans.

**Other Non-Current Liabilities** is a category to accumulate any other liabilities that will not be paid within a year and do not fit into any other category.

**Equity Investments** is the amount of capital the owners have invested into the business.

**Retained Earnings** reflects the owner’s stake in the company. It is the Net Profit that is re-invested or kept in the company.

**Owner’s & Investor’s Draws** includes amounts withdrawn by owners or investors in a sole proprietorship.

---

### Backyard Solutions Year-End Balance Sheet (Projected)

<table>
<thead>
<tr>
<th>Accounts</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
</tr>
<tr>
<td>Cash &amp; Equivalents</td>
<td>$110,320</td>
</tr>
<tr>
<td>Net Accounts Receivable</td>
<td>15,291</td>
</tr>
<tr>
<td>Inventory</td>
<td>5,352</td>
</tr>
<tr>
<td>Security Deposits</td>
<td>-</td>
</tr>
<tr>
<td>Other Current Assets</td>
<td>-</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td>130,963</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td></td>
</tr>
<tr>
<td>Property, Plant, &amp; Equipment</td>
<td>72,000</td>
</tr>
<tr>
<td>Less: Accumulated Depreciation</td>
<td>(14,095)</td>
</tr>
<tr>
<td>Other Non-Current Assets</td>
<td>-</td>
</tr>
<tr>
<td>Total Non-Current Assets</td>
<td>57,905</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$188,868</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$ -</td>
</tr>
<tr>
<td>Line of Credit</td>
<td>-</td>
</tr>
<tr>
<td>Other Current Liabilities</td>
<td>8,428</td>
</tr>
<tr>
<td>Total Current Liabilities</td>
<td>8,428</td>
</tr>
<tr>
<td>Long-Term Liabilities</td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td>37,735</td>
</tr>
<tr>
<td>Mortgages</td>
<td>-</td>
</tr>
<tr>
<td>Other Non-Current Liabilities</td>
<td>-</td>
</tr>
<tr>
<td>Total Non-Current Liabilities</td>
<td>37,735</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>46,163</td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
</tr>
<tr>
<td>Equity Investments</td>
<td>85,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>57,705</td>
</tr>
<tr>
<td>Less: Owner’s &amp; Investor’s Draws</td>
<td>-</td>
</tr>
<tr>
<td>Total Equity</td>
<td>142,705</td>
</tr>
<tr>
<td><strong>Total Liabilities and Equity</strong></td>
<td>$188,868</td>
</tr>
</tbody>
</table>

Because this company is only one year old, the Retained Earnings account reflects the same amount as the company’s first year’s Net Income.
**Cash Flow Report and Cash Flow Statement**

Entrepreneurs usually use one of two cash flow tools to assist them in financial decision making: the Cash Flow Report or the traditional Cash Flow Statement. Both can be used to report historical figures or budget future cash flow. The difference between the two documents is the way in which this information is prepared and reported.

Both of these reports include the cash flows received and paid out for loans and owner investments, as well as the purchases of fixed assets. But the primary difference is that the Cash Flow Report records cash activity as it relates to the individual revenue and expense categories such as you would find on an Income Statement. The traditional Cash Flow Statement reports cash activity as it relates to the operating, investing, and financing activities of the business.

**Cash Flow Report**—The monthly Cash Flow Report is one of the most important planning and reporting tools you can use in your business.

Compare the Cash Flow Report to your personal checkbook register. Every time you deposit money into your account or write checks out of the account you record the transaction and keep a running total. In the same way, the Cash Flow Report records every cash entry into your business and cash payment out of the business on a monthly basis. These inflows and outflows are grouped by categories that will affect the other financial statements, such as Equity Contributions, Inventory Purchases, or Operating Expenses.

The advantage of the Cash Flow Report over your regular checkbook register is the way it displays monthly financial activity over time, making it easy for you to analyze past fluctuations in cash flow in the year and predict future ones for next year.

The Cash Flow Report can help you with day-to-day cash budgeting. You need cash flow analysis because a delay usually occurs between the time you pay out cash to generate sales (for example, purchasing inventory or paying employees’ salaries) and the time you actually receive cash from those sales—also called the cash cycle. Since typical sales transactions have a cash cycle of days, weeks, or even months, you will need to locate additional funds to keep the business running while waiting for the cycle to be completed.

### Backyard Solutions

#### Cash Flow Report (Projected)

<table>
<thead>
<tr>
<th>Year</th>
<th>JAN</th>
<th>FEB</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash In</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Sales</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Collections from Accounts Receivables</td>
<td>15,504</td>
<td>13,798</td>
</tr>
<tr>
<td>Equity Received</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Loans Received</td>
<td>20,000</td>
<td>-</td>
</tr>
<tr>
<td>Other Cash In (receipts from other assets)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Cash In</td>
<td>35,504</td>
<td>13,798</td>
</tr>
<tr>
<td><strong>Total Cash Available</strong></td>
<td>45,504</td>
<td>27,000</td>
</tr>
</tbody>
</table>

#### Cash Out

<table>
<thead>
<tr>
<th>Category</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory Expenditures</td>
<td>8,363</td>
<td>8,363</td>
</tr>
<tr>
<td>Inventory/Raw Material (paid on account)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Production Expenses</td>
<td>2,256</td>
<td>2,256</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Insurance</td>
<td>225</td>
<td>225</td>
</tr>
<tr>
<td>Licenses &amp; Fees</td>
<td>215</td>
<td>-</td>
</tr>
<tr>
<td>Marketing &amp; Promotion</td>
<td>3,500</td>
<td>200</td>
</tr>
<tr>
<td>Meals &amp; Entertainment</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Office Expense</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Outside Services</td>
<td>70</td>
<td>70</td>
</tr>
<tr>
<td>Payroll Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; Wages</td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>Benefits</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Professional Fees</td>
<td>1,200</td>
<td>200</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Rent</td>
<td>4,200</td>
<td>4,200</td>
</tr>
<tr>
<td>Repairs &amp; Maintenance</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Shipping &amp; Delivery</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Telephone</td>
<td>300</td>
<td>350</td>
</tr>
<tr>
<td>Training &amp; Development</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Travel</td>
<td>5,000</td>
<td>-</td>
</tr>
<tr>
<td>Utilities</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Vehicle</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>Leased Equipment</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Paid on Account</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Non-Operating Costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Purchases</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Estimated Income Tax Payments</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Interest Payments</td>
<td>309</td>
<td>306</td>
</tr>
<tr>
<td>Loan Principal Payments</td>
<td>594</td>
<td>598</td>
</tr>
<tr>
<td>Owner’s Draw</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Other Cash Out</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Cash Out</strong></td>
<td>32,302</td>
<td>21,838</td>
</tr>
<tr>
<td><strong>Monthly Cash Flow (Cash In – Cash Out)</strong></td>
<td>3,202</td>
<td>(8,040)</td>
</tr>
<tr>
<td><strong>Beginning Cash Balance</strong></td>
<td>10,000</td>
<td>13,202</td>
</tr>
<tr>
<td><strong>Ending Cash Balance</strong></td>
<td>$13,202</td>
<td>$ 5,162</td>
</tr>
</tbody>
</table>
A Closer Look Financial Statements continued

Fortunately, cash flow planning is simple in concept, although coming up with the numbers can involve considerable work. Cash flow is exactly what its name implies: the anticipation of cash as it flows into and out of the company. Only cash transactions are included in this analysis. You can ignore non-cash accounting entries such as Depreciation and Amortization which do not appear on the Cash Flow Report.

The Cash Flow Report lists the sources of cash expected to be received into the business on a monthly basis. This list includes cash sales, collections from accounts receivables, equity contributions from owners, and loans from either owners or outside sources. The cash you expect to receive is added to the cash balance remaining from the prior month to total the cash available for that month. You deduct all items paid for with cash from the total cash available to identify the cash balance at the end of the month. This amount must always be above zero. In fact, you should try to maintain a healthy cushion to cover unexpected differences between budgeted cash flow and actual cash transactions.

**Cash Flow Statement**—The traditional Cash Flow Statement prepared by accountants reconciles the changes that occur within the Balance Sheet accounts with the cash provided from the operations of the business. The cash flows from investing and financing activities are also reported. Although these statements can be used to budget future cash flows, they are more effective at reporting actual cash activity than at budgeting predicted activity.

<table>
<thead>
<tr>
<th>Backyard Solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Statement of Cash Flows for the Year Ending 2012 (Projected)</strong></td>
</tr>
<tr>
<td><strong>Cash Flows from Operating Activities</strong></td>
</tr>
<tr>
<td>Net Income</td>
</tr>
<tr>
<td>Adjustments to reconcile Net Income to Net Cash provided by operating activities:</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization Expense</td>
</tr>
<tr>
<td>Decrease in Accounts Receivable</td>
</tr>
<tr>
<td>Decrease in Inventories</td>
</tr>
<tr>
<td>Decrease in Accounts Payable</td>
</tr>
<tr>
<td><strong>Net Cash Provided by Operating Activities</strong></td>
</tr>
<tr>
<td><strong>Cash Flows from Investing Activities</strong></td>
</tr>
<tr>
<td>Purchase of Property, Plant, &amp; Equipment</td>
</tr>
<tr>
<td><strong>Net Cash Used by Investing Activities</strong></td>
</tr>
<tr>
<td><strong>Cash Flows from Financing Activities</strong></td>
</tr>
<tr>
<td>Proceeds from Loans</td>
</tr>
<tr>
<td>Principal Payment on Loans</td>
</tr>
<tr>
<td>Payment of Owner’s Draws</td>
</tr>
<tr>
<td>Proceeds from Owner’s Investments</td>
</tr>
<tr>
<td><strong>Net Cash Provided by Financing Activities</strong></td>
</tr>
<tr>
<td>Net Increase in Cash</td>
</tr>
<tr>
<td>Cash at Beginning of Year</td>
</tr>
<tr>
<td><strong>Cash at End of Year</strong></td>
</tr>
</tbody>
</table>
One of the fundamental principles of entrepreneurship is continuous improvement. As a new entrepreneur, you may have once believed that you were going to create the perfect product or service, and then you’d be done with it. By now you know that business doesn’t work that way. If you don’t continually improve your offerings, your competitors jump ahead. If you don’t stay connected with your market, your customers leave you behind.

This module will help you think through ways to improve your products and services based on market needs, protect your products and services from competitors, and price your products and services. All of the decisions you make should fit into and support the overall strategic direction for your business. To document these decisions, you will prepare two sections of the Business Plan: the Product/Service Plan and the Pricing section of the Marketing Plan.

Key Questions

- How will I improve my products and services based on changing customer needs?
- How will I protect my products and services from competitors?
- How will I modify my prices to support my business strategy and fend off the competition?

### Action Steps

<table>
<thead>
<tr>
<th></th>
<th>Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.1 Prepare My Product/Service Plan</td>
<td></td>
</tr>
<tr>
<td>5.2 Prepare My Marketing Plan – Pricing</td>
<td></td>
</tr>
<tr>
<td>5.3 Finalize My Product/Service Financial Projections</td>
<td></td>
</tr>
<tr>
<td>Read Module 6 Seizing the Market</td>
<td></td>
</tr>
</tbody>
</table>
Adapting to the Market

To be successful—and stay successful—your business must carefully adapt its products or services in response to the market. For some businesses, this means highlighting different benefits of the product or service to the market. For others, this necessitates modifications to existing products or services. Sometimes it means developing new products or services.

New Belgium Brewing Company founder Jeff Lebesch says, “From the beginning, we have had a strategy to innovate continually when it came to our specialty beers.” New Belgium works hard at developing new beers to satisfy the thirst of its market—specialty beer drinkers.

Bill and Marilyn Moss, founders of Moss Tent Works in Camden, Maine, produced high-tech tents for backpacking. They knew their core competencies were designing and manufacturing strong, lightweight, frame-and-fabric structures and saw the potential to use these strengths for a new product line of exhibit structures for the trade show industry. They were so successful in this new market that they sold their tent division to focus on their trade-show business.

Lebesch, who continues to sell to the same market, and the Mosses, who targeted a new market, both have a common denominator: they understand their core competencies and respond to changing market needs.

You’ll increase your chance of success if you emulate these companies by knowing your strengths and limitations, developing and refining your strategy, understanding customer needs, and strengthening your product and service offerings by aligning your strategy and customer needs.

What this module asks you to do is tricky: balance your vision and goals with the day-to-day tug of your customers. It’s difficult to draw these two forces together, but the entrepreneurs who pull this off—the ones who align their product and service offerings with their strategy and customers—are the ones who grow the strongest businesses and maintain their success in the long run.

In the example on the next page, you’ll read how Wayne Hampton was caught in a price war and how he chose to respond.
changing the game to beat the competition

When Wayne Hampton launched Waco Composites, Ltd., four other companies were making bullet-resistant and bulletproof panels for the construction industry. Hampton carefully researched those firms to decide how he would compete against them. Since customers would view his product as similar to the others in the market, he decided to match prices of the industry leader. A similar product with similar prices made sense to Hampton.

“We didn’t want to come in with lower prices, for fear that would spark a price war,” Hampton explains. “No one wins a price war—except perhaps the customer.” Unfortunately, his major rival didn’t see things the same way.

As Waco Composites gained market share, the competitor began to slice prices, moving from about $15 to $13 per square foot on its bestselling panels.

In response, Hampton lowered his prices and watched his gross profit margin plunge from 28 percent to 18 percent. A few months later, the competitor slashed prices again, moving to $10.50 per square foot. Hampton followed suit but knew he couldn’t survive further decreases. Instead, he began to find ways to differentiate his product, such as:

- Offering free cutting for all custom orders—something no one else was doing.
- Offering same-day shipping on all orders received before 2 p.m.
- Implementing a new manufacturing process to fireproof panels.
- Securing approval from Underwriters Laboratories (UL) in eight areas.
- Determining ratings for specific product characteristics such as acoustical quality, tensile strength, and heat resistance.

Becoming UL-listed was the biggest expense—about $20,000—and it cost another $10,000 to determine product ratings. “Yet this data was very important to engineers and architects—the people who specify our products for projects,” Hampton says. “Since no one else was offering this information, we became the industry benchmark.”

Differentiating itself in both product and service enabled Waco Composites to raise prices, restore its profit margin, and continue growth, generating $4.5 million in revenue.

Granted, some of the changes were about perceived value rather than tangible value. “Yet perception is as important as real value in the mind of the customer,” Hampton says. “And, unlike competitors’ pricing, your company’s perceived value is something you do have control over.”

What was at the core of Hampton’s success? He changed his strategy when his original “do-what-everybody-else-is-doing strategy” didn’t work. What helped Waco Composites survive and thrive was Hampton’s push to strengthen both his product and service offerings. Most importantly, he did the hard work to find out what his customers wanted and then strengthened his product by catering to their needs and wants. He gave them benefits they valued that were not offered by his competitors.

Wayne Hampton considered his company’s offerings as a total package. The most successful entrepreneurs do the same. In this module, you’ll have a chance to consider ways to strengthen your products or services by:

- Improving your products/services based on market needs.
- Protecting your products/services from competitors and regulatory compliance omissions.
- Pricing your products/services to gain strategic advantages.
Improving Your Offerings Based on Market Needs

There are several ways to think about updating your products and services. All of them revolve around producing true value for your market. You can aim at your current market or at a completely new market with a whole new set of customers. As you recall from Module 2, there are a host of tactics available.

<table>
<thead>
<tr>
<th>Current Product/Service</th>
<th>New Product/Service</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Market</strong></td>
<td></td>
</tr>
<tr>
<td>Market Penetration</td>
<td>Line Expansion</td>
</tr>
<tr>
<td>Product/Service Improvements</td>
<td>Product/Service Improvements</td>
</tr>
<tr>
<td>Product and service features may or may not change slightly. The benefits emphasized may change to attract new customers or increase purchases from established customers.</td>
<td>New products and/or services are developed for the same market by adding distinct features emphasized to attract new customers or increase purchases from established customers.</td>
</tr>
<tr>
<td><strong>EXAMPLE</strong></td>
<td></td>
</tr>
<tr>
<td>Arm and Hammer® sold more baking soda when they emphasized additional benefits beyond its use for baking: cleaner, deodorizer, toothpaste, and antacid.</td>
<td>A consulting company that provides training programs extended their services by offering one-on-one coaching sessions. This personalized coaching attracted both new clients as well as training participants who wanted the benefits that come from additional follow-up assistance.</td>
</tr>
<tr>
<td><strong>New Market</strong></td>
<td></td>
</tr>
<tr>
<td>Market Expansion</td>
<td>New Product Development</td>
</tr>
<tr>
<td>Product/Service Improvements</td>
<td>Product/Service Improvements</td>
</tr>
<tr>
<td>Product and service features may or may not change slightly. The benefits emphasized may change to attract new customers.</td>
<td>New products and/or services are developed outside of existing established categories, and a whole new set of benefits is emphasized with a whole new set of customers.</td>
</tr>
<tr>
<td><strong>EXAMPLE</strong></td>
<td></td>
</tr>
<tr>
<td>Manufacturers of small pickup trucks emphasized different benefits when expanding their markets from the traditional truck market (farm and construction workers) to college students and city dwellers.</td>
<td>Apple®, originally known for its computers, developed an entire new product line around the iPod® which promises personalized, portable music and iTunes®, an easy-to-use online store to download music. Many of these customers have not owned an Apple computer.</td>
</tr>
</tbody>
</table>
The Importance of Features and Benefits
You may have noticed in the examples on p. 156 that the terms benefits and features were prominent in each description. This distinction is an important concept in developing and marketing a product or service. Features are characteristics that your product or service does or has. For example, some ovens include features such as self-cleaning, smooth stovetops, warming bins, or convection capabilities.

Benefits are the reasons customers buy the product or service. For example, the benefits of some ovens to buyers include safety, ease of use, affordability, or—in the case of many ovens that feature stainless steel casings—prestige.

Just like products, services differ from one another in having distinctive features and benefits, though these differences may not always be so obvious to potential customers. One building contractor may use master painters while a second uses laborers to paint. Both will tell you they do painting, but one has master painters (a feature) and produces a better-looking paint job (a definite benefit).

Every product or service has a purpose. For example, the purpose of an oven is to bake raw food, but not all ovens have the same features and benefits.

The uniqueness of a product or service can set it apart from the competition. Features can communicate the capability of a product or service. But features are only valuable if customers see those particular features as valuable. You want products or services with features which customers perceive as valuable benefits. By highlighting benefits in marketing and sales efforts, you’ll increase your sales and profits.

It’s important to remember that customers buy products and services because they want to solve a problem or meet a need. Consciously or unconsciously, your customers will always be asking the question, “What’s in it for me?” Your product and service offerings have to deliver solutions and satisfy needs, or they won’t be successful.

Given that benefits are ultimately more important to your customers than features, it is imperative that you understand the benefits your products and services provide, emphasize these benefits in your sales efforts, and update your products and services when new or additional benefits are desired by your customers.

Think about how automotive manufacturers advertise. To sell minivans, they don’t emphasize the layout of the vehicle or its carrying capacity. They show images of happy families loading their kids, sports equipment, and toys into the vehicle. They emphasize the benefits above and beyond the features.

Here are some other examples emphasizing benefits beyond the features:
• A website shopping cart vendor who offers hosted solutions to medium-sized businesses can emphasize the convenience and time-savings of not having to maintain a website. It’s selling convenience, not software.
• A carpet company might be more successful if it illustrated how its carpets could help create attractively decorated interiors. Pictures of beautiful rooms could be more beneficial than a stack of carpet samples or a list of fabric features. It’s selling beauty, not carpets.
• A consulting company might focus its marketing efforts by highlighting its end product—improved performance and increased profits—not its consulting methods. It’s selling profitability, not consulting.
• A manufacturer of computer printers might emphasize less hassle or less wasted time rather than emphasizing reliability or quality. It’s selling ease-of-use, not printers, and not quality.
• A salmon fishery might emphasize the health benefits of eating salmon. It’s selling health, not fish.
When Do Features Matter the Most?
Features always matter because they provide your customers with hints about how well your product or service will deliver its benefits. Although benefits are generally more important than features, there are some times when features make all the difference:

- When all the products in a category provide the same basic benefits, a unique feature may provide a competitive advantage. For example, when all boom boxes played tapes and CDs, the one with the bass booster stood out even though the benefit to the consumer was minimal. As another example, when all leadership consultants referred to similar performance improvement outcomes, the ones who developed online diagnostic tools distinguished their work from competitors.

- When products or services can be easily compared with competitors’—as the Internet makes increasingly possible—consumers can choose products and services with the most features. Thus, even though most cell phones will provide its owner with the same general benefits for communication, a person considering which cell phone to buy may not choose a certain model if it is missing a feature not found on a competitor’s phone. For example, if one phone has Bluetooth connectivity and a second one does not, consumers may choose the one with this extra feature even if they don’t even know what Bluetooth connectivity is. It’s not that such connectivity is important, it’s just that it is so easy to compare the feature sets.

Distinguishing between features and benefits will be a part of your Product/Service Plan which you will work on for Action Step 5.1. In the next module, you will use this information in planning how you will communicate these features and benefits to the customers most likely to respond to your marketing messages.

What Do Your Customers See as Your Competitive Advantage?
In Module 3 you were asked to outline your competitive advantages. You may have naturally identified your advantages from your perspective. For better or worse, your customers may have different perceptions than you. Suppose you think of yourself as the most service-oriented company in your industry, but your customers buy from you because of your premium image. If you don’t know this, you’re liable to change something that has made you successful, or you may miss out on opportunities to strengthen your position.

Levi Strauss & Co., maker of Levi’s® jeans and Dockers®, was once stunned by the results of a customer survey and follow up interviews of some select customers on videotape. Their customers were dissatisfied with their poor distribution and service. As a result, big changes were made. Levi’s discovered two things. First, their customers bought from them because of their brand dominance. Second, they were in danger of losing out to competitors who offered similar brand strength but who provided superior customer service.

Your company will build a competitive advantage when it:

- Provides products and services that are deemed valuable by its customers.
- Differentiates itself from other competitors in the market.
- Uses expertise, processes, or formulas that are difficult for others to copy.
“If you can’t do it better or different than your competitors then you are wasting your time,” maintains Carol Frank, founder of Avian Adventures®, Inc., a company based in Dallas that provides high-end cages for exotic birds.

After owning a pet shop and distributing bird products for several years, Frank saw a need for a better birdcage. To create a unique design that could not be confused with competitors, she hired a bird curator who had a master’s degree in landscape architecture and years of experience at the Dallas Zoo.

Launched in January 1996, today Avian Adventures generates more than $2 million in annual revenue.

Source: “Do As I Say, Not As I Did!: Gaining Wisdom in Business Through the Mistakes of Highly Successful People,” by Carol Frank (Entrepreneurial Adventures, March 2005).

Learning What Is Valuable to Your Customers
Improving your products and services should be done with your overall strategy in mind and with a deep understanding of your customers. To do this you need to learn what your customers—and potential new customers—find valuable. Their previous buying decisions will provide some good hints, but you’ve got to do everything you can do to learn about your customers. Talk to them. Survey them. Interview them. Read about them. Spend time with them. Hold focus groups. Show them prototypes and ask for their response. One of the best questions to ask is, “Why do you buy our products and services instead of others?”

Also, don’t forget your previous customers and your non-customers. Previous customers might have gone elsewhere because a competitor was offering something you weren’t providing or because of some change you made. You may get biased results if you only look at your current customers. For example, a coffee shop that didn’t sell tea wouldn’t learn much about the untapped market of tea drinkers by surveying only its coffee-guzzling patrons.

Finally, it’s good to remember that you can’t and shouldn’t try to please everyone. Don’t run off willy-nilly and make changes unless you hear the same message from a wide cross-section of your customers.

Use the following chart to think about what your customers find most valuable in relation to your product and service offerings.

| Tip |
| To encourage participation in a customer survey, offer something of value in return—a discount on their next purchase, inside information, or just an acknowledgement of gratitude. |

To stand out from the crowd, you need to be better or different than your competitors. This requires a deep understanding of your customers and how they value your products and services.
## Customers’ Motivators

Customers are motivated to buy your products or services because of the benefits they receive. The benefits help solve problems or simply meet the customer’s desires. Consider your customers’ needs and wants. Place a check beside the sample motivators that may influence your customers.

<table>
<thead>
<tr>
<th>Sample Actions</th>
<th>Sample Motivators</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAVE…</td>
<td>Time</td>
</tr>
<tr>
<td>PROTECT…</td>
<td>Investment</td>
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<tr>
<td>REDUCE…</td>
<td>Investment</td>
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<tr>
<td>INCREASE…</td>
<td>Satisfaction</td>
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<tr>
<td>IMPROVE…</td>
<td>Earnings</td>
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<tr>
<td>MAKE…</td>
<td>Money</td>
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</tbody>
</table>

### Specific Customer Motivators

Use the general categories listed above to help brainstorm answers.

What benefits do my customers ultimately seek from my products and services?

In what specific ways are my products and services meeting my customers’ needs?

What changes might I make to my products and services to better meet my customers’ needs?
Product/Service Life Cycle

Just as businesses go through stages, so do products and services. The product or service life cycle is determined by how long it is marketable. The life cycle of the home telephone is coming to an end as more and more cell phones are being purchased. The life cycle of the iPad is entering its growth phase as more and more people try the product.

The common stages a product or service may go through during its life are introduction, growth, maturity, and decline or innovation.

**Introduction stage**—Profits are low in this stage because research and development, production, and marketing costs are high. Prices are set high on the product or service to recoup some of the development and introduction costs. For example, microwave ovens that can now be purchased for $50 were priced between $2,000 and $3,000 when they were first introduced. In this stage, you’ll want to keep a close watch on the market’s reaction to your products and services and be ready to make changes. It sometimes helps to experiment with several different product and service configurations to see what works in these early stages.

**Growth stage**—Sales generally increase with the demand for the product. Cash flow improves and profits are at their peak. When real estate is being developed, there is an increased demand for construction and the products and services that support the development. Continue to make refinements to stay ahead of the competition. Build product and service development capabilities with the cash you get from increasing sales.

**Maturity stage**—Sales may continue to increase or level off. Profits decrease since prices are continually lowered to compete. Still, a great amount of cash flow is generated through sales. Conduct market research to determine trends. Invest in research and development. Adapt your product or service to meet the coming trends. If you don’t look for new opportunities in new markets and new products, the coming decline stage will leave you with products and services that no longer sell.

**Decline or innovation stage**—Sales drop rapidly even though prices continue to fall. Profits are extremely low at this stage, but the product or service has generated sufficient cash flow during its life. When a product or service hits this stage many entrepreneurs reintroduce it with a new feature or create a new benefit. Simply increasing the size of a candy bar by 33 percent can start its life cycle over again. Consider making changes to your product or service or the way you market it. You may decide to discontinue your product or service before losses eat into the cash flow generated by sales.

Knowing where your products or services are in their life cycle will help you determine refinements or adjustments you may need to make to align them with the vision and strategy you developed in Modules 1 through 3.
Brainstorming Product/Service Enhancements

Now that you’ve read the material above on market needs, features and benefits, competitive advantage, and the product life cycle, it’s time to put it all together to brainstorm ways that you can push beyond your current practices. In earlier modules, you may have already decided one or two growth strategies. This chart gives you an opportunity to focus on the details of how to accomplish your strategies.

How might you modify your product and service features or change your emphasis in how you talk about their benefits? Write your ideas in the chart below.

<table>
<thead>
<tr>
<th>Product/Service Ideas</th>
<th>Current Product/Service</th>
<th>New Product/Service</th>
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<tbody>
<tr>
<td><strong>Current Market</strong></td>
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<tr>
<td>Market Penetration</td>
<td>Ideas to Consider:</td>
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<tr>
<td><strong>New Market</strong></td>
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<tr>
<td>Market Expansion</td>
<td>Ideas to Consider:</td>
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Of the ideas you’ve listed, which two or three are worth considering within the next six months or so?
Stay Within Your Core Competencies

Because a core competence is a capability that could help your business achieve a competitive advantage, selecting products and services that can be offered within your current core competencies just makes sense. In Module 3 Making Strategic Decisions, you outlined your company’s core competencies in Action Step 3.1.

From time to time as you think about your customers, opportunities for new products or services or refinements will occur to you. Some of these will be within your company’s core competencies, but some will be clearly beyond your strengths. While it is sensible to first consider opportunities within your core competencies, those outside your core competencies may deserve some consideration as well.

Sometimes companies can create breakthrough products or services by pushing beyond their skill set. Sometimes companies have to move beyond their skills to survive. In the early days Microsoft had limited competency in building web-browsing technologies, and Netscape ruled the web. Realizing the competitive danger in being a backseat player when the market was driving toward Internet connectivity, Microsoft invested heavily in research and development to create Internet Explorer® which eventually dominated the Internet with a 95 percent market share.

While Microsoft’s wild success may encourage you to push beyond your core competencies, be careful. Microsoft had over $20 billion in the bank at the time. They could afford to create a new set of core competencies. Most entrepreneurial companies don’t have that type of luxury. On the other hand, if you find yourself in an industry that is becoming obsolete, you may be forced to take a chance with fundamental change.

One engineering technology entrepreneur wanted to share his theories of leadership outside his current market and explored the possibility of starting a magazine about technology leadership as a spin-off of his consulting business. During exploratory research, he found out quickly that magazines are not so much about information dissemination as they are about advertising and marketing—areas well outside his core competence. He decided to stick to what he knew best.

Taking a Hard Look
Before Committing to Product/Service Development

Answer these questions before pursuing new products/services for existing markets or new products/services for new markets. These questions will help you consider the strategic and tactical pluses and minuses of investing in new product/service development.

Circle the answer that best describes your current situation.

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes</th>
<th>Maybe</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does adding a product/service to meet customer demand make sense with my overall vision?</td>
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<td>Will a new product/service fit within my existing organizational structure?</td>
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<tr>
<td>Will daily operations of the new product/service mirror the operations of existing product/service lines?</td>
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<tr>
<td>Is research concerning the new product/service currently available so development can begin immediately?</td>
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<tr>
<td>Will the same profit margin apply to the new product/service?</td>
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</tbody>
</table>

Answering yes to these questions identifies new product/service offerings that may be a good fit with existing capabilities and your newly devised business strategy.
Protecting Your Product/Service

Being an entrepreneur means that you’re building something of value. You wouldn’t do all the hard work of building a wooden house without protecting it with paint—and it’s more than just the investment of time, sweat, and money. Many entrepreneurs feel more like parents than builders. As a parent, you would do everything possible to protect and nurture your children. You wouldn’t let your children play in the street or wander off with strangers. You’d protect them with all your heart and soul. An entrepreneur’s business needs and deserves the same kind of protection.

This section describes several things you should be doing to protect your business and comply with governmental regulations.

Identify and Protect Intellectual Property

You can create a competitive advantage for your company by developing expertise, processes, and formulas that are difficult for others to copy. This intellectual property can include much more than just patents and trademarks. Certain aspects of the way you do business can create a competitive advantage. This advantage can realize further profitability when your product and service and the expertise, processes, or formulas used to bring them to life are protected.

You can also use intellectual property to increase the value of your company. For example, one strategy might be to patent inventions to keep competitors from using the same technology for a period of time. Most often, branding enhances the value of your product or service and develops a large loyal customer base. Trade and service marks such as logos, tag lines, packaging and image, as well as product or service improvements and new products all combine to create value for your company.

The following section is a brief overview of intellectual property. For additional information, read A Closer Look @ Protecting Intellectual Property on pp. 186–189.

Intellectual property takes three forms: legal such as patents, trademarks, copyrights, and trade secrets; human such as employees’ knowledge and skills; and relational such as customers, suppliers, independent contractors, and consultants.

Legal Protection

Protecting intellectual property is critical to the growth, value, and stability of your company. But it’s not a one-time event. You can’t just register a trademark, file a copyright, or obtain a patent and be done with it. You need to guard your intellectual property and challenge competitors who tread on your turf. Once intellectual property is legally protected, a company must guard and maintain its rights zealously. If a company allows others to use its trademarks or copyrights or infringe upon its patent without legal challenge, its intellectual property rights may slip into the public domain and become public property.

Success alone can eliminate intellectual property. A name can become so dominant it takes on a generic meaning. For example, brand names such as Kleenex®, Xerox®, and Ketchup® have become synonymous with a type of product rather than a single brand. Unfortunately, protecting intellectual property rights takes time and money but defending those rights is what will maintain their value for your business. To learn more about patents, trademarks, service marks, and other legal tools, refer to A Closer Look @ Protecting Intellectual Property on pp. 186–189.
Human Protection
Entrepreneurs often say that their most valuable assets are their employees. Of course, your employees don’t show up on your Balance Sheet as an asset, and they aren’t owned by you or your company. Still, they can be the most critical aspect to creating and sustaining a competitive advantage. Employees use knowledge of a recipe, process, or formula to make a product or provide a service. This knowledge can be protected to prevent others outside your company from using exactly the same recipe, process, or formula. You can also protect the business against the loss of key employees and the information they may possess.

How do you protect against the loss of key employees and the knowledge they possess? Many of your employees will develop knowledge that is immensely valuable to your business’s continued success. You should use non-compete and non-disclosure clauses in employment contracts. Of course, the law will only allow you to restrict your employees’ activities for a period of time after they leave your company (usually about a year). It wouldn’t be fair to them to hinder their ability to make a living.

Legal options are not your only avenue of protection, of course. You can also obtain a fair amount of protection by being a respected employer, developing trusting relationships with your key employees, and helping them advance their careers.

Relational Protection
Your and your employees’ relationships with your customers, suppliers, independent contractors, and consultants are all a form of intellectual property. These relationships and the knowledge of how these customers, suppliers, and others operate have been built up over time and are of significant value. To the extent that intellectual property consists of knowledge—perhaps recorded nowhere but in the minds of your employees—it must not fall into the hands of your competition. You can’t lock it up or file it somewhere. You must prevent your employees from divulging or using it to compete with you.

To protect your company from employees sharing secret information, you will want to have all employees sign a non-disclosure and non-compete agreement that legally prohibits them from disclosing certain information during or after their employment or from going to work for themselves or others in competition with you. Such agreements are obviously easiest to obtain from employees as a condition to hiring them. You can use exit interviews to remind them of their obligations. As a last resort, litigation can prevent them from violating their agreements. These agreements must be reasonable in scope and duration and should always be written by your attorney.
## Protecting Your Intellectual Property

**Instructions**

Every business has some form of intellectual property. The following list of intellectual property items may help you identify the intellectual property of your business.

1. Place a check beside those items you will use to create a competitive edge and build value in the business.
2. Write your action steps in the column to the right.

<table>
<thead>
<tr>
<th>Instructions</th>
<th>Action Steps</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business name</td>
<td>What should I be doing now to protect my company’s intellectual property?</td>
</tr>
<tr>
<td>Business logo</td>
<td>Unless you’re completely up-to-date in protecting your intellectual property, write a few things in the space below that you’ll do within the next two weeks to protect your business:</td>
</tr>
<tr>
<td>Product packaging</td>
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<tr>
<td>Marketing brochures</td>
<td></td>
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<tr>
<td>Price lists</td>
<td></td>
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<tr>
<td>Letterhead</td>
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<tr>
<td>Product/Service design</td>
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<tr>
<td>Useful process, machine, product, or compound</td>
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<tr>
<td>Decorative appearance of an object</td>
<td></td>
</tr>
<tr>
<td>Word, name, device, or symbol that identifies products or services</td>
<td></td>
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<tr>
<td>Slogans or phrases used in advertising</td>
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<tr>
<td>Customer list</td>
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<td>Supplier list</td>
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<tr>
<td>Manufacturing technique</td>
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<td>System of operation or processes</td>
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<tr>
<td>Other:</td>
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<td>Other:</td>
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</table>

For assistance in protecting your intellectual property, ask your general business lawyer to recommend an intellectual property attorney. For more information, read A Closer Look @ Protecting Intellectual Property on pp. 186–189.

### Address Your Limitations and Reduce Your Liabilities

In addition to protecting your intellectual property, you need to periodically review another way of protecting your business—analyzing the ability of your company to produce products, deliver services, and create new products and services.

### Limitations

Are the limitations in your existing products or services fixable? Do you have the current expertise or staff time to alleviate the problems? What limitations might you find in new products? Do you have the resources to make refinements? How does your business strategy help you take appropriate actions to combat these limitations? Where will the additional staff and expertise come from? How will they be persuaded to join your business? What impact on the financial plan will occur because of additional payroll, costs of new or remodeled production facilities, more raw materials or inventory, or the need for additional cash to carry the business expenses in a growth or retooling phase? All of these factors are related. None stand alone. It is not enough to project new products or services; all aspects of your business will be affected by their delivery and must be realistically calculated and planned.

### Tip

It is not a failure to realistically assess a product or service as having unfixable limitations; it is a failure to allow your business to die as a result of them.
Imagine being the product manager for St. Joseph’s® Children’s Aspirin when the first studies came out suggesting that aspirin could be dangerous for children and teenagers because it can cause Reye’s Syndrome. Although this type of limitation may be difficult to anticipate, you can increase your chances if you try to brainstorm potential limitations and solutions. Even though the product immediately lost its main market after the medical reports surfaced, in 2000 McNeil Pharmaceutical bought the brand and is now repositioning the aspirin for adults to prevent heart attacks.

**Liabilities**
Successful entrepreneurs think about liabilities, so that they can overcome them or limit their effect. With the help of trusted advisers, consider potential liabilities inherent in your new or existing products or services and develop strategies to address them. In some situations, liability can be limited by the way you design, produce, package, label, and provide instructions concerning your product or service. You will also want to consider insurance or other forms of risk sharing to minimize the impact on your business should liability be assessed. You may be liable for:

- Negligent product design or packaging.
- Inadequate product or service testing.
- Failure of the product to be safely used for the purpose it is intended.
- Failure to adequately warn against misuse.
- Environmental damage.
- Safety violations.

Liability is not limited to product-centered companies. Any company—service provider, manufacturer, wholesaler, distributor, or retailer—can be liable for injuries or damages to others from the use or misuse of a product. Service companies are also at risk if the services involve any exercise of professional judgment, such as medicine or law. Other services share in liability risk as well, such as fulfillment businesses and suppliers through which failure or inadequate performance can cause severe economic damage to your customer. Carefully evaluate every product or service in terms of its potential liabilities.

Equally as important as identifying a potential liability is outlining plans to protect your business and personal assets against a potential lawsuit. The choice of legal structure, discussed in detail in Module 7, is the primary protection of your personal assets. Business assets may be at risk as a result of injuries or damages caused by the business.

Insurance and risk assessment and avoidance analysis can shield your business from catastrophic losses. Trade associations are a good source of liability exposure and protection information. Often, such associations collectively bargain for and obtain group rates for insurance not otherwise available. Consult an experienced attorney and fully understand the warranties both expressed and implied in product or service liability. You should have, at a minimum, a general business liability policy. A good independent insurance agent or risk consultant can help you define your particular needs.

**Provide Adequate Production Facilities**
The finest product or service with the largest potential market is still not viable without production capacity. Your planning should start with a candid assessment of current production capabilities. *Internal Assessment*, pp. 13–14, and the SWOT analysis in Action Step 1.1 should have already given you some idea of your business’s current capabilities. What strengths, weaknesses, opportunities, or threats regarding production and facilities were revealed? Perhaps your present facility is inadequate to meet current demand. Perhaps it is underutilized. Are your production personnel able to meet quality and quantity standards, or will better-trained or more skilled personnel be necessary? Can they produce your modified or new products or services? Production and facility planning starts with your current assessment and then solves problems or projects future needs.
Service providers may or may not need brick-and-mortar production facilities. Training companies need to be able to print training manuals. Web-hosting companies need special facilities to maintain and store servers. Construction companies need a place to warehouse supplies and materials. In addition to these physical production facilities, some service providers should consider whether they have the human-capital infrastructure to produce intellectual capital. Consulting firms often need the capacity to generate ideas and procedures requiring intensive labor effort and skills and special facilities like meeting rooms or project-team space.

Whether you’re a product or service firm, consider benchmarking your production process against your industry-leading competitors when designing or renovating your production processes. Look at competitors’ production processes and evaluate your company’s performance on these factors:

- Production capacity
- Absence of errors or reworks
- On-time processes and delivery
- Inventory reduction
- Cost reduction
- Other criteria relevant to the product or service

**Identify Excellent Suppliers**

If your business depends on suppliers to produce products or offer services, evaluate the effectiveness of your relationships with current suppliers. Your new business strategy may involve establishing new supplier relationships. If so, you will spend a lot of time planning your business and working towards achieving your vision. Do not risk your success on the performance of an unknown supplier.

One way you can improve your chances of finding good suppliers is to create a supplier-selection process. Ask and answer these questions before you set up any long-term relationship with a supplier:

- Who else does this supplier do business with?
- What is the supplier’s strategic plan?
- How is the company doing financially?
- What alternative companies should we consider?

If companies want to do business with you, they may be willing to provide basic financial information to help you evaluate their long-term viability. If they are not willing to provide this information, you can check on their credit ratings or obtain information from the Better Business Bureau or commercial rating agencies such as Dun & Bradstreet®. Don’t ignore what you find out. It may mean the difference between success and failure.

**Comply with Governmental Regulations**

Your company must comply with all federal, state, and local governmental regulations and obtain all licenses and other permissions before beginning or expanding operations. Most of these requirements were created for the purpose of putting people on various tax rolls, such as income, sales, Social Security, workers’ compensation, unemployment, and personal property (inventory). Other requirements have been established to prevent a person from doing things considered dangerous or undesirable.

Part of planning is being alert to and learning precisely which regulations do (or will) apply, how compliance is obtained, and the costs of doing so. Growth, expansion, the addition of more personnel, a shift in the product or service, an increase in the gross profit—any or all of these may result in new or different governmental requirements.
All businesses, regardless of type, must comply with regulatory agencies from all levels of government—federal, state, and local. For more information about the regulations that may apply to your business, refer to A Closer Look @ Complying with Governmental Regulations on pp. 190–192.

The many decisions you are making about your product or service will be captured in your Business Plan. The improvements, as well as the ways you will protect your product or service and comply with government regulations, will be part of your Product/Service Plan. The remainder of this module will focus on decisions included in a major section of the Marketing Plan—Pricing.

**Pricing Your Product/Service**

The prices you charge are one of the most critical components of your product and service feature set. They’re not just numbers. They tell your customers about the product or service they are buying. They convey the value of the product. They prod customers to buy or not buy. They can support your brand image or make it fuzzy.

Prices affect almost every aspect of your business including your brand image, your sales numbers, your cash flow, your profits, your ability to make investments in business operations, marketing, and even new-product or service development.

How you price your products and services has a direct impact on these six factors:

**Sales volume**—Sales volume correlates with the prices being charged for products or services. Higher prices often mean lower volume, whereas lower prices generally result in higher volume. Some entrepreneurs can charge more because of additional or perceived benefits of their products or services.

**Sales revenue**—Prices set for products or services will affect the total revenue projection. If prices increase, sales volume may decrease, causing an associated reduction in total revenue. Products or services priced effectively, however, can increase revenue and profit.

**Market share**—How products or services are priced and the pricing position of companies will determine their market share. Sometimes, lower pricing can command a higher market share.

**Competitive advantage**—Pricing plays an important role in how companies create and maintain a competitive advantage in the market. Much of the advantage depends on how competitors price their products or services and how they respond to price variances in the market.

**Company image**—The prices for products or services create a perceived image in customers’ minds. Customers perceive some companies as the lowest-priced provider while they believe others are the market leader for quality products with high-end margins.

**Profitability**—Pricing affects companies’ Gross Margin and Net Profit. Aligned with sales volume and revenue, how products or services are priced will determine overall profitability.

---

**Factors that Influence Pricing**

| Cost of goods | Demand for product/service | Competition | Market pricing | Customer perceptions | Margin standards |

**Factors Influenced by Pricing**

| Sales volume | Sales revenue | Market share | Competitive advantage | Company image | Profitability |
The Pricing Process

How do you know if your pricing strategies are helping you meet your goals? What information do you use to determine when and how prices for your products or services should change? In this section, you’ll review the pricing process and re-evaluate the prices for your product or service.

As part of your business planning process, you’ll want to evaluate how pricing will affect two aspects of your business: your position in the market and your ability to achieve your business goals. There are so many things that you might consider, it’s often difficult to keep focused on these goals.

Although pricing is not an exact science, you can use this three-step pricing process to make the task easier:
1. Determine your pricing boundaries.
2. Fine tune to meet market opportunities.
3. Set prices.

Step 1: Determine Your Pricing Boundaries

The first step involves narrowing down your options between clear boundary conditions. After you complete this step, you will be able to refine your pricing strategies.

Businesses are structured to have a fixed range within which a price can normally reside—somewhere between a ceiling price and a price floor. The highest price you can ask, the ceiling price, is usually set by your customers. If you go above that price, you lose customers. The lowest price you can charge, the price floor, is determined by your costs. If you go below that price, you lose money on each sale.

These barriers can sometimes be pushed farther out. For example, some companies may decide to price at a super-premium level. This strategy only works when a company has a clear competitive advantage, serves a niche or special market, or has relatively few competitors. Customers who are especially attracted to the image of the products are willing to pay the price. When Starbucks® first entered the market, it was able to raise the ceiling for what consumers were willing to pay for a cup of coffee by offering a unique ambience and specialty drinks.

Other companies sometimes go below floor pricing to attract customers or aggressively compete. Some companies will try to squeeze weaker competitors by pricing below their own break-even points. For example, airlines may price flights on some routes below break-even to hurt their competition.

There are other reasons to go below break-even. Some companies use deep discounts to temporarily attract customers. Retail stores often sell some products below break-even to attract customers into the store to buy other products selling well above break-even. Service companies sometimes have to sell their services below break-even when the economy is weak in an effort to make payroll and retain their key people. Finally, sometimes companies are forced to sell below break-even because they have no other choice. An orchard may have to sell its pears below break-even if the market price for pears is low at harvest time.

Tip

Positioning is not what you do to a product. Positioning is what you do to the mind of the prospect. That is, you position the product in the mind of the prospect. —Al Ries and Jack Trout
### Pricing Against the Competition
The ceiling and floor concept provides a broad pricing range. To whittle your options further, you need to consider how your prices compare with the prices of your competitors. Essentially, you can take one of the following three pricing positions:

1. **Lower pricing levels than the competition:**
   - Lower pricing aims for a high volume of sales with low profit margins.
   - Purpose is to expand the market, steal market share from other competitors, remain competitive in the market, or keep competition from entering the market.
   - Example: a retail store offers electronics and charges 10 to 20 percent less on items than other stores in the area because it is owned by a larger entity that purchases items in bulk at lower prices.

2. **Higher pricing levels than the competition:**
   - Higher pricing aims to maintain a quality position in the market with high profit margins to support production costs and promotional activities.
   - Purpose is to offset development costs for a product with a short life span, substantiate a quality image, take advantage of a high-demand and low-supply situation, or charge more because the product or service is hard for competitors to copy.
   - Example: an award-winning landscape company prices services at a premium level to align with the high quality, unique, and environmentally-conscious designs it is known for in the community.

3. **Parity pricing levels with the competition:**
   - Parity pricing aims to keep a portion of the market without being the highest- or lowest-priced competitor.
   - Purpose is to stay in the game when little differentiation in the product or service exists or when price is the basis of competition.
   - Example: a consulting company sets its fees to be within the same range as other consulting companies that provide similar services in the area.

Consider these benefits and drawbacks of the pricing position strategies:

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Pricing Lower</th>
<th>Pricing Higher</th>
<th>Pricing at Parity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forces competitors to keep prices low</td>
<td>Profit margins are high and fewer transactions needed</td>
<td>Forces competitors to keep market prices fair</td>
<td></td>
</tr>
<tr>
<td>Attracts customers to take advantage of special or low prices</td>
<td>Brand has a higher perceived value or image</td>
<td>Creates industry standards for costs and margins</td>
<td></td>
</tr>
<tr>
<td>May increase sales and frequency of buying</td>
<td>Customers think products/services are better than others in the market</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Must be the market leader for the lowest prices or best deals</td>
<td>Attracts a small, niche portion of the market</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competes at very low margins</td>
<td>Sales volume or number of transactions may be lower than other providers in the market</td>
<td>Must maintain prices that are the same as other competitors</td>
<td></td>
</tr>
<tr>
<td>Attracts price-sensitive customers</td>
<td></td>
<td>Competes at low or fair margins</td>
<td></td>
</tr>
</tbody>
</table>

| Drawbacks | | | |
|----------- | | | |
| Must be the market leader for the lowest prices or best deals | Attracts a small, niche portion of the market | Must maintain prices that are the same as other competitors | |
| Competes at very low margins | Sales volume or number of transactions may be lower than other providers in the market | Competes at low or fair margins | |
| Attracts price-sensitive customers | | May not differentiate from other competitors | |
Pricing Constraints
Pricing constraints are those things that keep you from having flexibility in your pricing decisions. When we discussed price ceilings and floor pricing, we touched on two of these constraints. But what your customers are willing to pay (ceiling) and your break-even point (floor) are not the only constraints you must deal with.

In some industries, the government regulates prices. This can benefit or hurt you depending on the situation. If you’re in a regulated industry, you already know how this works. If you’re not, make sure you understand what you’ll be getting into if you consider moving into regulated markets.

Customer demand is often price sensitive. For some products in some markets, raising or lowering your prices will have little effect on how much your customers buy. For example, when gasoline prices go up and down, people who drive to work and have no other transportation alternatives still have to buy the same amount of gasoline each week. When housing costs go up, customers have to pay the prices if they want a place to live.

In other situations, customers can be very sensitive to price changes. If the price of beef rises, people may buy chicken instead. If one 20-inch floor fan sells for three dollars less than competitive products, a vast majority of customers may select that product instead of the more costly alternative. When competing products are very similar, prices can make a difference in people’s buying habits.

Creating Value for Customers
For most companies, even those that sell commodity products, there are ways to add value to avoid making price the only consideration for customers.

thinking beyond price
Like beauty, value is in the eye of the beholder, says Neil Parham. Owner of Eagle Packaging, a $3.5 million supplier of packing materials in Lawrenceville, Georgia, Parham can’t stand out from the crowd on product alone.

“A cardboard box is a cardboard box. A pallet is a pallet,” he says. “Unless you differentiate yourself on service, you’re competing on price—and business based on price is too easy to lose.”

With that in mind, Parham keeps his eyes peeled for nontraditional ways to serve customers. That might mean making deliveries at a particular time of the day or warehousing some purchases and allowing customers to take smaller deliveries. “There’s no recipe, no single solution,” Parham says. “It’s a matter of staying alert to opportunities.”

“If you do something special for a customer, you’re creating value for your company and generating loyalty from the customer,” Parham says. Smaller companies can offer specialized service because they’re more nimble. But it’s important to think ahead to avoid negative consequences. “You can brainstorm and come up with great things to do for customers, but it has to be economically feasible on your side,” he stresses. “Both parties should be winners.”
Follow Parham’s advice and consider ways to add value to your products and services so you are not competing on price alone. Use the following chart to analyze your current pricing strategies.

### Current Pricing Strategies

<table>
<thead>
<tr>
<th>What pricing constraints have I found in my industry?</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Costs control prices.</td>
</tr>
<tr>
<td>☐ Price is regulated by the government.</td>
</tr>
<tr>
<td>☐ Competition dictates pricing constraints.</td>
</tr>
<tr>
<td>☐ Customer demand is price sensitive.</td>
</tr>
</tbody>
</table>

How do these issues affect my prices?

<table>
<thead>
<tr>
<th>What pricing position do I currently use?</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Lower</td>
</tr>
<tr>
<td>☐ Higher</td>
</tr>
<tr>
<td>☐ Parity</td>
</tr>
</tbody>
</table>

How do my current prices match my competitive advantage?

<table>
<thead>
<tr>
<th>How do my current prices support my business strategy?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>

What pricing position is consistent with the image I want to have in the market?

| ☐ Lower |
| ☐ Higher |
| ☐ Parity |

### Step 2: Fine Tune to Meet Market Opportunities

You need to consider your target market before selecting or changing your pricing strategies. It is especially important to pay particular attention to your customers’ attitudes toward your products or services, their perceptions of the key benefits, special niches or applications, specifically targeted users, and level of quality you offer your customers.

Consider the most common pricing strategies in the Pricing Strategies checklist on p.174. Notice how they support the three pricing positions—lower, higher, and parity pricing. This exercise will help you consider broad strategies. Immediately after you make your strategy selections, you will be prompted to select some specific pricing policies to further focus your pricing planning.

### The Pricing Process

1. Determine your pricing boundaries
2. Fine tune to meet market opportunities
3. Set prices
Competitors’ Pricing Strategies

Check the strategy that represents a pricing strategy used by your closest competitors.

<table>
<thead>
<tr>
<th>Lower Pricing Position Strategies</th>
<th>Higher Pricing Position Strategies</th>
<th>Parity Pricing Position Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>❑ Penetration pricing</td>
<td>❑ Image, value, or quality pricing</td>
<td>❑ Going rate pricing</td>
</tr>
<tr>
<td>Price products/services at a loss to gain market share. Offer lower prices to get larger volume sales. Use to enter a new market or to position a commodity product. <em>Examples: car and computer accessories, food, supplies, household items</em></td>
<td>Price to match customers’ enhanced perception. Customers see brands as status symbols, in high demand with limited quantities. <em>Examples: signed, limited editions, luxury perfume, cars</em></td>
<td>Create pricing wars between competitors who offer the same or similar products/services. No one charges more to prevent loss of market share. Few competitors control pricing. <em>Examples: gasoline, airfare, hotels/motels, electrical goods</em></td>
</tr>
<tr>
<td>❑ Predator pricing</td>
<td>❑ Opportunistic pricing</td>
<td>❑ Keystone or target pricing</td>
</tr>
<tr>
<td>Deliberate price-cutting prevents others from entering the market and forces competitors to compete on price and low profit margins. Offer free gifts and bundling of products/services that competitors can’t meet effectively. <em>Examples: computer and software packages, cell phones and special provider service plans</em></td>
<td>Set premium prices for products/services in high demand with short supplies. <em>Examples: fresh fish, pharmaceuticals</em></td>
<td>Set prices to reach or maintain specific profit levels. Mark-up is standard over cost. <em>Examples: clothing and department store items</em></td>
</tr>
<tr>
<td>❑ Expansionistic pricing</td>
<td>❑ Market or price skimming</td>
<td>❑ Contribution or marginal pricing</td>
</tr>
<tr>
<td>Set low prices to establish mass markets—an exaggerated form of penetration pricing. May offer temporary price reductions to increase sales or a lower-cost version to gain acceptance and then switch to higher-cost version after purchase. Prices hurt other competitors. <em>Examples: magazine and newspaper subscriptions, software</em></td>
<td>Set premium pricing on high-demand product in the early stage of its life cycle. Gain maximum profit from the market for high-tech or new inventions. <em>Examples: smart phones, video games</em></td>
<td>Set prices to cover variable costs and a portion of fixed costs. Follow industry standards for costs and profits. <em>Examples: airfare, catering</em></td>
</tr>
</tbody>
</table>

Which pricing strategies will most likely help me achieve my goals and why?

Tip

Remember, the price of the product must be consistent with its image. The same is true for service businesses: being the cheapest consultant may create a misperception about your ability.

Specific Pricing Policies

Now that you’ve selected your general strategies, you can better decide between the following specific pricing policies. You can use policies to respond to trends, follow industry practices, and influence customers’ buying behaviors.
Pricing Policies

Which of the following pricing policies will best support your pricing strategies?

- **Volume Pricing**—Studies show that small orders are costly, and many are sold at a loss. Encourage larger orders by providing volume discounts or tiered pricing on larger orders.

- **Bundled Products and Services**—By selling related products or services together, you can increase the amount of sales per purchase and profitability.

- **Fixed Price Bid**—Instead of working for an hourly rate, give the customer a fixed price bid for the job. This practice protects the customer and provides you an incentive to work efficiently. The customer pays for results, not time.

- **High-Margin Products**—Different products usually have different gross margins. You can offset sales of lower margin items by selling sufficient products/services with higher margins.

- **Discounts for prompt or early payments**—By offering term discounts, you can improve cash flow and collect on receivables earlier. For example, you may provide a term of 2/10, n/30, which allows a two percent discount on invoices paid within 10 days of an invoice due in 30 days.

- **Payment options**—Allow customers to spread out their payments over time, with or without paying interest. Provide coupon books if payments are stretched out for six months or more, invoice a portion over two or three months, or charge an automatic payment on customers’ credit cards.

- **Responding to pricing conflicts**—Price wars are generally costly, so plan ways to avoid them. If a price war develops, try to respond creatively without matching the competitor's price cuts penny for penny. See Wayne Hampton's story on p. 155 for an example of how to avoid pricing conflicts.

### Step 3: Set Prices

You’ve now done the hard work of analyzing your pricing boundaries and relevant market forces. But there’s more hard work ahead—making your pricing decisions. In Action Step 5.2 Prepare My Marketing Plan – Pricing, you will have a chance to formalize your decisions as you describe your pricing strategies and the prices of your products and services.

As you set your prices, remember to consider the following:

- **Costs**—Consider the actual costs for producing or creating the product or service. Include fixed costs such as space and equipment leases, salaries, and insurance and variable costs such as utilities, gas, supplies, and bonuses.

- **Market price**—Review the price floor and price ceiling for similar products or services in the market. Consider how much customers are willing to pay for your product or service. A product or service must have perceived benefits that equal or exceed the asking price.

- **Price positioning**—Ensure that your pricing is consistent with the pricing position you want in the market.

- **Return-on-investment**—Factor in the profit margins you expect by a predetermined time.

### The Pricing Process

1. Determine your pricing boundaries
2. Fine tune to meet market opportunities
3. Set prices

### Tip

If the quality of a product is not apparent, price is usually the major element by which buyers determine it. Buyers often assume that high price equals high quality.
Market Pricing

What is the price range in the market for the product/service I offer?

What is the estimated ceiling price for my product/service?

Do any competitors sell products/services above the price range? If so, what increase in value do their customers perceive?

Price List
Your price list is an important marketing tool. Customers may be motivated to purchase a product or service just by reading a price list. Remember that a price list should be attractive, informative, easy to read, and easy to use for ordering. Most entrepreneurs make the mistake of including only price information with the list. A price list should clearly identify all the different products or services, how much each costs, the terms of the sale, and other information to facilitate the sales process.

- Use easy-to-complete order blanks that can be entered online, faxed, or dropped into the mail.
- Obtain a toll-free telephone number and feature it on the price list.
- Display products or services on the reverse side of the price list.

The basic principle is to make ordering or requesting products or services as easy as possible for customers. Don’t forget to include information on where and how the goods can be purchased. Experts recommend you provide at least three different ways of placing an order including traditional mail, Internet ordering, fax, phone, or e-mail.

You might also consider some extraordinary measures to keep your price list out of the customers’ files—where it won’t be seen—by placing it on some useful advertising-specialty item such as a calendar, business card holder, magnet, or paper pad holder. Of course, these creative methods will not be appropriate for all businesses.
Summary

Strengthening your products or services and aligning them with your business strategy is critical to entrepreneurial success. In this module, you looked at the life cycle of your current products or services to determine what adjustments, refinements, or new developments you need to make. Then you considered strategies for products or services that support your vision and business strategy. These include analyzing customers’ needs and wants, staying within your core competencies, maintaining your competitive advantage, clearly communicating your product or service’s features and benefits, identifying and protecting intellectual property, dealing with limitations and potential liabilities, providing adequate production facilities, identifying excellent suppliers, complying with governmental regulations, and establishing pricing strategies.

Key Things to Remember

- Every product/service goes through a life cycle and must eventually be renewed or abandoned.
- Product/service planning must align with overall vision and business strategies.
- Product/service planning directly affects a business’s marketing plan in the areas of maintaining competitive advantage and describing features in terms of benefits.
- Identifying and protecting intellectual property can build value in a business.
- Addressing limitations, potential liabilities, production facilities, supply issues, and governmental compliance can greatly enhance the alignment of the product or service with the business strategy.
- Establishing the right price for the product/service has an impact on all other aspects of the business, including marketing and financial position.

Module 6 Seizing the Market will focus on effectively promoting and selling your products or services. As you develop your marketing plan, you will use the market research completed in Module 2 with the goal of aligning your marketing strategies and activities with the rest of your business.
### Activity 5a: Link Features and Benefits

Learn to describe my products or services in terms of their features and benefits.

**Directions**

**Step 1 List features and benefits.** Using the chart below, identify the features of one of your products or services on the left and list its benefits on the right.

<table>
<thead>
<tr>
<th>Features and Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>List features of your product/service (what it does) in the left column.</td>
</tr>
<tr>
<td><strong>Features of my product/service</strong></td>
</tr>
<tr>
<td>List benefits of your product/service (why people will buy it) in the right column.</td>
</tr>
<tr>
<td><strong>Benefits of my product/service</strong></td>
</tr>
</tbody>
</table>

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### Activity 5a: Link Features and Benefits

**Step 2 Write a benefits statement.** Referring to *Customers’ Motivators* on p. 160, write a benefits statement for this product or service.

<table>
<thead>
<tr>
<th>Product/Service Name</th>
<th>Benefit – Action</th>
<th>Benefit – Motivator</th>
<th>Feature</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flex-n-go office chairs</td>
<td>will improve</td>
<td>employee relations and productivity</td>
<td>by providing comfortable, ergonomically correct seating options.</td>
</tr>
</tbody>
</table>

**Customer Motivators**

<table>
<thead>
<tr>
<th>Sample Actions</th>
<th>Sample Motivators</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAVE…</td>
<td>Time</td>
</tr>
<tr>
<td>PROTECT…</td>
<td>Investment</td>
</tr>
<tr>
<td>REDUCE…</td>
<td>Investment</td>
</tr>
<tr>
<td>INCREASE…</td>
<td>Satisfaction</td>
</tr>
<tr>
<td>IMPROVE…</td>
<td>Earnings</td>
</tr>
<tr>
<td>MAKE…</td>
<td>Money</td>
</tr>
</tbody>
</table>
Activity 5b: Strategy, Products/Services, and Prices

Align strategy, products/services, and prices.

Directions

The prices you set for your products or services depend on how they compare to the competition as well as your overall business strategy. Evaluate your current prices and determine if any adjustments are needed.

Step 1 State your pricing position. In a few sentences, describe whether you will use lower, higher, or parity pricing in comparison to your competition. Is this pricing in line with the benefits your products or services provide your customers? Explain how this pricing position helps you compete in the marketplace. Refer to Current Pricing Strategies on p. 173 and Competitors’ Pricing Strategies on p. 174.

Step 2 Determine your pricing strategy. State how your strategy will help you remain competitive and retain a reasonable profit. If you have more than one pricing strategy, indicate the rationale behind each. Refer to Current Pricing Strategies on p. 173 and Market Pricing on p. 176.

Step 3 Set your prices. Identify how you will set or refine your prices to align with your pricing strategy and position. Refer to Market Pricing on p. 176.

Step 4 Determine your pricing policies. Identify which pricing policies will enhance your pricing strategy and position. Refer to Pricing Policies on p. 175.

Step 5 Share your responses with a partner.
Action Step 5.1: Prepare My Product/Service Plan

Define my Product/Service Plan using the Business Plan Template.

Directions
Product/Service Plan is the first major section of the Business Plan you will write. Throughout the process of writing a Business Plan, you will want to continually update previously completed sections. For example, you will probably find that you need to update the Product/Service Plan later in the program as additional information becomes available.

Even if you are not planning to complete a written Business Plan, use the Business Plan Template to capture the planning you have done in this module with regard to your product/service.

A. Use the business planning template. For this action step, you will use the Business Plan Template document you started in Action Step 3.2 Write My Executive Summary. Go to the Product/Service Plan in the template to insert your information. Each section of the template contains headings with questions in blue text which will not appear when you print the document. Consequently, your answer should incorporate the question. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. Answer all of the questions that apply.

B. Respond to the questions and statements below. Turn your responses into complete sentences and paragraphs to finish the first draft of your Product/Service Plan. If you cannot answer a question completely, answer as well as you can and make a note to do further research and determine the answer later in the program.

Product/Service Plan

Purpose of Product/Service
What is the purpose of the product/service?
How does the product/service benefit the customer?
Does it solve a problem or address an opportunity?
Is it a luxury item or a needed good?

Features and Benefits
What are the unique features of the product/service—such as cost, design, quality, and capabilities?
What benefits does the customer receive?
What problem is solved for the customer?

Stage of Development
What is the history of the product/service life cycle, and in what stage of development is the product/service?
When do you plan to achieve other stages of development?

Intellectual Property
How will you protect intellectual property?
What patents, trademarks, or copyrights have been obtained or which ones will be pursued?
What licenses or royalty agreements are associated with the product or service, and what plans have been made for future agreements?
What distribution rights have been obtained or given away?
Action Step 5.1: Prepare My Product/Service Plan

Governmental Approvals
What governmental approvals are necessary, and what is the status of such approvals? (Examples of agencies providing governmental approvals include the FDA, EPA, FCC, USDA, OSHA, IRS, secretary of state, state department of revenue and taxation, workers’ compensation division, health departments, and planning and zoning commissions.)

Product/Service Limitations
What are the inherent product or service limitations, if any? (Include perishability, limited shelf life, installation needs, legal restrictions, staff availability, or other relevant limitations.)

Product/Service Liability
What are the liabilities this product/service may pose?
What are the insurance requirements and costs?
What other factors may reduce or eliminate product/service liability?

Related Products/Services and Spin-Offs
What related products/services will be provided, and how will they increase or enhance the profitability of the venture?
What new product/service (spin-offs) could be developed to meet changing market needs in this industry or others?

Production
How much will be produced internally, and how much of the production will be subcontracted out?
What are the costs and services involved with subcontracting?
Who are the backup subcontractors, what are their costs, and who supplies the services? (Include shipping, billing, inventory, stocking, and payment terms.)

Facilities
What are the plans for facilities (manufacturing, office, retail)? (Include manufacturing facilities, production capacity, and future capital required to build facilities.)

Suppliers
Who are the major raw material or service suppliers, and what are the significant purchasing contracts with them?
Are there back-up suppliers?
Action Step 5.2: Prepare My Marketing Plan – Pricing

Complete the Pricing section of my Marketing Plan.

Directions
You will write the majority of your Marketing Plan after you complete Module 6, but because you have considered pricing in this module, you can begin to record your planning process for that aspect of the Marketing Plan now. You may want to come back to this section after reviewing the financial sections and determining your business costs.

A. Use the business planning template. For this action step, you will use the Business Plan Template document you started in Action Step 3.2 Write My Executive Summary. Go to the Pricing section of the Marketing Plan in the template to insert your information.

Each section of the template contains headings with questions in blue text, which will not appear when you print the document. Consequently, your answers should incorporate the questions. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. Answer all of the questions that apply.

B. Respond to the questions and statements below. Turn your responses into complete sentences and paragraphs to complete the first draft of your Pricing section of the Marketing Plan. If you cannot answer a question completely, answer as well as you can and make a note to do further research and determine the answer later in the program.

Pricing

Pricing Structure
What are your short-term and long-term pricing strategies?
What pricing constraints and sensitivities exist for your product or service?

Price List
What is your price list, including purchase price, quantity discounts, introductory offers, shipping costs, and warranties or maintenance contracts?

Pricing Policies
What are your pricing policies including volume pricing, avoiding price conflicts, and bundling products and services?
Action Step 5.3: Finalize My Product/Service Financial Projections

Finalize the financial projections associated with your company’s products and services.

Directions
In Action Step 4.2, you used the Financial Template to create an initial budget that will be used to compile financial information throughout the planning process. This jump start on the budget resulted in financial statements that you will update and improve as new information becomes available. Information about how to use the Financial Template can be found in A Closer Look @ Using the Financial Template, p. 138–143.

A. Review your initial budget. You entered the costs associated with your company’s products and services into the Financial Template in Action Step 4.2. From the Worksheet tabs or the Print Options tab, print the following worksheets to review your initial figures:
- Inventory Worksheet (for companies that sell products)
- Operating Expenses Worksheet
- Capital Budget Worksheet

B. Analyze the figures associated with your product or service. Each projection should reflect facts collected either from the company’s own historical financial statements or from outside sources. Look at the following lists of possible costs associated with a company’s product or service.

As you review this list, analyze your own figures. Have you included each cost item that applies? Are the projected costs supported by adequate research from trusted sources? If you can answer yes to both of these questions, or if the cost does not apply to your business, place a check in the boxes below. For those items that do not receive a check, research additional sources to identify changes that might be necessary to more accurately represent this figure in your final budget.

Remember:
The Financial Template contains all projected costs for your business entered into three main worksheets—Inventory, Operating Expenses, and Capital Budget. Because of this process, categories on each worksheet may contain figures associated with products and services as well as other costs of doing business such as marketing or management. For example, Professional Fees may include the legal fees associated with product protection as well as fees for legal organization.

If you have products, direct costs associated with producing these products are entered on the Inventory worksheet. For example, payroll expenses for production are recorded on the Inventory worksheet, whereas payroll expenses for marketing or administration are recorded on the Operating Expenses worksheet. Be careful not to duplicate these expenses.
Action Step 5.3: Finalize My Product/Service Financial Projections continued

Inventory Worksheet Considerations

- **Insurance** – Against casualty loss of raw materials as well as finished goods, workers’ compensation
- **Payroll Expenses** – Salaries, wages, and payroll taxes of workers involved in production
- **Benefits** – Health, retirement, and death benefits for workers involved in production
- **Rent** – Storage of raw materials and finished goods
- **Rework** – Costs to rework sub-standard finished goods or services provided
- **Subcontracting** – Cost for work performed by others outside the business

Operating Expenses Worksheet Considerations

- **Insurance** – Product/Service liability, business premises, and general business liability
- **Licenses & Fees** – Local inspection fees and business licenses, intellectual property filings
- **Professional Fees** – Consultations with attorneys about protecting intellectual property such as obtaining a patent, registering a trade or service mark, preparing non-disclosure and non-compete agreements, or “work made for hire” contracts; accountant’s fees for setting up accounting records for sales tax and withholding; attorney or risk management consultant regarding warranties and liability protection
- **Rent** – Production facilities
- **Repairs & Maintenance** – For production facilities and equipment
- **Utilities** – For production
- **Other** – Research and development for new or improved product/service

Capital Budget Worksheet Considerations

- **Computer Equipment** – For doing the work of the business as well as administration, including software and peripherals
- **Equipment & Machinery** – For production—anything from a 100-ton press to a cash register
- **Furniture** – Desks, chairs, file cabinets, waiting room, display cases, bookcases, and other furnishings
- **Vehicles** – Those used in and owned by the business
- **Leasehold improvements** – The walls, ceilings, floors, or fixtures the business must pay to decorate, make the space suitable for the business, or comply with governmental laws or regulations such as OSHA, ADA, health and safety codes, or zoning regulations in a rented space
- **Building** – If buying or building, the cost of labor and materials as well as permit and inspection fees

C. Make appropriate changes. Based on the new information available, enter changes into the Inventory, Operating Expenses, or Capital Budget worksheets to more accurately represent projected costs for your product or service in the Financial Template.
A Closer Look @ Protecting Intellectual Property

Many people think the only intellectual property a business might have is a patent or trademark. Every business has some form of intellectual property; it could be the name of the business, its logo, or its packaging. Brochures, price lists, letterhead, fanciful product or service names, a color scheme, font type, or a combination of these are intellectual property which identify the business and its products or services. Intellectual property is a great way to build value in a business. It means you have something more to sell than simply the hard assets. The value of the business is not determined solely by an examination of its financial statements.

Have you identified all of the intellectual property in your business? Have you adopted a strategy to develop it? Are you maximizing its value? Strategic planning answers these questions.

Intellectual property takes three forms: legal, such as patents, trademarks, copyrights and trade secrets; human, such as employees’ knowledge and skills; and relational, such as customers, suppliers, independent contractors, and consultants. Entrepreneurs must be able to explain what intellectual property the business owns, what intellectual property it will develop, how it is or will be protected, and how it will increase the value of the business.

Tip
Spending money to obtain a patent for an unmarketable product is foolish. Don’t consider a patent unless you can verify that it will pay off over time.

Patents
A patent is a grant of a legal right by the United States to certain property for a term of seventeen years. What is granted is not the right to make, use, sell, or import but the right to exclude others from doing so. Any person who invents or discovers a new and useful process, machine, product, or compound can apply for a patent. When a patent expires, anyone is able to use that previously protected knowledge. All of the patent holder’s rights are gone.

Patent law is a complex field that requires the assistance of a patent lawyer to navigate it. Not all patent lawyers have the same expertise; they specialize in various fields. Most patent attorneys have very specific product or service experience reflected in their fields of specialization.

Getting a patent is a very long and expensive process. It includes a search of existing patents, an application, probably at least one rejection, and then—even after it is issued—defending it. A patent can cost as much as $20,000 or more and take eighteen months or longer to obtain. After all these costs, your only right is its defense against claims of others. Many companies hire engineers and patent attorneys to do nothing more than design around existing valuable patents so the core of the invention can be used and the original patent holder can do nothing about it.

Spending the money to receive patent protection for a product or service is not always appropriate. Usually you should retain the services of a patent attorney to determine if an idea should be patented. Before hiring an expensive patent attorney, be aware of these patent realities. The product or service may not be patented if:

1. Another party already has patented the product or service. Preliminary patent searches can help to identify similar patents that have already been issued.
2. The product or service may not be useful. Patent law says that the patent will only be granted for a useful product or service.
3. The product or service was in the public use or offered to the public before the application.
4. The product or service is just an idea without a workable device or process.
5. The inventor disclosed it to another person more than a year before applying for the patent.

Tip
It is unlawful to put “Patent Pending” or an abbreviation to that effect on a product unless you have applied for a patent.

Running a Patent Search
Before investing in an intellectual property attorney’s advice, run an online search for prior patents at uspto.gov, delphion.com, or more traditionally, at the Search Room of the Scientific Library of the Patent and Trademark Office, which is located at 2021 Jefferson Davis Highway, Arlington, Virginia, 22202-3513. An attorney can make this search on your behalf for a fee.
A Closer Look @ Protecting Intellectual Property continued

**Trademarks and Service Marks**

*Trademarks (TM, ®)* or *service marks (SM, ®)* are important marketing tools that help distinguish the goods or services of a venture from those of its competitors. They add value to a company as intellectual property. Trademarks apply to goods, and service marks apply to services.

A trademark is any word, name, device, symbol, or combination of these used by a business to identify its products and distinguish the products from those offered by others. Probably the most recognizable trademark in the United States is the Nike® swoosh. Brand names are one form of trademark. Distinctive packaging, unique color schemes, unique designs, and slogans can also be trademarked.

Service marks are often titles, slogans, or phrases used in the sale or advertising of services as opposed to products. For example, FedEx® uses an easily identified service mark to distinguish its parcel delivery service. A service mark is used in advertising while trademarks appear on packaging.

In the eyes of many business experts, trademarks or service marks can be far more valuable than patents in protecting a business’s market share. In practice, trademarks continue for the life of the business and are transferable.

Trademark and service mark rights may be used to prevent others from using a confusingly similar mark but not to prevent others from making the same goods or from selling the same goods or services under a clearly different mark.

You may protect intellectual property with trademarks and service marks at the state or federal level. Federal registration is much more advantageous because it gives nationwide protection and permits greater damage recovery. Until the mark has been registered, one cannot legally use the ® symbol.

Trademarks and service marks are an affordable way to obtain protection for intellectual property. You can search registered marks at uspto.gov.

**Copyrights**

Copyright protection is automatic. It exists the moment an original work is created, but the work should be registered with the Register of Copyrights at the Library of Congress in order to prove when the material was created and to identify its contents.

Copyrights protect the property of the author who created the work. Copyrights protect original works of authorship from unauthorized copying or use. They are good for the life of the creator plus seventy years. Literary, musical, dramatic, choreographic, pictorial, graphic, sculptural, audiovisual, and architectural works can all be protected through copyrights.

Copyrights do allow limited use of the material by others for criticism, comment, news reporting, teaching, scholarship, and research.

Every company owns copyrightable material developed within the scope of business. Many businesses include copyright notices on all such materials as a matter of routine practice.

Copyright notices should contain all of the following three elements:

- The symbol ©, the word “Copyright,” or the abbreviation “Copr”
- The first year of publication
- The name of the owner or company

For example: © 2012 John Doe.

When employees produce work for a company, the company owns the copyright on the materials. Work produced by an independent contractor belongs to the contractor unless the contract specifies that it is “work made for hire” and belongs to the company. You must develop clearly written agreements with employees and subcontractors concerning who owns the copyright on the materials produced.

**Tip**

You can enforce trademark infringement much more easily and with more certainty than patent theft.
A Closer Look @ Protecting Intellectual Property continued

Licenses and Royalties
Another strategy some companies use is to license their intellectual property to another company. Such an agreement might limit the licensed usage to a particular category of product or service or to permit its use without limits. Since intellectual property is actual property, it can be sold completely just like any other property. When you license intellectual property, you retain ownership but another business or person may use it in accordance with the contract. Generally, you receive a license fee paid up front or over time, and you receive periodic payments based on use or sales called royalties.

You can issue a license for a specific period of time or key it to performance quotas. Many times the licensor (the owner) will insist upon minimum royalties regardless of sales or use. A license can be exclusive for the intellectual property, exclusive or non-exclusive for a particular market or territory, or otherwise restricted by the contract. The variations are limited only by the imaginations of those involved.

You can be the licensor and profit by licensing products or services to others, or you can be the licensee and gain the rights to use or sell other companies’ products. Whether you are the licensee or licensor, carefully consider the contents of the license agreement. Asking these questions may help:

- Will any money be paid up front for the license?
- What royalty will be paid? Will it be based upon time, units, or a percentage of sales?
- Will a minimum royalty be paid regardless of sales or use?
- What type of exclusivity will be negotiated? In most cases, if entrepreneurs can find one licensee, they will probably be able to find more.
- What level of involvement do the licensor and the licensee want in marketing the product or overseeing its production?
- What is the performance standard?
- What is the duration of the license?
- Does the licensee have the right to assign or sub-license others?
- Who will own any modifications or improvements to the licensed intellectual property?
- Who pays for any further research and development of the intellectual property?

Some organizations that deal with licensing issues include the Licensing Industry Merchandisers Association, the National Association of Small Business Investment Companies, and the National Venture Capital Association. Local chambers of commerce, Small Business Development Centers, venture capitalists, and banks can also assist with licensing leads.

Trade Secrets
A trade secret is something an entrepreneur or firm knows that others do not know. Trade secrets include techniques, designs, materials, processes, and formulas to which the public does not have access. They can be licensed in the same way as a patent. A supplier or customer list, manufacturing process or technique, and merchandising or promotional system may also be trade secrets and can be very valuable.

You may want to keep a process, technique, or formula a secret to all but the upper levels of your venture’s management. You may not allow even the employees to learn it. For example, very few people know the Colonel’s special recipe for KFC’s chicken.

You must be particularly careful that your employees do not divulge trade secrets. Employees should sign a non-disclosure agreement that legally prohibits them from disclosing the secret information during or after their employment. Further, the secret must be zealously guarded and disseminated only on a need-to-know basis. If employees leave the information lying around and available to anyone in the business, courts are not likely to enforce confidentiality agreements. Sometimes, only portions of a formula or process are shared with individuals so no one person can disclose the entire formula.
A Closer Look  @  Protecting Intellectual Property  continued

Employees at all levels of a business may have specific skills or knowledge that is immensely valuable to that business. Perhaps it’s a salesman who knows the customers—whom to meet with, when and where to call on them, and their internal procedures. That salesman doesn’t need a written list; it’s all in his head. Suppose one day he decides to work for the competition or start his own business? What about the plant manager who knows every detail of how to produce your product?

These are both examples of intellectual property that need to be protected. Employees cannot be forced to continue to work unless an employment contract requires it, and even then, when the contract expires they are gone. Non-compete clauses in their employment contracts, reasonable as to duration and scope, can provide protection for a period of time.

Trade secrets often are the most valuable asset of a business. Just as with patents, the protection of trade secrets needs the attention of an experienced attorney.

Using Intellectual Property Attorneys

Intellectual property issues can quickly become expensive and time-consuming. If your business launches you into these waters, find an attorney who specializes in the type of intellectual property law applicable to your business.

You can have valuable rights stolen from you and be unable to do much about it for a number of reasons:

- The cost of correcting the problem is prohibitive.
- You lack proof of theft.
- No legal cause of action is apparent.

It costs money to file patent claims and even more money to protect the intellectual property rights of a company. Patenting an invention could easily cost as much as $20,000 or more. Defending a patent against infringement is even more expensive.

An intellectual property attorney can do much to prevent problems. First, attorneys can spot intellectual property in your business and devise ways to protect it more readily than you can. Certainly attorneys can prepare the appropriate documents, but they can also advise you on protective measures in matters such as hiring, firing, administration, and operations. Prevention is cheaper than the cure.

For assistance, ask your general business lawyer to recommend an intellectual property attorney and then interview prospective candidates. When screening candidates, ask yourself the following questions:

- Can you and the attorney effectively communicate with each other?
- Does the attorney explain advice in terms you understand?
- Do you feel confident in the attorney and the advice?
- Does the attorney adequately explain the fee and billing procedures?
- Is the attorney accessible by phone?
- Does the attorney return phone calls within twenty-four hours or have a procedure by which others from the office will call you and see if they can help?
- When you do speak with the attorney does he or she appear knowledgeable about you, your business, and the status of the matter at hand?

If the answers to any of these questions are less than positive, work on changing that answer by telling your attorney directly what is negative about your relationship. If several answers are negative, find another attorney.
A Closer Look @ Complying with Governmental Regulations

All businesses, regardless of type, must comply with statutes (laws passed by legislative bodies) and regulations (rules enacted by regulatory agencies to carry out the purposes of statutes). These statutes and regulations can come from all levels of government; federal, state, and local. Some of these statutes and regulations apply regardless of the nature of the business and, of course, a venture engaged in business in more than one state or local jurisdiction must comply with applicable laws and regulations from all applicable jurisdictions.

The enforcement agency has no obligation to notify the business that it must comply with the law. It is the business’s obligation to inquire and comply. Fortunately, most agencies have public information departments eager to assist in providing information and obtaining compliance.

These laws and regulations include licensing and registration of business name, workers compensation, unemployment compensation, and permission to do business in a form other than a sole proprietorship. The collection of sales taxes and the withholding of employees’ wages are further examples of obligations with which to comply.

The Occupational Safety and Health Administration (OSHA) has very specific requirements concerning health and safety which apply to many businesses’ employees and customers. The enactment of the Americans with Disabilities Act (ADA) affects many businesses both in hiring practices and customer accommodations.

Product/Service Specific

The very nature of some businesses makes them susceptible to special laws and regulations. Most states require professions that require specific licensing such as medicine, law, architecture, accountancy, and engineering to go through several additional steps before receiving approval to do corporate or other forms of business.

Businesses supplying food or ingested items must obtain health permits and undergo initial and periodic inspections. Pharmaceutical manufacturers undergo a lengthy and costly approval process before receiving approval to offer their products for sale. Those engaged in inherently dangerous businesses such as handling or detonating explosives require special permits. Many lawful products are only to be sold to persons who have attained a certain age or meet specific criteria.

Entrepreneurs need to know what laws and regulations apply to their particular business. Once engaged in business, they must be constantly aware of what new or amended laws and regulations apply.

Trade associations provide excellent sources of such information and can suggest means to comply with laws and regulations. Often, trade associations will lobby for or against proposed changes in statutes or regulations on behalf of their members. Many trade groups offer education to their member organizations as new or amended regulations are promulgated. The buying power of a large group and the economy of scale generally deliver these services at a bargain price.

Land Use Regulation

Regardless of the type of business or its location—in a home, manufacturing plant, strip mall, or high rise office building—the uses to which land may be lawfully put are matters that should be of great concern to an entrepreneur. Virtually every incorporated city, town, village, and county have adopted zoning regulations that permit only certain business activities in certain zones.
A Closer Look @ Complying with Governmental Regulations continued

The Zoning Office, Land Use Office, or other so-titled agency has zoning maps and regulations that must be examined to determine if your business is permitted at your desired location. The attitude, “It’s my land and what I do with it is my business,” is not only wrong but also dangerous. Do not assume that simply because you have been operating a business in a certain location you may continue to do so, especially if the size of the business increases. Violation of land use regulations can shut down your business with little or no recourse. At the very least, it will cause an expensive and protracted interruption of that business. Make certain your plans for the future are compatible with zoning.

The fact that a business operates out of a home does not solve the land use problem. Most residential zoning codes limit home-based businesses to those which employ no more than a few employees, sometimes two or three people who are not members of the family, and also prohibit frequent motor carrier deliveries and customer parking.

Building and Fire Codes
Often when applying for a local license, a business is subjected to inspection by the fire department and building code officials. The fire department wants to know if you are doing anything that could be a potential fire or chemical hazard and whether exits are adequate and marked properly, fire extinguishers are present, and appropriate materials are used for fire retardant purposes. It also wants to know if the building meets all fire codes. The building inspection department may inspect the property to make sure it is safe for the planned use and in compliance with the building code.

Local governments can impose changes to existing and new buildings. For example, a new plant was forced to cut a large hole in the middle of its floor for another stairway from the basement even though the basement was not used for anything. The stairway added a significant expense of $9,500. Although the plant had been built to local building-code specifications, the local authorities still had the ability to order the extra stairway.

Taxation
The IRS wants to know where a business is and what it does. Most entrepreneurs must file form SS-4 with the IRS to register the business. If a sole proprietor has no employees, an SS-4 form may not be required. Upon filing the form, the owner will receive an employer’s kit containing information about the types of taxes owed, when to pay them, where to pay them, and how to compute the amounts due.

Owners also receive an Employer’s Identification Number (sole proprietors use their Social Security number) to identify the business. All communications with all governmental agencies must include this EIN. The EIN is also needed to open business bank and brokerage accounts and to deal with others who must report the business’s actions to any governmental agency. The government identifies the venture by its EIN, not by name.

If the business has employees, the business must withhold portions of each employee’s earnings and contribute the employer’s share as well. These funds are then deposited to special accounts at designated banking facilities. The regulations regarding withheld wages are very strict and must be complied with. Failure to make the required deposits in a timely manner usually brings swift action by the government. Agents can padlock the business and arrest the owner until the deposits are made. The reason for such drastic action is that the money involved belongs to the employees. The business is simply a temporary custodian or trustee of it.
One of the primary requirements of many state governments is that businesses collect sales tax from their customers. Although most states have a sales tax, the method of each state for handling the tax differs. Some states tax certain products and services differently. You can find out about state sales tax on the Internet, from local chambers of commerce, or by contacting your closest Small Business Development Center. If you conduct business in several states, you will have to be authorized to do business in all of them. Companies that plan to resell goods use a state sales tax identification number when purchasing goods that will be resold. In this way, sales taxes are not paid by the company but collected when the product or service is sold to the final user. The business must still pay sales tax on the things it buys for company use such as plant equipment, office supplies, and plant-maintenance supplies.

Tip

Sales taxes should not cost you anything. The intent is for the business to collect money from the customer for sales tax at the time of sale. This collected money is then turned in to the state sales tax division. Don’t get caught in the trap of spending the collected sales tax money before it is due. All state government agencies frown upon this practice.
You can have the best marketing strategy in the world, but if you don’t reach customers, your business is dead in the water. This module will help you connect with customers. Its aim is to help you sell your products and services and grow your business. While previous modules provided marketing insights and options, this module helps you create a focused plan of attack so that you can wisely use your limited resources to seize the market.

From your working knowledge and the research you’ve already completed, you probably have a good sense of your industry, your customers, and your competitive advantages and weaknesses as well as the growth opportunities and business model that fit your business. You will use this knowledge and information as stepping stones for your work in this module. When you’re done, you will have identified specific marketing tactics to implement that make the most of your opportunities.

Your analysis and decisions can be documented in your Business Plan under the Marketing Plan headings of Industry Profile, Competitive Analysis, Market Analysis, and Market Penetration. You’ll also project how these choices affect your profitability by updating your Financial Plan.

**Key Questions**

- How will I brand my products or services?
- How can I maintain constant visibility with customers?
- What sales and distribution strategies are best for me?
- How can I create exceptional customer experiences?

**Action Steps**

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The Importance of Marketing Tactics

You may have heard the old adage, “If you build a better mousetrap, the market will beat a path to your door.” But the truth is that the best products don’t always win in the marketplace. For example, in the personal computer world Apple’s® operating system is widely regarded as easier to use and more stable than that of the market leader, Microsoft®. Marketing strategies and tactics can be the difference in the success of roughly equal products and services. That’s what made the difference for John Bello and Tom Schwalm who founded South Beach Beverage Co., better known as SoBe®. Like its main competitors, Snapple® and AriZona®, SoBe is bottled sugar water—albeit all-natural sugar water with great packaging, great graphics, great flavors, some good ingredients, and funny slogans. It all adds up to huge marketing appeal.

While a great concept, SoBe achieved marketplace success because of the constant emphasis SoBe leadership placed on executing the SoBe marketing plan and the effectiveness of its sales force. SoBe’s sustainable competitive advantage was its superior and consistent sales effort.

The marketing and sales effort for SoBe achieved some dramatic results: after just five years, the founders sold the company to PepsiCo for $370 million. A nine-figure sales price may not be in your future plans, but you can apply the same basic strategies and tactics to your business to achieve your vision and goals.

This module describes strategies and tactics in four critical areas and helps you determine which ones to incorporate into your plans to grow your business:

- Using branding to generate sales
- Creating and maintaining visibility
- Choosing the right sales force and distribution channels
- Creating exceptional customer experiences

Throughout this module, you will evaluate the appropriateness and effectiveness of your current marketing efforts, consider your options, and work on constructing a strong Marketing Plan. The Marketing Plan is the bridge to reach your intended market and sell your products or services. You’ve already developed the supporting information for your bridge when you researched your industry, your competition, and your customers.

Whether your strategy to grow your business calls for you to focus on your current market or to attract customers in a new market, you will want to follow Kelly Scanlon’s lead and base your marketing decisions on careful research and analysis.
market research leads to a new brand

Market research confirmed what Kelly Scanlon, President & CEO of Thinking Bigger Business Media, Inc., had suspected for a while. The original name of her company, Kansas City Small Business Monthly, no longer represented what the company offered their audience. The word “monthly” no longer applied as they expanded their business to offer products that were offered daily, weekly, monthly, quarterly, and annually.

The words “small business” were creating a perception among advertisers that Scanlon’s company primarily served lifestyle business owners despite the fact that the content was focused on business growth. Scanlon knew that growth-minded business owners were their primary audience, but the company name misrepresented their audience. According to Scanlon, “We had, in fact, outgrown our brand, much like a plant can outgrow its pot and become root bound. Just as too small a container can stunt the growth of the plant, our brand was keeping our company from growing.”

Scanlon hired an agency to conduct market research. Through four separate focus groups, one each of advertisers/sponsors, readers/small business owners, staff and business resource providers, they confirmed the challenges with the brand. Scanlon was encouraged to seek a name that took out “small business” and better represented her market.

Using Branding to Increase Sales

One of the most effective market strategies your company can choose is crafting a company brand. A brand makes a product or service distinctive or unique compared to others in the market.

Your carefully constructed brand creates a visual, emotional, and cultural connection between customers and your company, the product or service, and the type of consumer it attracts.

Disney has a strong brand as the family entertainment leader of its industry. Disney’s brand doesn’t just happen. It is intentional and requires ongoing hard work and dedication to energetically support the brand. Its marketing materials and messages convey a consistent message of family fun, clean environments, and service excellence. Disney hires only those people who can meet its standards, and trains them at Disney University to learn their roles to provide great customer experiences.

Benefits of a Strong Brand

When customers buy your product or service, the experience they receive is what persuades them to buy from you again. By preferring to buy what your company offers, they are increasing the value of your brand. Customer loyalty to your brand helps you penetrate your market more effectively and maintain or increase market share.

A number of companies have successfully created a brand that stands out in customer’s minds. Their brands have a positive association, a recognized name, and a higher perceived value than their competitors.

Examples of powerful brands include the following:

- Lexus® is premium quality and luxury.
- Lysol® kills germs.
- Ben & Jerry’s® is wholesome, premium ice cream, with fun flavors.
- Whole Foods Market® is the supermarket of healthy foods.
- Patagonia® creates high-quality outdoor wear.
- Supercuts® offers haircuts at rock-bottom pricing.
- Jiffy-Lube® provides quick and reliable car service.

Strategies and Tactics

Branding
Visibility
Sales and Distribution
Customer Service
Branding is not just for large corporations. All businesses can use branding to win a place in both the customers’ hearts and minds. Danny O’Neill’s air-roasted coffee business, The Roasterie® communicates his company brand and his passion for the coffee bean through his logo, product packaging, website, and marketing message.

To communicate this passion, O’Neill includes his entrepreneurial story on each packet of coffee beans he sells. It starts with “I can tell you when I fell in love. It was November 22, 1978. On that day, as a foreign exchange student in Costa Rica, I picked my first coffee bean in the mountainous, volcanic, coffee-growing region around the Poás volcano. I fell in love with the country, the people, and the coffee. Especially the coffee. Fifteen years later my passion for great coffee could no longer be denied and The Roasterie was born….”

<table>
<thead>
<tr>
<th>Tip</th>
</tr>
</thead>
<tbody>
<tr>
<td>Every company has an image, intentional or unintentional. Make yours intentional through branding strategies.</td>
</tr>
</tbody>
</table>

**Branding is Double-Edged**

The effects of branding are powerful, so you need to be aware of the potential downside. First, make sure your brand does not become synonymous with negative images, issues, or themes. The second danger in branding is that it is difficult to change perceptions about a brand once a brand becomes known. You will want to create your brand intentionally, know in advance what brand image you want to portray, protect your brand from negative connections with vigor and vigilance, and be careful not to create too narrow a brand framing.

**changing perceptions to attract customers**

What’s in a name? An opportunity to increase revenue—it’s part of Clifton Boyd’s strategy to change perceptions about his company and attract new customers. President of B&L Supply Inc., Boyd recently renamed his company. Formerly known as B&L Electric Supply Inc., the $3 million company is a wholesale supplier of electrical, paper, and cleaning products.

When Boyd and his partner incorporated in 1997, they combined the initials of their last names to personalize the company’s name. They also included the adjective “electric” because they expected the majority of their customers to be electrical contractors. Over time, the percentage of business generated from electrical supplies began to increase, hitting a high of 90 percent. But Boyd wanted to reverse that trend because paper and cleaning products are a more stable, year-round business.

To expand non-electrical business, Boyd broadened his customer base, winning business with the state of Minnesota and General Mills. These new deals expanded paper and cleaning products to 35 percent of company sales, but Boyd wanted to push for even more and believed a name change would be the ticket. Along with the name change to B&L Supply, Inc., Boyd launched a new website to increase visibility. He expects these tactics to increase paper and cleaning revenue an additional 10 percent to 15 percent in the next year.

“We didn’t want to change the name too much and lose recognition with existing clients,” he says. “We hope this will give us the best of both worlds—attract new customers and win additional business from current customers.”
Building Your Brand

Branding is about uniqueness, clarity, and consistency. In branding your product, service, or business, you want to position your offering as a unique value. You need to convey the essence of this unique value with messages that are clear and consistent. They should flow from your marketing strategy and objectives. These messages come not only from your advertising and promotions, but also from the design and features of your product or service, your prices, the customer service you provide, and the way you interact with customers. A business’s brand is reinforced through its website, signage, and printed materials.

Everything a business does contributes to how customers view it. The following checklist can help you brainstorm additional branding opportunities.

### Branding Strategies

<table>
<thead>
<tr>
<th>Which of the following can be used to support your marketing objectives?</th>
<th>Instructions</th>
</tr>
</thead>
</table>
| Maintain a consistent visual image with logos, marketing materials, website, ads, uniforms, physical layouts, and business environment. | For each strategy, comment below on:  
1. How well your company is doing.  
2. Improvements to pursue further. |
| Communicate consistent messages in advertising and market messages, salesperson communications, tag lines, slogans or jingles, guarantees, core value and mission statements, and personal interactions and choices. | |
| Develop individual product/service identity using names, taglines, slogans, or jingles for each product or service that aligns with my company’s overall brand. | |
| Give the brand away providing members of the target market with screensavers, calendars, and premium or promotional products so they will keep the brand close to them. | |
| Humanize the brand by recording customer successes with my company’s products/services, celebrity and everyday endorsements, and staff involvement in my target market’s community. | |
| Create and maintain a brand community by sponsoring chat rooms, soliciting and sharing stories through newsletters and my website, hosting customer appreciation events, sponsoring sports teams, and conducting customer contests. | |
| Align product or service features with brand image by changing current products or service features, developing new products and services, and modifying customer-service practices. | |
Creating and Maintaining Visibility

Your customers are human, and being human, they forget information. That’s simply the way the human brain works. Memory researchers will tell you that forgetting has benefits—if we didn’t forget, we’d be overloaded by useless information. But marketing experts know that forgetting is one of the biggest obstacles to sales. As your customers go about their day-to-day lives, they are prone to forget about your company and your products and services.

In essence, one of your most important marketing objectives should be to help your customers remember your products and services. Branding helps in this regard, because if you have a powerful brand, it is more likely to pop into your customers’ minds when their needs arise. Think about your own purchasing behavior. If you need facial tissues, you’re more than likely to get Kleenex®. If you’re hungry for a hamburger, the first thing to pop into your head might be a Whopper. If you need auto insurance, one of the first companies you may call is State Farm.

But branding isn’t the only way to help customers remember your products and services. The other major option is visibility. Memory is aided by repetitions that grab people’s attention. If your company is visible—if your products and services are visible—your customers are much more likely to remember you when they need you.

Visibility can be maintained in many ways. Some may be obvious, but others are not. Check out the following table and brainstorm ways you can create greater visibility.

### Creating Visibility

<table>
<thead>
<tr>
<th>Instructions</th>
</tr>
</thead>
<tbody>
<tr>
<td>For each strategy, comment below on:</td>
</tr>
<tr>
<td>1. How well your company is doing.</td>
</tr>
<tr>
<td>2. Improvements to pursue further.</td>
</tr>
</tbody>
</table>

#### Which of the following can be used to support your marketing objectives?

**Gain visibility in my target market** by advertising in publications they read, participating in community events and networking, being active on pertinent social networking sites, joining the same organizations, moving my location to a higher traffic area, and volunteering in areas of common interest.

**Increase awareness about my products/services** by providing educational opportunities, sharing information online or in the community, writing articles or blogs about issues and solutions, and offering samples or providing other opportunities to experience my products or services.

**Be the expert in my field** by writing articles and white papers, post often in my social media sites, conducting seminars and giving presentations, providing tips and techniques, and acknowledging my certifications, awards, and accomplishments publicly.
### Creating Visibility

| Instructions | For each strategy, comment below on:  
|--------------| 1. How well your company is doing.  
|              | 2. Improvements to pursue further. |
| **Which of the following can be used to support your marketing objectives?** |  |

- **Develop alliances with other complementary professionals and build a referral network** by bundling my products or services with others that my customers want or need, sharing and receiving referrals, and co-marketing to share costs and opportunities.

- **Tap into others’ traffic** by participating in events and activities that target groups attend, offering special opportunities to other organizations’ customers, buying customer lists, and marketing through other organizations’ vehicles (for example, newsletters, invoices, fundraisers, websites, committees, boards).

- **Stay top-of-mind with prospects and customers** by maintaining pertinent information in my databases, using e-mail and direct mail, focus groups, surveys, phone calls, newsletters, premium or promotional products, and customer appreciation events.

- **Recognize and reward customers for repeat business and referrals** by providing contests, loyalty or frequent-buyer programs, coupons, special offers, incentives or gifts, special pricing, thank you notes, and volume discounts.

- **Other**: What other visibility strategies am I using now? What else might I try?
Visibility Tactics Must be Tailored
Different types of businesses will need different methods for creating visibility. A restaurant may benefit from a good location and great-looking décor. An online retailer may need web-based advertisements and an extensive customer list for sending e-mail brochures. Some buying situations—typically purchases that are more expensive, important, or complex—require visibility of a more personal nature. For example, many people will want a referral from a trusted colleague or friend when selecting a service such as an attorney, doctor, or consultant.

Visibility through Traditional Marketing Activities
The philosophy “if you build it, they will come” may have worked for Kevin Costner’s character in the popular movie Field of Dreams, but it doesn’t work for most businesses. Successful marketing plans involve a combination of approaches and activities tailored for each business and budget.

Tip
Review all your options for advertising, publicity, and promotions in A Closer Look @ Marketing Activities on pp. 235–240.

Using a variety of marketing activities—advertising, publicity, and promotions—creates a rounded approach to achieving your marketing objectives. You may have found that advertising alone is ineffective. Publicity may have given your company great visibility, but the media will only do so much for any one company. You may have used promotions to bring in the crowd intermittently but discovered that it requires ongoing time and investments. None of these activities alone will be sufficient to grow your business.

marketing activities target the customer
Your industry can give you tips on effective marketing activities. Kelly Scanlon settled on the name Thinking Bigger Business Media, as a result of the recommendation to focus on the audience’s mindset. Subsequently they assigned all their products some variation of the name – the monthly magazine is now Thinking Bigger Business and the Entrepreneur's Guide became the Thinking Bigger Guide. Scanlon also has an electronic newsletter called iThinkBigger.com Extra, a quarterly Thinking Bigger Speaker Series, and a quarterly BIG Breakfast. They changed the name of their website to iThinkBigger.com.

The transition to the new brand was smooth. Scanlon hired a graphic designer to makeover their monthly magazine, wanting to give it a more modern, powerful look. She rebranded her company using an overall strategy, considering the logo, name, image, marketing strategy and advertising themes. These are all things that must be considered by business owners when evaluating their brand.

Advertising
Print and advertising media range from newspapers, television, and radio, to direct mailings. Successful advertising communicates your competitive advantage, repeats brand messages, and focuses on what’s unique about your business, product, or service and how customers will benefit from doing business with you.

Publicity
Publicity usually consists of press releases, writing on blogs, feature stories, announcements, and quotes made during interviews. Build relationships with media contacts by offering to be an industry expert. Reporters and editors may contact you to collect information when
working on a story or needing a quote. They may reciprocate by interviewing you or featuring a story about your company.

Your publicity work is not finished when you send a press release. Follow up with a phone call or e-mail. Media sources sometimes receive more press releases than they have space to print them. Your follow-up efforts may help to get your information mentioned.

Five years after their launch, the founders of Three Dog Bakery spotted a man snooping around their shop, taking notes. He turned out to be a Wall Street Journal reporter interested in doing a story on the makers of “canine confections extraordinaire.” Sales accelerated at warp speed. Ever since, publicity rather than advertising has been the cornerstone of their marketing activities—to the extent that their paid advertising costs for the next year were less than $1,000.

**Reaching Your Market Using Social Media**

Social media is transforming the ways companies market their business. It offers unprecedented ways to reach customers and can play an important role in influencing your company’s growth. Social media is not a one-size-fits-all but rather a cornucopia of websites, applications, networks and tools. Defining and planning your web presence is a core component of your marketing strategy.

Some of the most popular media sites for business include:

**Linkedin**—Linkedin is one of the most popular sites for business professionals with an estimated 90 million users, spans more than 200 countries and territories and is available in 15 languages. Use the status updates to keep your information current and to stay top-of-mind with your connections.

Consider setting up a Linkedin site for your business. There are interest groups for most industries and professions, making it a useful platform for sharing solutions, engaging others in web-based discussion and building your professional reputation. It will also provide you with an opportunity to better understand what your customers and constituents are thinking about and what is important to them.

**YouTube and online video**—Forrester Research found that video is 50 times more likely to get a first-page search ranking than other content. YouTube is a video-sharing website on which users can upload, share, and view videos. In 2010, there were more videos watched on YouTube than there were searches performed on Google, according to comScore.com. Use short-form video to easily share product/service demonstrations, capture a computer screen and the activity that happens on it as a Flash video or hold a video conference.

You can also embed videos in your website, blog or Facebook page, or link to them from Twitter or Linkedin.

**Twitter**—Twitter allows users to “tweet” text-based posts of up to 140 characters with quick-hit messages in real time to their followers. Companies can use Twitter to create interest among consumers looking for the types of products and services you offer. With an estimated user base of 190 million, eMarketer estimates that nearly 22 percent of people on Twitter use it for business-related reasons making it a tremendous resource for connecting with your customers and increasing your brand visibility. It’s also becoming a major driver to business websites.

Twitter is ranked as one of the ten-most-visited websites worldwide. By monitoring what’s said about your business and product/service category, you can easily monitor trends, connect with prospects and customers, and support your brand. Twitter also allows you to respond to feedback immediately, provide quick updates about hours of operation or specials.
Connecting With Entrepreneurs

Kauffman FastTrac uses Twitter to connect with entrepreneurs. @fasttrac is a quick response vehicle for addressing questions and for sharing important information, news and events. The feed is an immediate channel to inform entrepreneurs of information that may be helpful to them in their business.

Facebook—Facebook is a profile-based, social networking service that connects consumers to each other and to companies, organizations and topics of interest to them. The number of companies using Facebook for business grew by 192 percent in 2010, according to Palo Alto Networks research. As of January 2011, Facebook has more than 600 million active users. Companies and brands like Zipcar, Oreos, and, PopTarts all have vibrant Facebook pages. You can use Facebook to promote incentives, sales and specials, share news, announce events and provide content that creates loyalty to the channel and your business.

A survey by Lucid Marketing found that many moms use Facebook to communicate with family and friends, but that three-quarters had “fanned” at least one brand; 16 percent were fans of 10 or more companies or brands. To further harness the power of Facebook, put a link to your fan page on your company website, blog, resume, business card, Twitter account, and email signature.

Business/Brand Blogs—Every venture needs a web presence, and thanks to blogging software such as WordPress or Blogger, you can make an attractive, dynamic site on your own. These free services don’t require deep technical knowledge and are an easy way to stay in touch with your customers.

Get your blog noticed and appear higher in search results by using keywords which are words or phrases that users put in search engines. Google’s free AdWords will help you research which words or phrases will be the most effective for your business. Remember to be specific in choosing your keywords. For example, a freelance Technical Writer might do better with the search phrase “Technical Writer” rather than “Writer” since the latter will be far more common. The more specific your phrase, the more likely you are to reach your target customer.

The key to a successful blog is to provide information that’s timely, relevant and valuable to your target audience—whether it’s new research, breaking news, product/service information or answers to commonly asked questions from your customers. Use your blog to demonstrate how your business can answer a need. Finally, allow comments so you can get feedback and build community—both of which enable you to capture insights from users and buyers of your product and service.

Plan your web presence

Successful social media marketing starts with a plan. Find a platform that is best for your business. It should be a key piece of your marketing strategy with clearly outlined objectives and an implementation plan that includes specific activities. To take advantage of all the opportunities social media offers, ask yourself the following questions:

What are my objectives? As Stephen Covey says, begin with the end in mind. What are you trying to achieve through the use of social media? Are you trying to create brand awareness? Reach an existing customer base? Create a new customer base? Do you want to educate, inform, entertain? Just as smart goals are part of your marketing plan, they should also be an integral part of your social media plan.

Who is my target market? Refer back to your market research for demographic information and other key market characteristics. Identify which social media sites are most likely going to be used by your target market. Spending time tweeting when most of your target audience is on Facebook isn’t going to do you much good.
How do I want to position my brand? There are many opportunities to profile your business using social media. It is important to identify which are best suited to meet your support your business goals and attract your customers. It is also imperative to remember that you are representing your company. Be true to your values and ensure alignment with the market you are trying to reach.

How can I get the most out of social networking? It is important to focus your social networking efforts in order to maximize the search engine optimization (SEO). Because so many business searches are done on the internet, you want your organization to appear at or near the top of all queries. Eighty-two percent of consumers use the internet as their first choice to find a local business—92% find what they need during the search.

Do I have time to devote to keeping my information current? Because social media applications enable instant updates, it’s important you monitor your digital channels regularly to stay on top of what people are saying—and to address problems or issues that are mentioned. Some experts suggest updating your information as often as three times a week and spending 30-60 minutes per week participating in social networking.

Do I understand the culture? Every social network has its own standards, characteristics and atmosphere. Learn the “norms” and become familiar before deciding if the site is right for your business.

Monitor Your Impact
Once you have established your web presence it is important to monitor it to assess the impact. Use tools such as Google Alerts, Google Blog Alerts and Google Analytics to be notified whenever you or your business is mentioned online. TweetBeep.com will notify you if you are mentioned on Twitter. Facebook also has an insights function (facebook.com/help/search.php?q=insights) that tracks the number of visitors to your company’s Facebook page and provides information on the number of new fans you have and their demographic information. Remember—While it’s great to know all the statistics, the real objective is to measure the business you actually gain.

For easy information updates, Ping.fm allows you to update a variety of social media sites with one post. You can also save time by using SocialOomph.com which allows you to schedule Twitter updates in advance.

A Word of Caution
Max Muller, attorney and author of Speak! (speakllc.com) warns that for all the benefits social media offers, it has a dark side.

According to AMA/ePolicy surveys:

- 14% of employees admit to sending third parties potentially embarrassing and confidential company e-mail that is intended strictly for internal readers.
- 89% of employees admit to using the office system to send jokes, gossip, rumors or disparaging remarks to outsiders.
- 9% of employees have used company e-mail to transmit sexual, romantic or pornographic text or images.

The many forms of social media available to employees while both onsite, on duty and offsite, off duty has created a number of risks for employers. Depending on the nature of their businesses, company owners face some or all of the following risks:

- Liability for words, photos or videos employees post using the organization’s electronic systems.
  - Discriminatory and/or harassing statements about/to other workers.
  - Discriminatory and/or harassing statements about/to individuals or entities external to the organization.
- Allegations of libel or invasion of privacy.
- Trade libel. Misstatements or misrepresentations about a competitor.
• Computer system security breaches that get through or around firewalls and antimalware software.
  - Employees posting significant amounts of personal information on the internet, e.g., birthdays, pets’ names, etc., and then using that information as the basis for pass or login codes at work.
  - Hackers creating false identities on social media sites and then “friending” an employee they wish to target. They then send a message with a poisoned attachment that an employee downloads and opens believing it is from a trusted source.
• Significant damage to an organization’s reputation when employees post offensive words, photos or videos that feature the entity’s name, logos, service marks or products. (This is known as “denigration through association.”)
• Liability for copyright or patent infringement.
• Liability for violations of privacy laws, e.g., HIPAA, ADA.
• Loss of patentability.
• Emails or blog post violating securities laws, e.g., Sarbanes-Oxley.
• Endangering the organization’s
  - intellectual property, e.g., trademarks, logos,
  - service marks, customer lists and proprietary, and/or
  - operating information.

In order to manage the risks associated with employee use of social media both on- and off-duty, employers—both large and small—must:
• understand the nature of the risks directly related to their particular situation,
• appreciate what must be included in their written policies to prevent, mitigate and react to social media use by their employees, and
• develop contingency plans for mitigation and reaction to actual events or issues arising out of employee use of social media.

Because of the rapidly changing nature of the technologies and case law surrounding social media even organizations that have written social media policies that were drafted one or more years ago may not be positioned to control or minimize the subject risks.

Promotions
Entrepreneurs have to find ways to promote their products or services to the same buyers or target market over and over again. Staying in front of potential or existing customers creates interest. You have probably found that promoting your business consistently does not always have to cost a lot of money. It does, however, require forethought and creativity to find new and cost-effective ways to market your business.

The most common promotional activities include networking, premiums, coupons and rebates, and product or service demonstrations. Many entrepreneurs also use telemarketing and trade shows to get the word out about their business and stay in front of their target market.

Marketing on the Internet
Over the last several years, you may have experienced how technology has changed the way your company and your competitors promote products and services. Most businesses have found that Internet marketing, when used as part of a comprehensive Marketing Plan, can build sales and target a large customer base relatively inexpensively. The Internet can be used for showing and explaining your product or service, taking orders, providing customer support, and even delivering the product or service over the Internet. People can now buy an e-book and download it within seconds of purchasing it.
E-mail has become a way of contacting new customers, offering special discounts, or reminding customers that a specific product or service is now available. It is hard to imagine doing business without a website, the Internet, or other technology. For more information on using your website as a marketing tool see A Closer Look @ Effective Websites on pp. 247–248.

Your strategies as well as your resources—time, money, and people—determine how many activities to undertake each month. Marketing activities are varied, and costs span a continuum of zero to thousands of dollars. Use Deciding Which Marketing Activities to Undertake below to verify which activities you are currently using and which you are thinking about incorporating into your Marketing Plan.

### Deciding Which Marketing Activities to Undertake

The chart below highlights common activities entrepreneurs use in their marketing activities. Check which activities you have used in the past, and then answer the question at the bottom of the table.

<table>
<thead>
<tr>
<th>MARKETING ACTIVITIES</th>
<th>Advertising</th>
<th>Publicity</th>
<th>Promotions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newspapers</td>
<td>Blogs</td>
<td>Premiums (advertising specialties)</td>
<td></td>
</tr>
<tr>
<td>Magazines</td>
<td>Featured stories</td>
<td>Coupons</td>
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<tr>
<td>Television</td>
<td>Press releases</td>
<td>Demonstrations</td>
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<tr>
<td>Radio</td>
<td>Community recognition</td>
<td>Telemarketing</td>
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<tr>
<td>Infomercials</td>
<td>Contests</td>
<td>Trade shows</td>
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<tr>
<td>Direct mail</td>
<td>Webinars</td>
<td>Networking</td>
<td></td>
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<tr>
<td>Websites</td>
<td>Published articles</td>
<td>Electronic media</td>
<td></td>
</tr>
<tr>
<td>Web banners</td>
<td>Other:</td>
<td>Newsletters</td>
<td></td>
</tr>
<tr>
<td>E-commerce catalogs</td>
<td>Other:</td>
<td>Workshops</td>
<td></td>
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<tr>
<td>Printed catalogs</td>
<td>Other:</td>
<td>Website cross promotions</td>
<td></td>
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<tr>
<td>Fliers</td>
<td>Other:</td>
<td>Conference presentations</td>
<td></td>
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<tr>
<td>Floor slicks</td>
<td>Other:</td>
<td>Speaking engagements</td>
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<tr>
<td>Posters</td>
<td>Other:</td>
<td>Other:</td>
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<tr>
<td>Billboards</td>
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<td>Other:</td>
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<tr>
<td>E-mail to customers</td>
<td>Other:</td>
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<td>Other:</td>
<td>Other:</td>
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</table>

Which of these activities are not currently part of my marketing activity but should be incorporated into my Marketing Plan?
Sales and Distribution Channels

To grow your business, you will want to examine your sales and distribution strategies and determine if any changes need to be made. When John and Mark Friess—founders of wiredMD who you read about in Module 2—decided to grow their business, they stopped their marketing efforts to doctors’ practices and targeted health resource centers. Instead of going to trade shows, they hired two people to make cold calls and used direct mail and direct e-mail. They changed from selling software to distributing streaming video over the Internet.

Another approach was used by Gabriel Goncalves, founder of PeopleAnswers, Inc. who you read about in Module 3. To help generate the sales momentum he wanted, Goncalves decided against building a large internal sales team. Instead, his team trained independent dealers to sell PeopleAnswers® software on an exclusive basis.

Though substantially different, both strategies were effective in achieving the goals the entrepreneurs set for their business. The following topics on sales and distribution channels will focus on common issues for both products and services.

Sales

As an entrepreneur, it is important to be prepared for the challenge of generating sales. Bottom line success in your business hinges on sales execution. Often, early stage companies don’t have a sales force, and as Craig Wortmann and Waverly Deutsch outline in their paper Entrepreneurial Selling—“Before a new venture has a track record, familiar brand, clearly established value proposition, satisfied customers—often before it even offers a full tested robust product or service—the entrepreneur must begin selling.” Selling is the bridge between marketing and customer service—It is an essential activity.

Wortmann and Deutsch outline a four stage entrepreneurial selling process.

1. **Selecting the Target.** Deciding who is most likely to need and buy a product or service is challenging at the beginning when there are so many potential market segments that could be chosen. In the entrepreneur’s vision, the business can service a wide swath of buyers, industries, geographies, and applications. The first important decision of entrepreneurial selling is where to start.

   *The entrepreneurs challenge:* In the professional selling environment this has typically been done in depth by the marketing organization. Lacking that support and discipline, most entrepreneurs sell opportunistically to everyone they can. It is critical to narrow the target to be effective.

2. **Engaging the prospect.** Marketing is about getting a compelling message of the product’s value proposition into places the potential buyer is most likely to see and/or hear it. Sales pick up when an individual in that target market expresses some interest in the product. How does the entrepreneur get that expression of interest? Sometimes the customer calls the company or registers on the website but far more often than that, the entrepreneur must proactively reach out to the target using that dreaded dirty word…prospecting.

   *The entrepreneurs challenge:* Established firms often have internal sales teams dedicated to lead and meeting generation. They can afford to buy targeted lists from brokers, attend a lot of events and use mass marketing tactics to increase their prospecting databases. For the entrepreneur, getting the message out there is much harder since it often takes a prospect as many as seven exposures to a new product or company to even recognize the name.

3. **Making the match.** Make no mistake, selling is a conversation. Not a monologue. The entrepreneurs job is not to “pitch” or sell the features and benefits of the product or
service – something they love to do. The entrepreneur’s job is to get the potential buyer to clearly articulate her needs, budget, timeframe, and desired outcomes and to sit there and listen. Only when the entrepreneur has truly listened to the customer, can he match what his startup offers to what the client is specifically looking for—this is much more difficult than “pitching”.

The entrepreneurs challenge: Lacking the context of an established brand, extensive track record and robust, well-tested offering, the entrepreneur must spend a lot of time in this phase building credibility and overcoming the liability of newness. It is essential to do a lot of homework before beginning entering into this dialogue so the entrepreneur can become as knowledgeable about the prospect’s industry and business issues and is prepared to add value in the sales process.

4. Doing the deal. Again, entrepreneurs assume once the client sees the value proposition, out comes the wallet. Not so fast. If the entrepreneur has done a good job in the matchmaking phase, a deal is there for the doing but it will take some work. Buyers are often reluctant to commit. Making the ask, or closing the deal, is something entrepreneurs must be prepared to do—and do elegantly.

The entrepreneurs challenge: Entrepreneurial overconfidence—and desire to win every deal—can easily lead to contracts that the small firm is challenged to deliver on, will drain the startups scarce resources or will fail outright. Spending time resetting expectations right after the ink dries will help both the entrepreneur and the client move forward with confidence.

Following this process outlined by Wortmann and Deutsch will help you move forward and start making sales.

If you do hire salespeople, make sure you have developed and supported them as they are a main link to your customers. Make sure you keep them updates on company and industry information. Help them see customer satisfaction as a key goal. Your salespeople are the ones who are building the brand and contributing to its visibility.

Sales methods vary almost as widely as the products and services being sold. Internal sales methods include a solo approach, a direct sales force, and the internet. External sales methods include licensing and sales manufacturer’s representatives. Whatever your sales method, the process will be nearly the same. For a detailed look at various sales methods and the sales process, read A Closer Look @ Your Sales Process, pp. 241–246. By thinking of sales as a process with finite steps you will be able to work on mastering each step.

Distribution
The word distribution may conjure up images of trucks loaded with boxes, but distribution is as much a sales and marketing issue as it is a delivery issue. We can define distribution as the method companies use to deliver products or services to their target market and channel as the means by which products or services are distributed, but these definitions hide an important truth. Your distribution channels are not only a means to ship your goods or deliver your services; they may also provide you with additional opportunities to sell your products.

New Distribution Opportunities
The type of distribution channel you use depends on your industry, type of products or services, and business model. In the past, distribution channels were largely standardized by industries which left entrepreneurs with a limited number of methods for getting their products or services to their intended audience. For example, clothing manufacturers traditionally sold their goods through department stores. Now manufacturers can sell their clothing through various types of retail entities and over the Internet.

Examples of turbulence that can affect distribution are everywhere. Newspapers are cutting staff because advertisers are moving to the Internet. Software-development houses are shutting down because programmers in Bangalore, India can do the work for a fourth of the
cost. Life insurance companies are being forced to change their pricing and sales tactics as low-cost term-life policies are sold as commodities on the Internet.

New business models can be risky, but for many companies they are paying dividends. Amazon.com competes with local and on-the-ground chain book stores. Sit4Less.com® sells chairs direct to consumers. Small mom-and-pop manufacturers like 123Exclusively.com sell their products over the Internet. Even the U.S. Postal Service sells stamps online through Stamps.com®.

The point is that there are new and evolving opportunities for you and your company. If you’re serious about growth, you’ll be serious about investigating your distribution alternatives. Remember: challenges to your business don’t just come from your traditional competitors. The most dangerous threats often come from new start-ups who take advantage of cataclysmic changes in business infrastructure—like those happening today in distribution channels.

The chart following illustrates the most common distribution channels used by businesses over the past decade.

### Distribution Models

For many entrepreneurs, distribution of their products or services is managed directly by the company. As their companies grow, these entrepreneurs increase their internal sales force and operational capabilities to meet the demands of their customers. Distribution in these companies resembles the illustration below.

#### Offering the Same Products/Services to Multiple Customers

![Diagram: Offering the Same Products/Services to Multiple Customers](image)

Some entrepreneurs prefer to expand their capabilities for growth by going outside the company to intermediaries such as independent representatives, wholesalers, or distributors. For these entrepreneurs, distribution may resemble the following illustration:

#### Offering Products/Services Through Intermediaries

![Diagram: Offering Products/Services Through Intermediaries](image)
Many high-growth entrepreneurs use intermediaries because they can provide these benefits:

- Find more customers for products/services without hiring additional internal sales staff
- Use their customer and community relationships to garner more business
- Share the risk of sales and doing business in the market by assuming responsibilities for marketing, sales, and distribution
- Advertise at the local level
- Receive and monitor customer feedback in the market
- Break down bulk shipments into smaller units for resale
- Move goods throughout the market efficiently
- Consolidate goods and services for distribution
- Manage point-of-purchase promotions
- Finance purchases
- Provide customer service and support on a local level

The most successful companies are those who have the widest distribution to deliver products or services to their customers.

A distribution network requires additional inventory, literature, training time, and hotline support on your part—in short, an outside sales force that must be managed.

**The Retail Distribution Channel**

Some retail businesses use only one distribution channel—their retail store. If you have a retail business, it might be time to ask yourself whether your operation is limiting your growth or making you more vulnerable to competitive threats. Use the checklist Retail Location Analysis to re-evaluate how well your current location serves your business goals.

```
<table>
<thead>
<tr>
<th>Retail Location Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does my current location get enough walk-by or drive-by traffic?</td>
</tr>
<tr>
<td>Is my location easy to get to by foot, car, or public transportation, and is there adequate parking?</td>
</tr>
<tr>
<td>Should we consider changing or adding locations to meet my target market’s needs better?</td>
</tr>
<tr>
<td>Does my competition have an advantage in the market because of their locations?</td>
</tr>
<tr>
<td>Do my lease or ownership arrangements enable me to stay where I am (cost and lease term)?</td>
</tr>
<tr>
<td>Am I in danger from competitors who use other distribution channels (for example, the Internet)?</td>
</tr>
</tbody>
</table>

Based on the answers to the above questions, what location strategies should I consider?

- Moving location to a more desired area
- Expanding the current location
- Opening additional location(s)
- Owning/Building
- Other:

- No change
```

Even if you’re not in the retail business, you might brainstorm your distribution issues from a retail perspective. The old maxim is that the three most important determinants of retail success are location, location, and location. Why? Because having a great location enables customers to have easy access to products and businesses to have easy access to customers.
A good retail location makes products visible, creates credibility and trust, enables customers to get comfortable with the products, and makes it easy for customers to pay and receive the products they purchased. Even if your business is not a retail business, you might evaluate yourself on these criteria.

Internet Distribution Models
The Internet has opened up a variety of new distribution models, and more models are continually being developed. Consider the following for your business, and be sure to investigate new models as they develop:

**Product catalog with shipped products**—Like Amazon.com, many companies essentially offer an online catalog of products that can be shipped directly to customers.

**Product catalog with downloadable products**—Software companies, publishing companies, and even the product creators themselves (musicians, photographers, writers, and thinkers) offer their goods in electronic files that can be downloaded immediately upon purchase.

**Subscription services for downloadable products**—Downloadable products can also be sold as subscription products, often automatically renewed on a previously registered credit card.

**Free use with advertising**—Companies offer free online products and services and make money on advertising. Yahoo!® provides free news, information, games, forums, and makes money through advertising.

**Free use with potential to purchase premium options**—Companies may offer basic online services for free but make money off premium services. While Yahoo! offers free e-mail, they also offer other e-mail options that cost money. SurveyMonkey.com® offers free survey software but also provides additional services for fees.

**Temporary free use with later move to paid use**—Companies either provide free service to everyone for a while and then transfer everyone to full cost, or they offer their service free for a short time to everyone—providing free trial subscriptions—and then offer trial subscribers a paid membership.

**Free information sharing in exchange for sales opportunities**—Companies and consultants often share their knowledge through online white papers, newsletters, and webinars—making this information available only if users provide their contact information which will later be used for sales efforts. Often information is shared without this quid pro quo—with only the hope that the shared information will entice users to make contact with the intention of making a purchase.

There are other Internet distribution models and more developments evolving every week. You need to keep an eye toward these developments for opportunities and to fend off potential competitors from leapfrogging your current practices or finding a better way to connect with your customers.

Evaluating Your Distribution Channels
Your distribution channel strategy will depend upon your business model. Review your answers to Module 3’s *Aligning the Business Model and the Vision* on p. 84. Answer the questions in *Distribution Channel Analysis* on p. 211 to determine the best means to distribute your products or services.
developing a web strategy

Erika Feinberg and her husband Larry Fugleberg bought a small business in Scottsdale, Arizona, that sold medical products to seniors, primarily through a low-grade website with limited capabilities. During their first year they worked intensively to create and implement a strategy that would help them meet their vision and goals for sales and profitability. They initiated a complete re-branding. “We wanted to expand the business beyond its elderly image,” Feinberg says. To emphasize their new focus on preventative and active care, they adopted the tag line, “solutions for daily living.”

“One of our FastTrac assignments was to define and quantify our target market,” says Feinberg. “That led us to concentrate on a much bigger market where we could touch hundreds of thousands of people instead of a few thousand.”

Adopting a more sophisticated, quantifiable marketing plan spurred faster growth with a more effective use of marketing dollars. In the past, they weren’t investing the proportionate amount of time and money to reach the largest pool of potential buyers. Fugleberg and Feinberg decided to increase their Internet presence while retaining a retail store and a print catalog. They also started to calculate their precise return on investment in targeting a far larger national audience.

“We evaluated our marketing by saying if our Internet campaign will touch 100,000 people, and if 2 percent of them convert, it will equate to a specific level of sales,” Fugleberg says. “FastTrac helped us identify the Internet as providing the greatest leverage and model of what we could expect in increased revenues.”

As a result Fugleberg and Feinberg reassigned their marketing coordinator to focus on online initiatives, such as establishing alliances with health-related websites that attract millions of visitors. They also set a goal of producing $10 in revenue for every $1 they invested in marketing.

With their new focus on Internet marketing, the couple’s business is growing faster than ever. “It’s easy to spend lots of money experimenting with marketing options like print, radio, and TV,” says Fugleberg. “But it’s critical to make sure our marketing dollars are well spent to target the right people in the right way.”

Distribution Channel Analysis

a. Where and how does my target market shop for similar products/services?

b. What distribution channels do my top competitors use?

c. What new distribution channels are being used in my industry?

d. What other distribution channels are being used successfully in other industries that may be effectively adapted to my industry?
### Distribution Channel Analysis continued

e. What Internet distribution channels might work for my business?

f. What typical barriers or challenges for entering into new distribution channels do I foresee?

g. How effective is my current selling method in meeting goals (for example, in-house staff or intermediaries).

Check which distribution channel strategies will best help accomplish my marketing objectives and business goals:

<table>
<thead>
<tr>
<th>Mass merchandise</th>
<th>Franchises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount</td>
<td>Dealerships</td>
</tr>
<tr>
<td>Off-price</td>
<td>Television programs and infomercials</td>
</tr>
<tr>
<td>Department stores</td>
<td>Internet strategies</td>
</tr>
<tr>
<td>Specialty shops</td>
<td>Product catalog with shipped products</td>
</tr>
<tr>
<td>Chain stores</td>
<td>Product catalog with downloadable products</td>
</tr>
<tr>
<td>Direct mail</td>
<td>Subscription services for downloadable products</td>
</tr>
<tr>
<td>Chain grocery stores</td>
<td>Free use with advertising</td>
</tr>
<tr>
<td>Independent grocery stores</td>
<td>Free use with potential to purchase premium options</td>
</tr>
<tr>
<td>Mass merchandisers</td>
<td>Temporary free use with later move to paid use</td>
</tr>
<tr>
<td>Specialty stores</td>
<td>Free information sharing in exchange for sales opportunities</td>
</tr>
<tr>
<td>Convenience stores</td>
<td>Other Internet distribution strategy</td>
</tr>
<tr>
<td>Independent reps</td>
<td>Other Internet distribution strategy</td>
</tr>
<tr>
<td>Direct sales</td>
<td>Other distribution strategy</td>
</tr>
<tr>
<td>Wholesalers</td>
<td>Other distribution strategy</td>
</tr>
<tr>
<td>Distributors</td>
<td>Other distribution strategy</td>
</tr>
<tr>
<td>Company-owned offices</td>
<td>Other distribution strategy</td>
</tr>
</tbody>
</table>

Why have I selected these strategies?
Creating Exceptional Customer Experiences

Earlier, this module discussed two ways to grow your business: selling more to the same customers or finding new customers and selling to them. As an experienced entrepreneur, you’ve probably already figured out that it’s a lot easier to sell something to a current customer than to a new customer. One of the best ways to grow is to provide customers with such a great experience that they return again and again.

Providing exceptional products, services, and interactions has the added advantage of attracting new customers as well. You may have heard of the concept of viral marketing. That’s when a product or service becomes so popular among current customers that the word spreads from them to others like a flu germ at the height of flu season. The point is that there’s nothing better for growth than customers who sing your praises to all their friends and colleagues—and the only way to get that kind of momentum is by making a conscious decision to create exceptional customer experiences. So even if you are in a business like real estate in which the customer purchases infrequently, attention to your customers will reap more business from their friends and colleagues.

Sales and customer service strategies can build the reputation you desire for your business as well as for your products or services. You may already have effective sales strategies that focus on attracting and retaining customers. Maybe you have policies, warranties, guarantees, terms and conditions, or procedures for dealing with customer complaints. One of the key things to remember is that every interaction with a customer is an opportunity to create an exceptional experience. From the first time a potential customer hears about your company, goods, or services to their experience long after the sale has been made, everything matters.

Every time your client thinks about your company, your people, your products, or your services is an opportunity to make them happy or disappoint them. John Nordstrom, founder of the national department store chain Nordstrom® created a culture on the retail floor that epitomized the right attitude. He didn’t emphasize a long set of rules for his sales people but rather a few simple principles: Listen to the customer. Provide them with what they want. Appreciate the fact they came to your store, and do everything within your power to ensure that they’re satisfied when they leave. Another Nordstrom secret is to instill this attitude in everyone throughout the chain of command, empowering each employee to make decisions on their own about how to satisfy customers.

go the extra mile

Carefully considered sales processes and customer service policies are essential to achieving your marketing objectives over the long haul. “I want to keep taking things off customers’ to-do lists,” says Danny O’Neill, founder of The Roasterie. “That way, if a competitor slashes prices, our customer says, ‘Yeah, but we can’t leave The Roasterie—they do this and this and this for us.’”

To provide that peace of mind, O’Neill asks himself two simple questions: What are we doing for customers today that we didn’t used to do? And what can we do that will mean more to them? For example, about 45 percent of The Roasterie’s customers are restaurant and coffee shops—frantic environments where ordering supplies is either a last-minute activity or a downright emergency. “You can hear the stress in customers’ voices when they call,” says O’Neill. So he tried a new twist on “don’t-call-us-we’ll-call you.” To keep accounts well stocked, The Roasterie makes weekly phone calls to see what customers need.

“Customers love it because it takes one more thing off their to-do list,” says O’Neill. “They know The Roasterie is going to call and check on supplies, so they don’t have to think about it.”

Besides sparking customer loyalty, the new process has another payback—enabling The Roasterie to better organize its production and deliveries. “Before, we never knew when we would be making deliveries,” says O’Neill. Going the extra mile in customer service after the initial sale has provided benefits for both customer and retailer. It increases sales and efficiencies as it generates loyalty.
If you’ve ever been annoyed at the local supermarket when you have to wait five minutes for the manager to hit a key on the cash register after the cashier makes a simple mistake, you’ll know why empowering employees to make customer-satisfaction decisions is so important. You can’t just will these exceptional customer experiences into existence. You have to inspire your people, train them, and empower them. The more you empower your employees to act on behalf of the customer, the more likely your strategies will build a competitive advantage in the marketplace. When employees respond quickly to customer issues, recognize and reward them for doing so.

**Tip**

Establish a service oriented culture. Focus on customer needs and preferences.

You can enhance your existing customer service strategies several ways. The most successful include the popular approaches detailed in the table below. Analyze your methods and plan to take action if you spot any opportunities for improvement.

<table>
<thead>
<tr>
<th>Exceptional Customer Experiences</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Which of the following can be used to support your marketing objectives?</strong></td>
</tr>
<tr>
<td><strong>Provide an exceptional experience throughout every transaction</strong> by ensuring that customers are acknowledged, appreciated, and find it easy to do business with you. Note that this requires you to (1) make a list of the typical chain of contacts between you and your customers—from when they first see your advertisement until you send them a customer survey after the sale, and (2) evaluate your company’s performance on each contact point.</td>
</tr>
<tr>
<td><strong>Provide sales materials that are clear and easy to understand</strong> including website, marketing materials, retail displays, and sales conversations.</td>
</tr>
<tr>
<td><strong>Respond promptly to customers’ requests and concerns</strong> by acting with urgency and responsibility in customer inquiries, transactions, and complaints. Have a service recovery plan in place.</td>
</tr>
<tr>
<td><strong>Listen to customers and respond accordingly</strong> by soliciting feedback, encouraging interaction, staying engaged throughout transactions, and taking the appropriate action necessary to please the customer.</td>
</tr>
</tbody>
</table>

**Instructions**

For each strategy, comment below on:

1. How well your company is doing.
2. Improvements to pursue further.

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### Exceptional Customer Experiences continued

<table>
<thead>
<tr>
<th>Stand behind products/services</th>
<th>by providing guarantees and warranties and ensuring customers that we deliver on our promises. Also, create products and deliver services that exceed expectations.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treat customers as family members and best friends</td>
<td>by valuing them the same way you honor those you care most about.</td>
</tr>
<tr>
<td>Stay in the hearts and minds of my customers</td>
<td>by not taking customers for granted and finding ways to let them know you hold their best interests.</td>
</tr>
<tr>
<td>Other initiatives?</td>
<td>List them here.</td>
</tr>
</tbody>
</table>

Listen to your customers by asking for feedback. There are a variety of ways to get feedback from your customers. Be creative and go beyond traditional methods. Most waitresses ask, “Is everything all right?” The ones who really want to improve ask, “What could I have done to make your experience even better?” Don’t forget customers who have stopped buying from you. Following up with lost customers can provide valuable feedback and may encourage them to come back.

### Marketing Implementation

The material in this module and previous modules has probably started you thinking about options for growing your business. That’s a good start. One of the purposes of a program like this is to generate thought, but ultimately you have to make some choices. You can’t do everything.

### Marketing Objectives

Just as you can’t use every strategy you think of to grow your business, you have to choose among marketing options as well. So while the first step was to generate marketing ideas, your second step must be to determine your marketing objectives. What do you want to accomplish with your marketing efforts? Use the table on the next page to narrow down your choices.
Marketing Objectives

Check one or two objectives for each category. Choose objectives you would like to focus on immediately. After you have chosen objectives for each category, prioritize them, and select up to six to include in your Marketing Plan. Insert a star ★ behind the ones you select for your Marketing Plan.

Target Market
- Introduce new products/services to existing customer base.
- Enhance specific products/services to meet changing customer expectations.
- Develop new products/services for different target markets.
- Other (Tailor a strategy to your specific business.)

Distribution
- Enhance current distribution channel.
- Expand distribution to reach specific markets.
- Adopt a new distribution channel.
- Other (Tailor a strategy to your specific business.)

Market Penetration
- Increase market share within the same territories or target markets.
- Gain market share from competitors.
- Enter new territories or target markets.
- Other (Tailor a strategy to your specific business.)

Sales Revenue & Transactions
- Increase total dollar sales of specific products/services.
- Increase total dollar sales (no specific products/services referenced).
- Increase/decrease the number of units sold.
- Increase/decrease number of transactions.
- Increase/decrease the average transaction amounts.
- Other (Tailor a strategy to your specific business.)

Pricing
- Raise/decrease prices of specific products/services.
- Implement across-the-board percentage price increases/decreases.
- Other (Tailor a strategy to your specific business.)

Marketing Strategies

Once you are clear about your marketing objectives, the next step is to determine what strategies you will use to reach those objectives. You may have detailed many possibilities in earlier parts of this module, but now it is time to be very clear about what you’re actually going to do. Keep in mind not only your objectives but also your target market. Use the Marketing Strategies table on p. 217 to detail your most important strategies.

Marketing Implementation Plan

The next step is to develop an implementation plan. Your implementation plan will describe:
1. Marketing activities you will undertake to meet your objectives and implement your strategies.
2. Timeline for executing marketing activities.
3. Estimated costs associated with implementing the plan.
## Marketing Strategies

Choose up to five marketing strategies for you and your company to work on over the next two to six months. You can certainly come up with more but be careful not to overcommit unless you really intend to commit your time and energy, your management team’s time, your employee’s time, and significant resources to accomplish the extra strategies.

How to generate and select these strategies:
- Review the sections of this module and your responses to the questions and checklists.
- Confer with your management team, your marketing folks, your advisers, and relevant employees.
- Create an initial list of priorities and select the top three to five.

<table>
<thead>
<tr>
<th>Branding</th>
<th>1.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2.</td>
</tr>
<tr>
<td></td>
<td>3.</td>
</tr>
<tr>
<td>Visibility</td>
<td>1.</td>
</tr>
<tr>
<td></td>
<td>2.</td>
</tr>
<tr>
<td></td>
<td>3.</td>
</tr>
<tr>
<td>Sales and Distribution</td>
<td>1.</td>
</tr>
<tr>
<td></td>
<td>2.</td>
</tr>
<tr>
<td></td>
<td>3.</td>
</tr>
<tr>
<td>Exceptional Customer Experiences</td>
<td>1.</td>
</tr>
<tr>
<td></td>
<td>2.</td>
</tr>
<tr>
<td></td>
<td>3.</td>
</tr>
</tbody>
</table>
Why would you want to invest your valuable time to plan your marketing activities? If you don’t have a plan to follow, you’re likely to let the flood of day-to-day activities dilute your efforts and drown out your best marketing intentions. Detailed planning will help you push your business beyond the status quo and get things moving toward growth.

By specifying the timing and budget for each marketing activity, you make your intentions real. You help yourself—and your employees—get a real sense of what you can do and what will have to wait until later.

See the following example of an entrepreneur’s marketing activities schedule for six months. Using Action Step 6.4 Prepare My Marketing Plan—Market Penetration, you will create a Marketing Activities Schedule for your Marketing Plan.

**Calculating Marketing Costs**

Marketing activities take a commitment of resources—your time, your staff, and your money. As part of your planning process, you will need to anticipate the financial impact marketing has on your budget. Some entrepreneurs determine how much they are willing to spend on marketing each year for their business and then create their Marketing Activities Schedule. Others create a list of marketing activities and include those items as part of their overall budget for the year. In either case, you will need to recognize the cost of marketing and anticipate the return-on-investment. You will finalize your estimated marketing costs in Action Step 6.5 Finalize My Marketing Financial Projections.

**Marketing Evaluation**

When all is said and done, there’s always more to be done—which is especially true of your marketing efforts. Marketing requires guesswork. It’s like casting bait into muddy water. Sometimes customers will see your bait, sometimes they won’t. Sometimes they’ll take your bait, sometimes they’ll ignore it. The key to your long-term success will depend on how much you learn with each marketing effort. If you don’t get feedback, you won’t learn from your mistakes. Your goal should be to avoid the sentiments of the entrepreneur who said, “I know half my money on marketing is wasted, I just don’t know which half.”

The smartest entrepreneurs see the marketing process as a circular process like in the diagram to the right.

Note how this module has followed the progression depicted in the diagram. In Modules 2, 3, and 5 you analyzed your industry and markets and developed general ideas about your marketing objectives. In this module you specified specific objectives, strategies, and implementation plans. Now we’re discussing how to take this full cycle. The following topics will provide you with ideas on how to track the effectiveness of your marketing activities.

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**Tip**

While preparing your marketing activities schedule, decide whether you will do the work in-house with your current staff or outsource part or all of the activities.

---

While preparing your marketing activities schedule, decide whether you will do the work in-house with your current staff or outsource part or all of the activities.
## Marketing Activities Schedule for Johnson Security Systems

<table>
<thead>
<tr>
<th>Activities</th>
<th>Objectives</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Branding</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rethink branding with management team</td>
<td>Increase awareness by new customers.</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Redesign all marketing materials.</td>
<td>Increase sales to new customers.</td>
<td></td>
<td></td>
<td>$7,000</td>
<td>$7,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Visibility – Advertising</strong></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Internet</td>
<td>Increase sales to new customers.</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
</tr>
<tr>
<td>Industry publications</td>
<td>Increase sales to new and existing customers.</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
</tr>
<tr>
<td>Direct mail postcards</td>
<td>Increase sales to new customers.</td>
<td>$1,000</td>
<td>$1,000</td>
<td></td>
<td></td>
<td></td>
<td>$1,000</td>
</tr>
<tr>
<td><strong>Visibility – Publicity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Feature stories</td>
<td>Increase sales to new customers.</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Press releases – quarterly</td>
<td>Increase sales to new customers.</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Community recognition – paid</td>
<td>Increase positive image by customers.</td>
<td></td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Visibility – Promotional</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coupons for new products, specials</td>
<td>Increase sales to existing customers.</td>
<td></td>
<td></td>
<td>$2,500</td>
<td>$2,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade shows</td>
<td>Increase sales to new customers.</td>
<td></td>
<td>$5,000</td>
<td></td>
<td>$5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>E-newsletters</td>
<td>Increase sales to existing customers.</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
</tr>
<tr>
<td><strong>Distribution</strong></td>
<td></td>
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<td>Revamp website.</td>
<td>Increase sales to new customers.</td>
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<tr>
<td>Develop subscription technical support service options.</td>
<td>Increase sales to new customers.</td>
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<td>Staff training</td>
<td>Increase customer-service ratings.</td>
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<tr>
<td>Management follow-up</td>
<td>Increase customer-service ratings.</td>
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The X signifies activities requiring time but no additional expense.
The ROI of Marketing

Many entrepreneurs pre-determine how they will measure each marketing activity to determine whether the activity generated its anticipated results. For example, if an entrepreneur passed out coupons for a discount to buy a specific product, she may count how many coupons were redeemed. If she placed an ad in a local newsletter, she may consider every phone call or e-mail that results from the ad as being a response to that effort.

Monitoring and Controlling Marketing

Some marketing activities require several attempts before determining if they are worthwhile. Since consistent exposure over time yields better results, repeat the marketing activity several times for six months or even a year before making a decision to cancel an ad or try something new. Keep records of your marketing activities, tracking the following aspects of your initiatives:

- Media used
- Timing of the promotion
- Cost
- Reach (the number of persons exposed to the promotion)
- Responses generated
- Sales generated
- Return on sales (the sales generated minus the cost)

Evaluating your marketing initiatives can be tricky. Keep four things in mind as you evaluate their effectiveness:

**External factors**—Realize that your actions are not the only factors that may affect your results. You can make the best marketing decisions possible, but if the economy dips into a depression, you’re not likely to see rising sales figures. When deciding how effective your marketing efforts are, you need to take external factors into account including economic shifts, competitor moves, and your industry’s general trajectory.

**Cost-benefits**—Evaluate effectiveness from a cost-benefit perspective. If you look only at the results of various initiatives, you may be fooled. Consider two initiatives—one that increases sales by 20 percent and a second that increases sales by 5 percent. Which one would you choose? You shouldn’t answer yet because you don’t have enough information. What if the 20 percent increase cost you $10,000 while the 5 percent increase cost you $100? Now the answer becomes obvious, right? The 20 percent increase cost you $2,500 for each 5 percent increase, so it is clearly more expensive. But wait. What if the 5 percent increase required your management team to spend 90 percent of its time over a month to complete? You have to remember your real internal costs as well.

**Feedback**—Consider the validity and reliability of your feedback mechanisms. If you send a traceable e-mail to 2,000 customers and 20 click through to take advantage of the offer, your data is fairly reliable. Certainly the data is much more valid and reliable than tracking the results of your branding efforts, which will be difficult to evaluate at best. Don’t forget to consider the costs of various feedback mechanisms that you might develop. Some costs may be high enough to be prohibitive or not worth it from a cost-benefit standpoint. For example, hiring a national market research firm to evaluate your changing brand image may not be worth the substantial cost you may incur.

Some marketing efforts can be more easily tracked than others. Don’t choose an alternative just because it can be easily tracked but keep the validity and reliability of your data in mind.

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**Checking Effectiveness.** In this example, all three promotions resulted in positive Net Sales. Although the business expo had the lowest cost-per-response, it required the most time. Remember to evaluate your marketing activities based both on costs and time.

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Tip

Don’t expect results from a single advertisement. Marketing experts believe average consumers need to hear or see a message at least seven times before they act.

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Tip

Don’t expect results from a single advertisement. Marketing experts believe average consumers need to hear or see a message at least seven times before they act.
as you analyze your results. Don’t put too much stock in areas that can’t be easily tracked, and don’t forget to do all you can to develop good measures of effectiveness—as long as they don’t cost too much.

**Long term perspective**—Don’t be fooled by short-term results alone. If you’re like most entrepreneurs, you’re trying to build long-term value, not short-term results. You could lie and cheat your customers through your marketing messages and raise your revenues 50 percent in the short term but kill your business in the long term.

**Marketing Plan**

The Marketing Plan is a document that helps you structure your thoughts and focus your marketing and sales activities. As Jay Levinson, the author of *Guerilla Marketing* puts it, “The primary function of the marketing plan is to ensure that you have the resources and the wherewithal to do what it takes to make your product work.” A product or service that works is one that meets the demands of the customer.

The Marketing Plan is an integral part of your overall Business Plan. Whether you produce a polished completed written Business Plan or not, document your Marketing Plan in the Business Plan Template so that you have a clear record of your marketing objectives, strategies, tactics, and activities. That way, you can accurately evaluate your marketing effectiveness and tie your increased sales, market share, or other marketing successes to specific, repeatable marketing activities.

Here are the sections of the Marketing Plan you will develop. You have already begun collecting information in previous modules for this. Action Steps 6.1 to 6.4 will guide you as you complete your Marketing Plan. The following chart details the sections of the Marketing Plan and describes the Action Steps you’ve taken—or will take—in FastTrac® GrowthVenture™ to complete this section of your Business Plan.

<table>
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<tr>
<th>Marketing Plan Components – Detail of Your Work</th>
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<tbody>
<tr>
<td><strong>Market Plan Section</strong></td>
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<td>Pricing</td>
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<tr>
<td>Market Penetration</td>
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Summary

This module has focused on the market planning cycle and the key sections of your Marketing Plan. You determined your marketing objectives, strategies, and activities. You aligned your marketing strategies with your overall business goals and determined ways to measure their effectiveness.

Key Things to Remember

- Market planning is an ongoing process.
- You can monitor the changing marketplace by analyzing your industry, competition, and target market.
- A good Marketing Plan states its objectives—what the company will accomplish through its Marketing Plan.
- Marketing strategies help you accomplish your objectives and sustain a competitive advantage in the marketplace.
- Marketing activities should align with your strategies and objectives.
- A successful mix of marketing activities will include a blend of advertising, publicity, and promotions.
- Your marketing activities schedule will have a direct impact on your budget and should be tracked to ensure its effectiveness.

In this module, you focused on the best ways to connect with your customers. In Module 7 Leading the Organization, the spotlight shifts to the people who make it happen: you, your management team, and your employees.
Activity 6a: Growth Cycle Strategies: Market Analysis

Identify key factors for Growth Cycle Strategies to consider for market analysis.

Directions
Step 1 Read the scenario for Growth Cycle Strategies. Look for information about its industry, competition, and target market.

Growth Cycle Strategies is a firm that helps maximize the role of product managers for other firms through two means. First, the firm trains product managers to perform their roles as strategists. Second, the firm consults with those who manage product managers to help them understand how to realize a better return on their investment from their employees. A variety of industries are realizing that training for product managers is crucial to success.

Jack Elliott and Joe Brooks have, in over three years of being in business, built a base of approximately 30 clients. Growth Cycle Strategies has earned a high level of customer satisfaction in its consulting and training engagements. The partners’ experience in the area of product development and their ability to share their knowledge effectively with the product managers of their clients makes their services unique and valuable.

The backgrounds of the partners of Growth Cycle Strategies combine knowledge of technical detail with sales ability; yet both confided that sales were the least favorite part of their job.

The company targets industrial and high-tech firms with a sales volume of $25 million or more annually. Firms with lower revenue levels will not typically employ product managers. Growth Cycle Strategies targets industrial firms rather than consumer goods firms because this is the area where its partners’ expertise lies.

Decision makers within the target market tend to vary widely. That is, the firm has worked with marketing managers, directors of product management, vice presidents of sales, and presidents of companies.

For the company to continue to succeed, Growth Cycle Strategies must continue to grow its client base. The firm currently conducts one training seminar per month and completes one consulting project every two to three months. The firm has established objectives to complete 24 training seminars and 12 consulting jobs per year.

Elliot and Brooks handle the marketing efforts of the company, which takes about one third of their time. Growth Cycle Strategies has a website that gets about 1,000 hits per month (without being linked to other sites). The firm tried a direct mail campaign last April and had a response rate of 1.5 percent, which was good for direct mail; but the quality of the leads was poor. Often the individual responding was not the appropriate decision maker within the company. Now the focus is on building a referral network via existing satisfied clients. A $100 gift certificate to Amazon.com for any referral that generates business has resulted in a number of new accounts. The firm now connects with a prospective client’s decision maker regarding that company’s training budget. “We have no problem selling our service,” says Elliot.

As Growth Cycle Strategies continues to grow, Elliot and Brooks will have less time to devote to marketing and will need to concentrate on servicing their clients. Elliot and Brooks acknowledge that it may be time to add someone to the company in some capacity. In order to serve the client well and maintain Growth Cycle Strategies’ high level of customer satisfaction, they considered hiring a person with a product development background whom they could train to handle a portion of their responsibilities including sales/marketing and consulting/training. The dilemma of Growth Cycle Strategies is how to grow the company effectively.
Activity 6a: Growth Cycle Strategies: Market Analysis  continued

Step 2 Answer the following discussion questions.

1. Who is the current target market and what research needs to be undertaken regarding this target market?

2. Why is the firm not reaching the targeted volume of sales now?

3. Is the current marketing strategy sufficient to increase the volume of sales? Why or why not?

4. How could Elliot and Brooks best use the current client base to increase sales?

5. What are the advantages and disadvantages of hiring an additional sales person or direct sales force? Do you agree with Elliot and Brooks’ plan to hire someone with a product development background?

6. What impact might growth have on the current staffing structure?
Activity 6b: Growth Cycle Strategies: Marketing Strategies

Identify specific strategies that Growth Cycle Strategies, the company introduced in Activity 6a, could use in its marketing plan.

Directions
For each heading listed below, generate ideas for strategies Elliot and Brooks can use in their Marketing Plan. Use the collective knowledge of your group to come up with ideas different than are currently being used by Growth Cycle Strategies.

Growth Cycle Strategies’ Objective: Complete 24 training seminars and 12 consulting jobs per year.

Target Market: (For ideas, review A Closer Look @ Defining Your Target Market on pp. 104–106.)

Distribution Channel: (For ideas, review Distribution Channel Analysis on pp. 211–212.)

Market Penetration: (For ideas, review A Closer Look @ Marketing Activities on pp. 235–240.)

Sales and Customer Service: (For ideas, review Exceptional Customer Experiences on pp. 214–215.)

Pricing: (For ideas, review Pricing Policies on p. 175 in Module 5.)
Activity 6c: Marketing Activities Brainstorming

Identify potential marketing activities (advertising, publicity, and promotional).

Directions
Brainstorm as many activities as you can think of that would fall under advertising, publicity, and promotional. List your ideas below. When you have completed your brainstorming, put a star ★ by those that you will want to consider using for your business.

Advertising:

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Publicity:

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________________________________________________________________________

Promotional:

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**Action Step 6.1: Prepare My Marketing Plan – Industry Profile**

Analyze the current environment in which my business competes.

**Directions**

Complete an Industry Profile for your business that describes your industry by identifying growth potential, trends, and opportunities.

A. **Use the business planning template.** For this action step, you will use the Business Plan Template document you started in Action Step 3.2 Write My Executive Summary. Go to the Marketing Plan—Industry Profile in the template to insert your information.

   Each section of the template contains headings with questions in blue text which will not appear when you print the document. Consequently, your answer should incorporate the question. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. Answer all of the questions that apply.

B. **Respond to the questions and statements below.** Turn your responses into complete sentences and paragraphs to finish the first draft of your Marketing Plan—Industry Profile. If you cannot answer a question completely, answer as well as you can and make a note to do further research and determine the answer later in the program.

### Industry Profile

**Current Size**

What is the current size of your industry for this product/service?

What is the size of your industry at the national, regional, state, and local levels?

How many dollars are spent annually and/or how many units are consumed annually in the industry?

Cite the sources of information.

**Growth Potential**

How much is the industry growing, stabilizing, or declining?

Cite the sources of information.

**Industry Trends**

What are the trends in the industry?

What effect does technology have on the business?

How is the Internet affecting your industry?

Cite the sources of information.

**Other Characteristics**

What seasonal issues affect your industry?

What is the average profit for businesses in the industry?

In what area of the country are most businesses in your industry located?

Cite the sources of information.

**Distribution Channels**

What distribution channels currently exist to support the sale of your product/service?

Cite the sources of information.
Action Step 6.2: Prepare My Marketing Plan – Competitive Analysis

Identify my competitive advantage and outline strategies to compete in the marketplace.

Directions
Complete a Competitive Analysis for your business. Action Step 2.3 Analyze Direct, Indirect, and Future Competition and the research you completed for Module 3 Competitive Analysis on pp. 80–81 are a good foundation for this section.

A. Use the business planning template. For this action step, go to the Marketing Plan—Competitive Analysis in the template to insert your information.

Each section of the template contains headings with questions in blue text which will not appear when you print the document. Consequently, your answer should incorporate the question. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. Answer all of the questions that apply.

B. Respond to the questions and statements below. Turn your responses into complete sentences and paragraphs to finish the first draft of your Marketing Plan—Competitive Analysis. If you cannot answer a question completely, answer as well as you can and make a note to do further research and determine the answer later in the program.

Competitive Analysis

Competitive Analysis
What is your competitive advantage?

Include a competitive analysis matrix from Competitive Analysis on pp. 80–81 and summarize key points. The Competitive Analysis matrix is also available at fasttrac.org/resources. How does your product/service compete in the areas of price, quality, unique features, distribution system, marketing/advertising, geographic location, and strengths/weaknesses?
### Action Step 6.3: Prepare My Marketing Plan – Market Analysis

Clarify my target market and related strategies to fulfill my marketing objectives.

**Directions**
Complete the Market Analysis section of the Marketing Plan. The Customer Profile you developed in Action Step 2.2 Develop My Customer Profile is a good foundation for this section. Also refer to A Closer Look @ Defining Your Target Market on pp. 104–106 in Module 3.

A. **Use the business planning template.** For this action step, go to the Marketing Plan—Market Analysis in the template to insert your information.

   Each section of the template contains headings with questions in blue text which will not appear when you print the document. Consequently, your answer should incorporate the question. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. Answer all of the questions that apply.

B. **Respond to the questions and statements below.** Turn your responses into complete sentences and paragraphs to finish the first draft of your Marketing Plan—Market Analysis. If you cannot answer a question completely, answer as well as you can and make a note to do further research and determine the answer later in the program.

### Market Analysis

**Target Market Profile**
What is your target market(s)?
How many potential customers and/or potential dollars are available in this market segment?
What is your share of the market?
What other markets, if any, will be targeted and at what stages of the business?
(Note that the target market might be firms in the distribution channel instead of the end user.)

**Customer Profile**
What is the profile of the intended customer? Include relevant information: age, gender, profession, income, and geographic location.
What attitudes, values, belief systems, and social status define this customer group?
For business customers, what is your customer’s business type, SIC and NAICS codes, intended use for the product/service, geographic location, and size of organization?

**Future Markets**
What opportunities could occur in future markets including market size, method of market penetration, projected date of entry, and approximate costs?
### Action Step 6.4: Prepare My Marketing Plan – Market Penetration

Identify market penetration strategies to achieve my marketing objectives.

**Directions**

Complete the Market Penetration section of the Marketing Plan. Use the checklists, activities, and action steps from this module to complete this action step.

**A. Use the business planning template.** For this action step, go to the Marketing Plan—Market Penetration in the template to insert your information.

Each section of the template contains headings with questions in blue text which will not appear when you print the document. Consequently, your answer should incorporate the question. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. Answer all of the questions that apply.

**B. Respond to the questions and statements below.** Turn your responses into complete sentences and paragraphs to finish the first draft of your Marketing Plan—Market Penetration. If you cannot answer a question completely, answer as well as you can and make a note to do further research and determine the answer later in the program.

**Market Penetration**

**Distribution Channels**

What distribution channels will be used for selling the product/service to the end user?

**Location**

Where will the business be located?

How will this site promote your business?

What are the demographics of the surrounding neighborhood?

How long do you plan to be at this location?

**Direct Sales Force**

Will an internal sales force be used for selling the product/service to the end user?

How many sales persons will be hired?

What will a direct-sales force cost (compensation package, training, support staff, contests, bonuses, meetings, sales aids, displays, samples, training materials, catalogs, and brochures)?

**Sales Representatives**

Will external sales representatives be used to sell the product/service to the end user?

How many representatives will be used?

What will be the cost of using sales representatives (compensation package, allowances, catalogs, brochures, and samples)?

**Licensing or Distributors**

To whom, if anyone, will you license your product/service?

What upfront, annual, and royalty fees will you charge?

What companies will be used to distribute your products/services? List the name and address of the distribution company, contact person, geographical area assigned, and a brief description of the distribution contract.

**Brand Identity**

What is the image of your company?

How will you portray that image?

How will your brand be noticed by potential customers (for example, how the phone is answered, what the invoices look like, the company’s involvement in civic organizations and causes)?
**Market Penetration continued**

**Customer Service**
- What are your customer service strategies?
- What policies will you establish for warranties and guarantees concerning your product/service?
- What will be your policy for returns and service costs?

**Advertising and Promotion**
- What advertising/promotion will be used for the distribution channel and customers?
- What media will you use to promote your business?
- What will the advertising/promotion cost?

**Publicity**
- What strategies do you have for obtaining publicity for your business?
- What events will you promote through press releases?
- What media will you attempt to solicit publicity from?

**Telemarketing/Direct Mail**
- Will telemarketing or direct mail be used to sell the product/service to the end user?
- Where will you obtain a mailing list?
- What is your schedule for telemarketing/direct mail and estimated response rate?
- What will the telemarketing/direct mail cost (mailing list, print materials, postage, and cost per contact)?

**Internet**
- How will you use the Internet to market your services?
- What features will you have on your website?
- Will you use e-mail to communicate with customers?
- What will it cost to build and maintain a website?

**Trade Shows**
- What trade shows do you plan to use to exhibit your product (name of the trade shows, location, date, size of booth, cost to attend, the projected number of contacts, and other information)?
- What trade shows do you plan to attend without an exhibit?

**Market Activities Schedule**
- Which advertising, publicity, and promotional activities will you use to market your business for the next twelve months?
- What are the expected costs?
- Include a Marketing Activities Schedule (see p. 232 for ideas; this schedule is also available at fasttrac.org/resources) showing the time frame for each activity and the estimated expense under the month it will occur.

**Market Penetration Effectiveness**
- What activities are planned for penetrating the market?
- When will they begin and end?
- Who is responsible for each activity?
- How will you measure the effectiveness of each market penetration tactic?
### Action Step 6.4: Prepare My Marketing Plan – Market Penetration

#### Marketing Activities Schedule

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Action Step 6.5: Finalize My Marketing Financial Projections

Finalize the financial projections associated with your company’s planned marketing efforts.

Directions

In Action Step 4.2, you used the Financial Template to create an initial budget that will be used to compile financial information throughout the planning process. Your financial information was updated in Action Step 5.3 to reflect costs associated with your company’s products and services. This action step will help you update your budget to reflect the costs associated with your planned marketing efforts.

A. Review your initial budget. From the Operating Expenses Worksheet tab or the Print Options tab, print your Operating Expenses Projections to review your updated figures.

B. Analyze the figures associated with your Marketing Plan. Each projection should reflect facts collected either from your company’s own historical financial statements or from researched sources. Look at the following list of possible costs associated with a company’s marketing plans.

As you review this list, analyze your own figures. Have you included each cost item that applies? Are the projected costs supported by adequate research from trusted sources? If you can answer yes to both of these questions or if the cost does not apply to your business, place a check in the boxes below. For those items that do not receive a check, research additional sources to identify changes that might be necessary to more accurately represent this figure in your final budget.

Remember:

The Financial Template contains all projected costs for your business entered into three main worksheets—Inventory, Operating Expenses, and Capital Budget. No worksheet specifically lists marketing costs. Therefore, categories on each worksheet may contain figures associated with marketing as well as other costs of doing business such as general or administrative. For example, Payroll Expenses may include the costs of employing secretarial, accounting, and marketing staff members.
Operating Expenses Worksheet Considerations

- **Advertising** – All costs for ads, including newspaper, radio, magazines, newsletters, television, direct mail, billboards, web banners, catalogs, directories, and any other media selected
- **Dues & Subscriptions** – Costs for membership in chambers of commerce, trade or professional associations; for subscriptions to magazines, journals, newspapers, and monthly, quarterly, or annual service fees for online services such as survey software or anti-virus fees
- **Licensing & Fees** – Costs for using licensed products and logos, distribution fees associated with marketing and selling other companies’ products, special license or fees to market, sell, and distribute specific products
- **Marketing & Promotion** – Costs for printing collateral materials such as business cards, stationery, brochures, postcards and flyers; promotional products, coupons, rebates, contest prizes, sponsorships, demonstrations, trade show booths, focus groups, surveys, and customer appreciation activities
- **Meals & Entertainment** – Costs associated with events, networking, outings with clients, tickets to concerts and sporting events to entertain clients, and meals for trade shows and conferences
- **Miscellaneous** – Any miscellaneous or minor costs that do not fall into other categories
- **Outside Services** – Costs associated with outsourcing that are distinctly different than those classified as Professional Services—may include staffing or temporary employment fees, distribution of flyers, and direct mail services
- **Other** – Significant costs that do not fall into other categories (Identify the category associated with these costs by entering a description next to Other.)
- **Payroll Expenses** – Costs for salespersons or marketing staff—including salaries, benefits, commissions and bonuses
- **Professional Fees** – Fees paid for services such as website design, development, and updates; graphic design fees, consultants, and other costs associated with outsourcing work (If specific costs are associated with customer projects, those costs should be categorized under Cost of Goods.)
- **Shipping & Delivery** – Costs associated specifically for marketing such as sending samples, direct mailings, or products and material shipping costs for trade shows (Costs may include postage, insurance, or courier fees.)
- **Telephone** – Costs associated with making calls for marketing
- **Travel** – Costs associated with marketing such as airfare, hotel, car rental, and taxicabs expenses to call on prospects and customers and to attend conferences and trade shows

C. **Make appropriate changes.** Based on the new information available, enter changes into your Operating Expenses Worksheet to more accurately represent projected costs for marketing in the Financial Template.
A Closer Look  @  Marketing Activities

You can market your products or services in many ways and combine any number of activities to create your marketing activities—advertising, publicity, and promotional activities.

Advertising
Advertising is one way to get information about your product or service to potential customers. Because advertising can be expensive, you will want to focus your reach on a very specific target market—which means getting in front of specific prospects most likely to be interested in what you offer. For example, if you own a chain of day care centers, it may be more effective to advertise in selective local publications that target parents with young children; or you could advertise in school newsletters that reach families within a ten-mile radius of each of your centers. Advertising is only effective if it reaches the eyes and ears of your intended audience.

Print and Media Advertising
Print and media advertising include newspapers, magazines, television, radio, and the Internet. If you are considering advertising in these venues, you need to ensure that the advertising will yield the results you desire—quick results and rapid sales. Consider the advantages and disadvantages of each of these venues as listed on p. 236.

Tip
In your ads, focus on what’s unique about your business, product, or service—your competitive advantage—and how customers will benefit from doing business with you.

swapping services

When a Boston public radio station needed office relocation assistance, entrepreneur Gretchen Fox, president of Fox Relocation Management Corp., saw an opportunity. In lieu of a fee-for-service arrangement, she swapped her services for radio spots promoting Fox Relocation. The market synergy was perfect: among the station listeners were the top executives of professional and financial firms in Boston. The urbane, understated announcements positioned Fox’s firm as professional and civic-minded, educated the market about the new service she was offering, and gave the impression of a more established firm.

Advertising can be costly. If you plan to promote your business this way, consider:
• Purchasing small blocks of local radio or television time at a reduced rate.
• Buying pre-emptable time. If timing is important, this won’t work.
• Selecting a smaller local newspaper, radio station, or television station that reaches your market.
• Working with a media-buying service that provides expertise in buying various types of media.
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<th>Medium</th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tr>
<td><strong>Newspapers</strong></td>
<td>Reach a large audience</td>
<td>Short life span of ads</td>
</tr>
<tr>
<td></td>
<td>Fit various budgets depending on size and frequency of ads</td>
<td>Uncertainty that the target audience will see ads placed for a specific date</td>
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<tr>
<td></td>
<td>Have short deadlines that make placing or changing ads easy</td>
<td>Clutter of other ads</td>
</tr>
<tr>
<td></td>
<td>Offer special feature sections and articles</td>
<td></td>
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<tr>
<td><strong>Magazines</strong></td>
<td>Reach a more specific audience based on well-defined geographic, demographic, or lifestyle variables</td>
<td>Long lead time between placement and printing</td>
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<tr>
<td></td>
<td>Maintain a longer life and more exposure since readers look through it more than once</td>
<td>Higher costs for production and ad placement</td>
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<tr>
<td></td>
<td>Provide superior production quality</td>
<td>Fewer options for ad sizes and formatting</td>
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<tr>
<td></td>
<td>Offer unsold spaces at deeper discounts</td>
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<tr>
<td></td>
<td>Provide extra services such as reader-response cards which allow you to build a mailing list</td>
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<tr>
<td></td>
<td>Delay fee collection until ad appears in print</td>
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<tr>
<td><strong>Television</strong></td>
<td>Reaches a large number of people in a short time</td>
<td>High costs</td>
</tr>
<tr>
<td></td>
<td>Conveys messages using visuals, language, sound, and motion</td>
<td>Short exposure</td>
</tr>
<tr>
<td></td>
<td>Offers the option of spot ads in one market with one station or cable television advertising</td>
<td>Need multiple exposures to be effective</td>
</tr>
<tr>
<td></td>
<td>Maintain a longer life and more exposure since readers look through it more than once</td>
<td>Competition from national and larger companies</td>
</tr>
<tr>
<td><strong>Infomercials</strong> (cable television show)</td>
<td>Demonstrate how a product or service works</td>
<td>Up-front expenses such as setting up a toll-free number and purchasing television time before generating sales</td>
</tr>
<tr>
<td></td>
<td>Reach large population bases where high sales can result</td>
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</tr>
<tr>
<td><strong>Radio</strong></td>
<td>May reach a larger audience than print or television</td>
<td>No visual impact on the target market</td>
</tr>
<tr>
<td></td>
<td>Allows you to target a very narrow segment of the market by advertising during a specific time block or program</td>
<td>Branding more difficult</td>
</tr>
<tr>
<td></td>
<td>Offers cheaper rates and shorter deadlines than print advertising</td>
<td>Less time to convey messages</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Repeat exposure for ads to be effective</td>
</tr>
<tr>
<td><strong>Internet</strong></td>
<td>Can reach a global audience</td>
<td>Must compete with lots of clutter</td>
</tr>
<tr>
<td></td>
<td>Allows targeted messages to certain interest groups through search engine optimization or pay per click</td>
<td>Up-front expenses for designing and placing an ad before sales are generated</td>
</tr>
<tr>
<td></td>
<td>Provides links from the advertising directly to an online site for ordering; potentially minimal time lapse between message and result</td>
<td>Links can be ignored</td>
</tr>
</tbody>
</table>
A Closer Look @ Marketing Activities continued

**Other Forms of Advertising**

Other popular advertising venues include direct mail and ads. Many entrepreneurs also reach their target market by using new and creative advertising options that are just emerging. One example of a new form of advertising is floor slicks—ads of food products placed in front of shelved products in grocery store aisles. Other ad options include grocery store carts, digital messages on display boards, theatre screens prior to movie previews, and magnetic billboards on vehicles. Consider these and other advertising options, including the following:

**Web banners**—Place advertisements for your company, product, or service on other companies’ websites.

**E-commerce catalogs**—Make electronic catalogs available to customers on your company website. The advantages include no printing or mailing costs and product or service descriptions. Prices can be updated anytime.

**Direct mail**—Direct mail means sending marketing information and sales literature to potential customers by mail. From the standpoint of size alone, direct-mail marketing provides a way to reach a large number of customers quickly. It allows entrepreneurs to easily measure the response. The quality of the mailing list has a major impact on the effectiveness of the campaign. Many of the lists sold are only updated annually, and the contact information may be outdated quickly.

Thoughtfully designed direct mail pieces can produce desired results. Research has shown that more than 90 percent of Americans have bought at least one item as a result of direct mail. The disadvantage of using direct mail is that the cost is front-loaded. The mailing piece, mailing lists, and postage are paid for up front without any guarantee that sales will be generated. Response rates for direct mail are low and average about 1 to 3 percent. Carefully targeting the recipients can improve response rates.

You can compile the best mailing list from actual customers. If you keep track of their names and addresses via receipts and order forms, you automatically have a list. Asking customers to sign a list or enter e-mail information enhances your customer mailing list.

**Flyers**—You can use handouts or flyers at networking events or trade shows. They often contain a discount coupon to attract customers. This method can be a cost-effective way to reach a small market area since you can design flyers or coupons on a personal computer and have a printing service print hundreds of them fairly inexpensively. You can also trace how many customers are attracted to your business by counting the redeemed coupons.

**Catalogs**—The catalog industry has grown significantly. Firms such as L.L. Bean®, Orvis®, and Lands’ End® have all enjoyed tremendous growth and success. Catalogs, however, are expensive to produce and send, and these costs are incurred prior to making any sales. It is important to develop a targeted customer list before investing in this advertising venue.

**The Not-So-Ordinary Options**

Entrepreneurs are exploring newer options for advertising that allow them to access target customers based on behavioral variables. Ads can be placed in airports, on ski lifts, and on television monitors in stores. By using creativity and “why not?” approaches to accessing customers where they shop and play, you are more likely to be seen and heard by your intended audience. Resist the urge of one hockey-impassioned entrepreneur who couldn’t pass up the opportunity to purchase advertising at the hockey rink in exchange for receiving season tickets. Although he enjoyed many games during the season, his target market—female baby-boomers with mid-range incomes—rarely attended the hockey games. His advertising was ineffective in this medium.
A Closer Look  Marketing Activities continued

Through the design of your advertising, you can build on your brand identity. Once you know which medium you want to use for advertising, you can decide on the format that would work best and the message you want to present. You can find experts for each medium who can help you design advertising that fits your goals and budget.

Publicity
Besides paid advertising, you can get the word out about your business through publicity. Publicity is known as “free advertising” because the media publishes stories or notices about businesses, products, or services at no cost.

Feature Story
One way to stimulate publicity is to be featured in news stories or other media coverage. You can contact newspapers, magazines, radio, and television stations to learn their guidelines for submitting ideas for stories. By building relationships with programmers and editors, you might be interviewed or profiled on shows and in publications as an expert in your industry. Many publications might also accept interesting or educational articles that you or someone from your company writes.

If you are trying to use publicity to gain awareness about your business, be prepared to present an interesting angle or fact about your business’s uniqueness. Programmers and editors look for information that is timely, important, and interesting to a large segment of their audience.

Press Releases
Another way to make publicity work for you is to submit press releases on a regular basis to local and regional media sources. Press releases should be as short as possible. Most editors and media representatives prefer them to be no more than one page. Examples of press releases can be found on the Internet or in books that focus on publicity or public relations.

Media sources are most interested in press releases that create news angles such as those that feature these components:
- Controversial issues
- New trends
- Shock value or hard-to-believe facts
- Links to current local, regional, or national news
- Celebrity or well-known personalities
- Timeliness

Your work is not finished when you send a press release. Follow up with a phone call or e-mail. Don’t give up if your first effort does not result in a story. It may take several attempts to get coverage. If nothing results, ask an editor or reporter for suggestions.

Community Recognition
Other ways you can gain positive publicity are by sponsoring an award or community event or donating your product or service as a prize for a local charity. This recognition is a subliminal way of marketing your business and helps to provide visibility for the charity or cause you sponsor.

Contests
Publicity is about learning to make your own noise in the marketplace. Another way to create awareness and excitement about your business is to stage a contest. You can create the title of the contest, develop a theme, establish categories for entries, and offer awards or prizes to the winners. For example, if you are a website designer you could stage a “Worst Website” contest and set the criteria for winning. The winner would get a gift certificate towards a new website. You or a celebrity panel would be the judges.

Tip
“Free advertising” or publicity can be expensive in terms of the time and resources you invest.
A Closer Look @ Marketing Activities continued

By staging a contest, you can generate publicity from various media sources, be interviewed about the winning entries, and position yourself as the expert in the area. The contest is another reason to create press releases—for the contest, the winners, sponsors, and your business.

Contests do not have to be conducted on a large scale. If you own a restaurant, you can ask customers to place a business card in a bowl for a chance to win a free lunch. You can hold monthly drawings and contact winners by mail or phone. Offering this type of contest also helps you collect contact information from customers to use in future promotions.

Promotions

You have to find ways to promote your products or services to the same buyers or target market over and over again. You should recognize the importance of staying in front of potential or existing customers to create interest to buy again or to refer a new customer. Promoting your business consistently does not always have to cost a lot of money. It does, however, require forethought and some creativity to find new and cost-effective ways to market your business.

The most common promotional activities to market your business include premiums, coupons and rebates, and product or service demonstrations. Telemarketing, trade shows, and networking also may be ways to get the word out about your business and stay in front of your target market. Don’t forget emerging technologies that offer new avenues for promotion.

Premiums

Premiums or gifts offer prospects or customers something at no extra charge and reinforce your brand. Also called promotional products or advertising specialties, premiums have been around for quite a while. They include t-shirts, mugs, magnets, and cool gadgets that capture people’s attention because they are unique.

The objective behind premiums is providing value to customers and visibility for the business. When using premiums, consider choosing items that customers will want to use and keep. You can buy premiums from representatives whose catalogs feature thousands of items and who can help you select items that meet your budget. Keep in mind that premiums require camera-ready logos and artwork, minimum volumes to place orders, and space to store the inventory. Premium dealers offer discounts for different volumes, so it pays to order in larger quantities.

Coupons

Coupons provide a variety of options to promote a small business. They may offer a price reduction, two-for-one offer, or limited incentive for purchasing products or services. An incentive can be anything from a free gift, opportunity to win a grand prize, or discounts on future purchases.

Rebates fall into the same category and are redeemed by the customer or by the vendor who sold the product or service. Only a small percentage of customers use coupons or rebates. The average redemption rate for coupons placed in newspapers is between 1 and 5 percent. Other coupons placed in magazines, direct mail pieces, and enclosed with products still average less than 10 percent redemption.

Demonstrations

Demonstrations, or demos, allow prospects and customers to try a product or service before they purchase it. Although demos may be expensive since they require planning, labor, and hard costs, they allow people to sample what they normally might not buy. Studies have shown that up to 80 percent of shoppers buy through this form of promotion. Demos may offer a product sample, initial free trial period for using a service, or a coupon or rebate to create an incentive to buy at that time.
A Closer Look @ Marketing Activities continued

Telemarketing
The telephone has emerged as a major sales tool with the advent of automatic dialers and computerized-screening sales pitches. No matter the scale, the modern marketer should make maximum use of the telephone. One advantage of telemarketing is its low cost. It costs little to get started, and the marketer can choose the scale of operations. The disadvantage is that staffing and managing a telemarketing salesroom can be stressful. Rejections occur often, and customers are not always pleased to be called by telemarketers. Be sure to comply with any “do not call” laws for your community.

Trade Shows
Another face-to-face opportunity to interact with prospects is to participate in trade shows. They are used frequently in marketing products or services to businesses and consumers. Spending a few days attending or exhibiting at the right show can reach a large number of high-quality prospects. Studies indicate that 50 percent of people attending trade shows do so for the purpose of seeing new products or services.

Literally hundreds of trade shows span the country, as do local events planned by associations, chambers of commerce, and civic organizations. Trade show organizers can provide lists of past exhibitors and attendees to help you find shows that match your business. Managing a trade show effectively requires a specific set of skills such as attracting prospect traffic to the booth, building rapport, and following up with good leads. It’s important to set goals for trade show participation and follow-up on all leads and contacts immediately after the trade show ends.

Networking
Word-of-mouth marketing is one of the best means of promoting a business. Face-to-face opportunities with prospects allow you to use your personality and passion to market what you offer. Networking provides opportunities for you to respond to questions, build rapport with prospective customers, and market your business with little or no financial investment.

When starting a new business, check out networking opportunities through chambers of commerce, association meetings, and community events. If you are not comfortable with your networking skills, consider taking a class on developing those skills or start with groups that are smaller, allowing you to talk with a handful of people. Practice using your elevator pitch until you feel confident about trying it out in larger networking scenarios.

E-Newsletters
Stay in touch with customers, educate them about new products or services, and offer incentives that can be downloaded and used for their next purchase through your company’s e-newsletter. This form of communication costs less than the print version because it eliminates the costs of printing and postage.

Electronic Media
Send an interactive CD-ROM or DVD instead of a print brochure. This marketing technique allows customers to view diverse forms of information on their own time. Using e-mail to communicate with customers, suppliers, employees, and colleagues can be a good marketing and communication tool because of its speed, lower cost, reliability, and efficiency. With today’s technology, communication is faster and, sometimes, more reliable.
A Closer Look @ Your Sales Process

Sales methods vary almost as widely as the products or services being sold. What works for you might not work for your competitor and what worked for you last year may not be enough to help you reach your goals for the coming year. As you grow your business, you will want to consider new methods to achieve your vision and goals.

Whatever your sales methods, the sales process will be nearly the same. You should master this process or use an experienced sales manager who will direct this process for you. A Closer Look @ Your Sales Process is designed to get you thinking about your current sales methods, your process, and ways to improve them.

Comparison of Sales Strategies

<table>
<thead>
<tr>
<th>Employment Status</th>
<th>Internal Sales Team</th>
<th>External Sales Team</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supervision</td>
<td>Your company can direct their sales effort.</td>
<td>Call their own shots.</td>
</tr>
<tr>
<td>Compensation</td>
<td>Your company pays salary, salary plus commission, or straight commission.</td>
<td>Commission</td>
</tr>
<tr>
<td>Impact on operating expenses</td>
<td>Salary is an expense regardless of sales effectiveness.</td>
<td>Commission is an expense only when a sale is made.</td>
</tr>
<tr>
<td>Sales reach</td>
<td>Limited to your company's resources and relationships.</td>
<td>Sales agents can be engaged in many territories.</td>
</tr>
<tr>
<td>Knowledge of customers</td>
<td>Based on your company's knowledge or personal relationships.</td>
<td>May have pre-existing customer relationships.</td>
</tr>
<tr>
<td>Products sold</td>
<td>Only your company's.</td>
<td>Often sell products of more than one company.</td>
</tr>
<tr>
<td>Customer service</td>
<td>Provided by your company.</td>
<td>Provided by the sales agent.</td>
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</table>

You can use internal or external sales methods to sell your products or services. The type of sales method you use depends on the industry, type of product or service, sales volume you need to grow your business, and the resources you are willing to invest in sales. When deciding on the best sales method for your business, research how competitors are selling their products or services and consider learning methods used by other businesses outside your industry.

Internal Sales Methods

In an internal sales method, teams of employees market and sell your company’s products exclusively. The advantage of using an internal sales method is that your company has control over the sales process, pricing, customer service, and relationships with the customer. The primary disadvantage of using internal sales methods is that your company carries the sales costs until the customer pays for the product or service. Another disadvantage is that your sales revenue depends on the size of the internal sales team. If you use a solo approach, all revenue depends on you.
The following are the most common types of internal sales methods:

**Solo Approach**—You sell the products or services yourself. Initially, you may do so out of necessity if you did not have enough profit to pay commissions or salaries. With the many roles you need to play in your business, you will eventually consider other methods to increase your sales volume.

**Direct Sales Force**—Internal salespeople, also known as a *direct sales force*, work directly for you and are paid straight salary, salary plus commission, or straight commission. The advantage of using a direct sales force is that they are full-time employees. You can orchestrate their sales efforts and monitor their activities closely. You have more control in training them to sell, price, and support the product or service. The disadvantage is the expense involved in maintaining a full-time sales force. You have to pay salary, travel, office support, and benefits for each salesperson.

**Internet**—Many entrepreneurs have been successful selling products or services over the Internet or on websites. Technology is quickly changing industry distribution patterns, specifically for books, music, and software products. Using this method allows some sales functions to be done electronically. Over time, this sales method will increase the need to hire additional staff in operations or to outsource entire functions such as sales processing and fulfillment.

### External Sales Methods

The advantage of using an external sales method is that your company typically does not incur any sales costs until the customer pays for the product or service. You hire another company to do the selling for you. This method allows you to utilize a large sales force and sell more products or services locally, regionally, and nationally. The primary disadvantage of using external sales methods is that these entities usually sell other products or services. External sales teams tend to push the products or services that are easiest to sell and that already have a large customer following. Another related disadvantage is that you have little control over external sales teams since they do not work directly for you. Therefore, they can be harder to manage in regard to pricing, follow-up, and service.

The most common types of external sales methods include the following:

#### Licensing

Many entrepreneurs seek companies or people to whom they can license their products. In addition to upfront and annual fees, licensees typically pay the licensor a royalty percentage for each product sold. In some cases, other entrepreneurs can launch their business faster and more economically by buying the rights to your existing products than by developing their own. If you have a solid product, you can grow faster by licensing the rights to your product or service to other entrepreneurs. Going rates for you as the licensor for licensing your product or service are 5 to 12 percent of wholesale revenues over the life of the agreement.

**Existing Distribution Channels**—Your industry may have existing distribution channels that could market and sell your products or services. Many manufacturers use wholesale distributors to reach both business and consumer markets. Food and toys are common products that have well-established wholesale distributor channels. You can see why distribution is a marketing issue because it affects your approach to sales.

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**Tip**

Both the licensee and the licensor should seek professional advice from an intellectual property attorney before signing a licensing agreement.
**Sales or Manufacturer’s Representatives**—External salespeople—also known as representatives, sales agents, or sales reps—are engaged as subcontractors for your business. You pay these agents by a commission which is calculated as a specified percentage of the wholesale price. They receive their commission after you collect from customers. The sales agent pays for expenses—such as product samples, travel, office, telephone, and supplies—inured in selling your product or service. You save the cost of full-time employees.

**The Sales/Service Process**
The Sales/Service Process refers to the steps you take to prospect, sell to, and retain customers. By adapting this process, you can create a pattern to follow, improve, streamline, and replicate successful sales. You can also train others to use the same process. If your sales begin to drop, you can use this process to diagnose whether one aspect or another of your sales process needs particular attention. Planning your sales process will help you address deficiencies more quickly to keep your business running smoothly.

Using the Sales/Service Process illustrated below, determine how prospects in your industry turn into a first sale and then become repeat customers and referral sources. By anticipating each step in the process, you can prepare your approach, learn customer’s needs, highlight features and benefits of your products or services, overcome objections, close sales effectively, and build long-term relationships with customers.

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**A Closer Look @ Your Sales Process continued**

**Tip**
Periodically document your actual sales process to identify how well you or your sales team follow each step. Determine what changes should be incorporated and define a new sales process.
A Closer Look @ Your Sales Process continued

Define Target Market
Your target market is a specific group of customers you have identified as the best fit for your product or service. Your target market should be relatively easy to enter, offer a significant profit potential, or have competitors with identifiable weaknesses.

Generate Sales Leads
Once you know your target market, consider methods for generating sales leads. You can use marketing to reach your sales leads and generate interest for your products or services. Referrals from your current customers are often the best source of sales leads for many businesses.

Another way to generate sales leads is to join local clubs or networking groups created for business owners or sales people to share sales leads. Chambers of commerce often have several such groups and others are listed in the local newspaper.

You can also purchase mailing lists that match your customer profile to generate sales leads. List brokers usually price lists by the number of names and sort them by zip codes or other demographic variables. Find local list brokers or develop your own list from professional association directories or other local sources.

Qualify Sales Leads
In this step of the Sales/Service Process, you determine whether the sales lead matches your customer profile. If leads were generated by a listing service—a firm that gets paid to sort out potential customers in a target area that matches pre-selected demographic variables—or comes your way through a referral, you may consider these leads as potential customers.

If sales leads have not been generated by a professional list broker or referral source, then you will need to develop a process to determine their suitability through further research. Create a set of questions that may help you determine if a lead matches your customer profile and then answer these questions by conducting more market research. This research may be as simple as asking others who may know more about the consumers you are considering contacting.

Approach Prospects
In order to make sales, you have to approach potential customers. For many businesses, this step usually means that the sales representative makes an initial contact with the prospect in person or by phone. If sales is currently one of your responsibilities, you may find that as your business grows, adding someone to your management team to lead the sales effort makes sense.

Prospects may also initiate the approach by coming to your business or by calling, mailing, or e-mailing with requests for information. Part of your Sales/Service Process is creating a standard for greeting prospects, making them feel welcome, and responding to their requests or visits. With some businesses, the prospect is the one initiating the approach. For example, retail stores and restaurants generally have prospects coming to them.

Regardless of who initiates the approach, the objective is to establish rapport with the prospect and determine the level of interest in your product or service. You will spend a great deal of effort, time, and money marketing your products or services. Interacting effectively with prospects is critical to making sales.
A Closer Look @ Your Sales Process continued

Make Sales Presentation
In this step of the Sales/Service Process, prospects learn more about your products or services and how they align with their needs. Although some sales presentations are pitched formally using a script or pre-determined format, many entrepreneurs have found that using either consultative selling or relationship selling is more successful. Concentrating their focus on each client’s particular situation, needs, and vision, a sales staff can create opportunities to increase business. Consider how your company and product or service can provide meaningful value to a client and include that in the sales presentation.

Consultative Selling—In a consultative selling approach, sales representatives diagnose each customer’s particular situation and needs. The goal is to find out if the benefits the sales representative can provide match the needs. They ask questions to learn more about the prospects’ problems and then collaborate with prospects to consider solutions. This approach is also called solution selling. The emphasis is on the prospects’ needs and not on the product or service. The sales representative’s objective is to provide the prospect a solution with the company’s product or service.

Relationship Selling—When using the relationship selling approach, sales representatives first focus on building a relationship with a prospect. Once rapport and trust have been developed, sales representatives provide valuable solutions to meet the prospect’s needs and problems. This approach is focused on connecting with people profitably, not on persuading them to buy. By creating and nurturing relationships with prospects, sales representatives can build long-term customers and generate more referrals. Recognize that if your product or service does not meet a customer’s needs you can create future opportunities by referring them to another product or service that does.

Handle Objections
During the Sales/Service Process, you might encounter obstacles that could prevent the sale from closing. Customers may express objections to the price, features or benefits, or their perceived need. The best way to prepare for this step is to anticipate possible objections and be prepared to address them.

Use the Yes, and technique when prospects raise objections. Agree with the objection (the yes) and then offer additional information that will influence the sale (the and). Avoid acting defensively. Objections are part of the sales process and provide opportunities to close the sale.

Close the Sale
The next step in the Sales/Service Process is about recognizing buying signals made by prospective customers and asking for their business. Buying signals may include body language, comments about delivery or quantity discounts, or other statements that show readiness to buy. The best way to close a sale is by asking questions that indicate you are ready for the transaction. If prospects raise an objection, you will need to respond to those concerns before closing the sale. Consider these sample questions for closing:

- “How many cans of paint do you want to take with you today? If you need more to finish painting the fence you can call us, and we’ll have it available before you come down.”
- “What day would you like it delivered to your home?”
A Closer Look @ Your Sales Process continued

Create Relationships
Although the sales transaction is complete when the prospect buys the product or service, you want to maintain ongoing relationships with your customers. You want customers to buy again. Many companies only focus on marketing to customers and closing sales. Very few businesses concentrate on creating long-term relationships with customers. Several studies have documented, however, that it costs as much as five times more to get new customers than it takes to keep them.

By developing strategies to create relationships with first-time customers, you are more likely to generate repeat sales and referrals. In fact, repeat customers may become a strong competitive advantage for your new business.

Service and Repeat Sales
Depending on your business model, you may perform services after the sale. For example, if a house cleaning company makes a sale and schedules the service, the actual service occurs after the sale. If your business involves service after the sale, take this step even further by contacting customers after transactions are completed to check on their satisfaction and to determine if additional opportunities exist. Most businesses overlook this step and lose repeat sales and referral opportunities.

For many companies, this part of the sales and service process is about being responsive to customers when they contact them. If sales and company representatives respond favorably to customers, they have a higher likelihood for repeat business and referrals. In almost every industry, building a strong business depends on repeat sales and referrals. If current customers and their referrals generated 20 or 30 percent of your company’s new business, you would spend less on marketing costs and build a strong and loyal base of customers.
A Closer Look @ Effective Websites

Websites are standard for doing business in many markets. Most customers will expect you to have one. Your website should be more than another piece of collateral marketing material; it should earn its keep by opening a new avenue of sales. Done correctly, a website will work hard for your business and help you build your brand, your customer list, and your business.

The look and feel of your website should align with your brand image. Make sure that your website and collateral materials are consistent. Because the website is a dynamic environment, you can use it everyday to help promote your business and keep it in the public eye. Information on your site can be changed in seconds to promote your latest press release or to tout your new product offering. If you add a well-known person to your board, you can mention it on your website almost immediately. If you win a big contract, the news can be posted in a flash.

Many companies believe they should build their own website to save money and maintain control, but this is not necessarily true. If you have a graphics person or web designer on staff and can afford to pay for their time as an overhead cost, building it yourself might make sense. If the designer is billing hours to clients, however, having them stop to build the company site may actually cost you money.

Hiring a professional design firm, a freelance website designer, or even an online web design site through elance.com or a search engine such as Yahoo!® may turn out to be a better option. No matter who builds the site, maintain control over the process—including content, design, layout, and updates.

Creating an effective website entails more than hiring a designer to put up a pretty homepage. The actual design is just a small piece of the puzzle. A website should be designed to quickly satisfy a customer’s needs and expectations, not impress them with flashy graphics.

Use the questions below when you discuss your website with a web designer:

Who is my target web audience? Just as in other marketing avenues you need to know your target web audience.

Why will this audience visit my website? Prospective customers using the web will visit your site for one of two reasons: to learn or to buy.

What does my target audience expect to find at my site? Product reviews and descriptions, pricing and delivery information, customer testimonials, a client list, a company info page, a press release, a downloadable product spec sheet—these are just a few types of information web users may be looking for.

What other visitors might my site attract? Consider the needs or intentions of prospective employees, potential partners, investors, news media, and competitors. But be cautious. Never put anything on the web that may give competitors information you do not want them to have.

What’s the competition doing? You will find yourself competing for website visitors in the same way you compete for other customers. Search similar businesses in your industry and click around their websites. How are they designed? What messages do they convey? What do you like about their websites? What don’t you like? Take notes and share your findings with your site designer.
A Closer Look @ Effective Websites continued

How will people find my site? Search engines are a big part of online marketing. Studies have shown that the vast majority of web surfers use search engines to find what they’re looking for. Google® and Yahoo! dominate the search industry, so it is imperative that you try to establish a presence there. You have two options for search engine listings: free and pay per click.

• **Free search engine listings**—Many companies hire experts who spend enormous amounts of time trying to get the company’s website listed high on Google and other sites. Search engine optimization (SEO) experts can work with you to make sure your website is coded correctly and that keywords are used wisely, but in the end free search engine optimization is not something you should depend on. If the SEO does their job well and the Google algorithm doesn’t change you might find yourself listed one day, but it will be later rather than sooner.

• **Pay per click search engine listings**—One of the fastest, although more costly, ways to get your website on Google, Yahoo!, and other search engine sites is to use pay per click (PPC) advertising. PPC ads are the text ads you see along the right side of a Google results page. Advertisers there have set up a Google Adwords account and have placed bids on certain keywords. For example, you may choose the keyword oranges and pay to have your ad appear each time someone searches on oranges. If the person then clicks your link to go to your website, you are charged a nickel. You can find more in-depth information on pay per click advertising by doing an online search for “PPC marketing.”

What sales and operational functions do I want my website to handle to save time or resources? Consider your website an “online branch” of your business. It can offer basic information and automate many business functions such as adding or making changes to the database, monitoring sales transactions, checking on the status of orders, and even paying bills. Will you sell products or services online? If yes, consider e-commerce capabilities and security issues.

Who will manage and maintain my website? Effective website marketing has far less to do with buzz words than with real and accurate information. Making timely adjustments keeps the website working for you. Do you want to access your website internally to make small changes as necessary? If so, maintain an in-house web expert or outsource the task to a reputable firm. Many firms will make your updates in less than an hour. If it takes more than twenty-four hours for you to get a web update, hire a different firm.

How do you launch a new website? Think of the launch of a website as the opening of a store. Send out press releases, e-mail customers and partners, and call everyone you can think of. Do anything to get the word out that your site is open and ready for business. Some companies will actually start the marketing process before the site is launched to build anticipation and have customers waiting at the electronic door. Recently, a savvy Internet marketer used online marketing to build anticipation for the release of his new DVD and book product. On the day the product was made available online his gross sales were over a million dollars.
While entrepreneurial mythology glorifies the individual who by sheer willpower, cleverness, and hard work creates a profitable business from little more than nothing, the reality of most successful businesses of any size is usually another story. It’s a tale of teamwork, with each member playing a vital role in the growing business. Knowing how to select and lead a strong management team is one of the secrets to growth.

This module will help you think about your changing role in leading the organization and the roles of your team members. As you work on your Management and Organization Plan—a major section of the Business Plan—you will explore proven leadership strategies and ideas for hiring, compensating, and motivating your team. You will match your organizational structure to your strategy and ensure you have the right organizational culture as well as an empowering leadership style to carry out the tasks and activities needed to reach your business goals. This module gives you the opportunity to step back and reflect on the structure of your business—not only the legal but also the human aspects of management and organization.

Key Questions

- Do I have the right people on my management team?
- How can I improve the way I lead people and manage work?
- Am I using the appropriate legal form of organization for my business?

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<td>7.3 Finalize My Management and Organization Projections</td>
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Primed for Growth

Many new businesses resemble a one-man band: the entrepreneur is playing all the parts but is fairly limited in what can be accomplished. Entrepreneurs who want to grow their business will instead want to think of themselves as a band leader: they bring in people with the right expertise who will work together and follow the direction of their leader. They know their part, the theme, and the rhythmic framework and realize some improvisation may be needed to make the performance a masterpiece.

Every company reaches a point when the entrepreneur needs to take a hard look at the roles and responsibilities within the business and the best persons to perform them. One of the greatest challenges is to make the transition from being a hands-on manager to turning over some of the decision-making authority to others. This transition allows you to focus on coordinating efforts and leading the company.

You may find it difficult to know where to focus your efforts. Even when entrepreneurs know what to do, they sometimes have trouble getting it done while fighting daily fires in other areas of the business. Successful entrepreneurs often describe how they worked longer and longer hours running their companies before they started sharing the decision making.

This module will help you determine whether your management approach and structure are working—are you playing the right tune? It will help you develop a productive workplace by looking at leadership, organizational culture and change, and legal protection for your business. Packed with helpful insights and suggestions, this module will help you think about your business now and later can serve as a reference as your business grows.

Entrepreneurial Leadership

Leading an entrepreneurial organization primed for growth requires the following three critical competencies:

1. Ensuring the right people are filling the right roles on your management team
2. Communicating a compelling vision and clear goals
3. Creating alignment with the tasks, roles, performance, rewards, and overall strategic direction of the business

Growing Pains

Many businesses fail to reach their potential because their leaders get stuck in old ways of doing things. They waste time on unproductive activities. They underutilize the talents of their employees and outside professionals and advisers. How are you doing as an entrepreneurial leader? Go back to Module 1’s Internal Assessment, p. 14, and review your responses under the Management and Organization heading.

If you answered all the questions with a resounding Yes, then you’re probably doing a lot of things right. If you answered with more Needs Improvements, then you’re probably looking at a need to make some changes in your leadership style or your management structure.

Tip

Reflecting on your business is the first step in the process of business improvement. There are no shortcuts to long-term success.

Before you consider the type of team you need to have in place, let’s spend some time looking at how your role changes as your business grows. This module is designed to put that critical information into your hands. The first section touches upon many of the most important indicators of your leadership success. The rest of the module goes into depth exploring the current strengths and weaknesses of your organization and providing proven techniques to help you achieve leadership excellence.
“One of my biggest mistakes was having everyone in the company report to me for the first six years,” says Andy Schwartz, president of A.J. Adhesives in St. Louis, as well as two other companies that provide industrial adhesives, packaging equipment, and applications engineering to manufacturers. Schwartz launched his business and six years later realized its growth was stymied because he was consumed with management issues. “It was maddening,” says Schwartz. “I was always working on systems, processes, or problems and couldn’t focus on new revenue-seeking opportunities—I was just too tired.”

To correct the problem, Schwartz reorganized the company and created a level of middle management, a move that reduced his number of direct reports from fourteen to six. That approach worked well for a couple of years until Schwartz bought a company in Spring, Texas, and moved there to oversee operations. With the acquisition and relocation, six direct reports soon became overwhelming, so Schwartz cut back to two—his chief financial officer and his operations manager.

Schwartz admits letting go was difficult: “Doing busy work and putting out fires all day is much easier than establishing a vision and plotting strategy to get there. But to grow the business, it was important for me to become a better decision maker.”

About the same time, Schwartz formed a board of directors with three outside members. “Because they all come from different backgrounds and have different experiences, they’re a great sounding board for me,” he says.

Since Schwartz began working on his business rather than in it, he’s been achieving annual revenue increases of 12 to 19 percent.

Scaling back on direct reports doesn’t mean Schwartz lacks direct contact with his staff. “I spend a lot of time with my employees,” says Schwartz, who likes to join them for lunch or long walks. “I want to know what their stories are…how they grew up, what their favorite vacations are. When I know what makes them tick, it helps me be a better leader.”

Over the years, Schwartz has learned to hire slower and fire faster. “That sounds harsh, but I’ve come to view our staff as a baseball team,” he explains. “And on that team, everyone has to play their positions strong. As soon as you identify someone no longer fits on the team, you’ve got to let them go.”

An important quality that Schwartz looks for in employees is curiosity. “That leads to good thinkers—people who don’t just accept things but are always looking for ways to improve the status quo,” he explains. “Today I can honestly say that I would rehire everyone in my organization, which makes me feel really good about the future. We may encounter a process problem, but we never have a people problem.”

Your Role Changes as Your Business Grows

Although no one perfect blueprint exists for you to follow at different stages in your business’s life cycle, some common stages occur across businesses. Your role should evolve along with the needs of your business.

**Initial conception stage**—Entrepreneurs are usually making all the decisions at this stage. Their efforts are focused on identifying business opportunities to pursue and creating initial strategies and operational plans. Your reputation will drive your success at this point. It will attract customers who buy, entice prospective employees to knock on your door, and prompt important individuals in your industry to think of ways to work with you.
Start-up stage—After the business is launched, entrepreneurs struggle to survive while managing things on their own. Their work focuses on modifying the products or services to meet customer needs, experimenting with marketing activities, and struggling to get customers. During initial hiring, focus on the values and mission of the organization. You should look for people whose core values match the company’s.

Early stage—The business has attracted customers but struggles to increase sales at this stage. The entrepreneur begins to rely on other management members and key personnel. Smart entrepreneurs often hire a professional marketing person at this point. Your leadership role must begin to move away from micromanaging and toward visionary leadership and goal-setting.

Growth stage—Even though the markets are established, many companies experience continual cash flow challenges at this stage. New investors, customers, and staff are added quickly. Sales management is critical. Manufacturing companies need to hire a production manager. You may want to bring in someone else to take over the operations of the company while still retaining your role as the visionary leader, primary goal setter, and public face of the company.

Rapid growth stage—When the business outpaces industry growth rates and has established itself as a viable on-going concern, it is often time for a professional management team to be put in place. At this stage you can maintain your role as visionary leader or find specific niche roles to play depending on your inclinations and organizational needs.

Maturity stage—The business has well-established markets with multiple products or services. It experiences increased competition and saturation of the market. At this stage you’ll be working with a full management team to fulfill the vision and goals of the company and preserve the business so it will continue to be healthy and increase in value.

Innovation or decline stage—The final stage of any business emerges when it must innovate or lose market share. All levels of the organization must be actively involved in innovation. In concert with the management team, you will have to drive change or the organization may die.

Strengthening Your Management Team
You only have so many hours in your work day. If you try to manage everything on your own, you’re going to fail, unless your business is very small. Could Bill Gates have succeeded in growing Microsoft® if he hadn’t gotten others to share the management responsibilities? No, and neither can you.

Entrepreneurs learn sooner or later that they can’t do all the work by themselves. Most successful entrepreneurs learn early. What many fail to appreciate—or have a hard time accepting—is that they can’t always manage or supervise everything on their own.

If you don’t have a management team, is it time for you to consider hiring one? If you do have one, is it time to adjust responsibilities and hire new members? Look at the telltale signs in Need for Management Changes and analyze the current state of your management-team needs.
Need for Management Changes

You may need to add to, or make changes in, your management team if one or more of the following are true. Answer the questions that apply to your business.

Circle one answer for each question

1. The work of the business isn’t getting done and hiring additional staff people won’t completely solve the problem. True False
2. My company has outgrown its old structures, its ways of doing things, or its capacity to meet competitive demands. True False
3. My company has begun to miss more and more market opportunities because of a lack of time, resources, or planning. True False
4. I am personally overstretched or am spending inordinate amounts of time dealing with issues in one particular area or another. True False
5. I find myself spending too much time managing employees and not enough time on business development and planning. True False
6. I am using consultants or contractors on a regular basis, and it’s costing me too much money. True False
7. My business is suffering from lack of experience and knowledge in a particular area (such as marketing, finance, or human resources). True False
8. I am ready to grow my business in a significant way or into areas in which my current team and I have little experience. True False
9. One of my current management team members is not meeting performance goals and should be trained, coached, or replaced. True False
10. The employees who report to one of my management team members are not motivated, productive, and/or happy. True False
11. I want to make changes in my organizational culture, and my current management team is unable or unwilling to change. True False
12. My senior managers are family or friends and are underperforming after being hired based on proximity, comfort, or obligation. True False

If you answered any of these questions with a True, you ought to seriously consider taking some action to fix the problem. Remember these results when reading relevant topics in the remainder of the module.

Action Step: Write down the actions you want to remember to implement.

Hiring management team members should not be done on a whim. Managers costs money—salaries, benefits, office space, desks, computers, phones, and the perks that may be required to recruit the best talent. Think about hiring the same way you think about investing. You’re going to incur costs—are those costs worth the investment? What will you get from this investment? Management team members can bring skills and knowledge that you do not necessarily have. Having your own internal management team provides greater control, camaraderie, flexibility, institutional memory, and improved communication. The right management team will allow you to lead the business to its next stage of growth.
Jim Houtz, founder of CyCare Systems, was a pioneer in the group medical practice billing and insurance software systems business. He attributes much of his success to the people he was able to recruit. To build great companies, Houtz suggests entrepreneurs adopt the attitude of the fighter pilot. He explains, “Entrepreneurs must always be in control of the plane; they must be the person calling the shots; but something else separates the great fighter pilot from the true ace, and it isn’t exceptional skill, daring, education or weapons accuracy—those characteristics are given. Instead, aviation lore has it that what makes the difference is the pilot’s wingman—the individual flying behind and outside the leader. A great wingman gives the leader the chance to be great.”

Filling Management Roles
Knowing what you need in management team members begins with knowing yourself. What skills, knowledge, and expertise do you bring to the venture? The Leadership Scorecard on p. 268–269 of this module will help you assess your interpersonal and communications skills as well as your ability to lead and inspire. In addition, consider what functional skills (such as management, finance, marketing, and sales) as well as specific expertise (such as operations, distribution, negotiations, and raising capital) you possess or need. Think about the skills your business needs now and those it will need as it grows.

It can be challenging to transition from a very small organization that relied extensively on one or two people to that of a functional, professional management team. The natural tendency for many entrepreneurs is to hire individuals very much like themselves. Although similar values are important—commitment to the organization’s growth and high standards of achievement—different backgrounds and skills are critical to balance, strengthen, and grow the organization.

Because of the fast-paced, sometimes chaotic environment in which a growing business operates, you need team members who have conceptual and creative problem-solving skills, function well within flexible, rapidly changing work and market environments, and are able to manage multiple tasks, viewpoints, and sometimes conflicting priorities. As individuals join the team, identifying their areas of responsibility and delegating authority is critical.

A classic trap unwary entrepreneurs fall into is placing close friends and family members in key positions because they are convenient to hire or because of a sense of obligation. You must have good reasons to support the hiring of each member of the team. Only hire management team members who have a track record to prove their talents and have the training and skills to do the job.

Every new manager you add will affect the work of the rest of the team, so think through, reorganize, and redefine the roles and responsibilities of each member of your management team. In Action Step 7.1 Create Job Descriptions you will be asked to define the roles and responsibilities of your management team. It is important that each member understand their specific role, responsibilities, and duties.

New roles necessitate that you clearly communicate these changes to the entire organization. As you expand the leadership role of your managers, help them develop through coaching and regular performance reviews. Module 8 Managing Operations for Growth covers performance measures and reviews.

Once the team is in place, many entrepreneurs fail to optimally use them by continuing to make many decisions in isolation. An attitude of “I know what it took to get here...”
and nobody knows this business as well as I do” both discourages input and causes the entrepreneur to discount what feedback is given.

Make the most of having a management team with these suggestions:

- Keep team members current on business and market developments.
- Seek team member input when you develop your vision and plan to achieve it.
- Update team members on the company’s progress towards its goals.
- Solicit input on key decisions.
- Periodically assess the needs of the organization and talent, skills, and structure of the team.
- Respect lines of authority and structure instead of circumventing the predetermined structure.

Leadership matters. You and your management team set the tone for your entire organization. The vision, goal setting, and strategy building you have worked on in this program can either be achieved or destroyed by the quality of the people on your management team. Be intentional about hiring and organizational team building. If you can’t hire team members for every functional aspect of your business, you can consider using some resources from the outside.

**Using Consultants, Contractors, or Advisers**

If you are like most entrepreneurs, you will find that to accomplish the work that needs to be done, you’ll need to obtain specialized and technical advice on a regular basis. Entrepreneurs use outside professionals because they are usually less expensive than hiring full-time staff, especially when they need a specific problem solved or have a project that needs an outside expert.

As you consider how you will fill the roles and responsibilities for your organization, recognize that many of the specialized skills you need can be filled with outside professionals. Your responses to *Need for Management Changes* on p. 253 may have jumpstarted your thinking about the outside expertise you need in specific areas. Some common business functions that are often filled by outside professionals include legal counsel, accounting, training, marketing and public relations, website design and maintenance, and information technology.

What you don’t want to do is outsource the core competencies of your business. If you cede control of the very things that give your business its competitive advantage, you may be gambling away your business’s future success.

Many skilled professionals can provide invaluable services. The best way to find consultants, contractors, and advisers is through referrals from other entrepreneurs, lawyers, accountants, business consultants, and Small Business Development Centers. Successful entrepreneurs avoid unsatisfactory consulting relationships by considering the following characteristics when seeking outside services:

- **Expertise** – Consider whether a generalist or a specialist is needed.
- **Experience** – Consider the consultants’ prior track records. Who else have they worked for, and what services did they render?
- **Proposals** – Ask for a written proposal. Evaluate proposals by looking for the outcomes and objectives the consultants say they will accomplish.
- **Attitude** – Interview the person to determine if you would be comfortable working with them.

If you are considering outside help, read *A Closer Look @ Using Consultants and Contractors* on pp. 284–287 for hints about what kind of help you may need. It will also provide you with guidance about how to contract and retain this help.
Getting Support
What separates entrepreneurs from success may sometimes be access to industry knowledge and insider networks. Developing this knowledge often begins with the guidance of successful, experienced entrepreneurs. They know where the pitfalls are and can help you avoid many rough spots. Using mentors, advisers, and community resources can make the difference between success and failure for your business. They can serve as a sounding board and challenge your decisions and thought process, providing you with information and helping you make contacts at critical points as you boost your business into growth. Most entrepreneurs feel accountable to their mentors and advisers—which can help keep them on track.

Mentors
In Homer’s *Odyssey*, Mentor is the character who teaches and nurtures Odysseus’ son while his father is away. The word *mentor* has evolved to refer to an experienced person who develops a one-on-one relationship, advising and nurturing a less knowledgeable person. An effective mentor can be an experienced entrepreneur in the same type of business or a professional who works with entrepreneurs and understands the requirements for success.

In addition to those relationships you are able to develop on your own and in this program, you may find other programs that pair entrepreneurs with a mentor. You may find it worthwhile to check if any formal mentoring programs exist in your community or find an online mentoring program.

Formal mentoring programs—Some formal mentoring programs may be available to you through organizations that serve entrepreneurs in your community. The organizations offering formal mentoring typically pair a successful entrepreneur with a less experienced entrepreneur. The match is usually based on type of business, goals, stage of business, personality, and other relevant criteria. Most formal mentoring programs specify the types of businesses they wish to assist. Yours may be among them.

Informal mentoring—Informal relationships are set up directly by the mentee and the mentor. The informal relationship may grow out of casual contact such as membership in the same chamber or industry association or through community volunteer work. It may also be facilitated by another person, such as a peer or relative. Ask others if they would be interested in helping you as a mentor and explain what you would like in a mentoring relationship. Realize that not everyone has the time or inclination to be a mentor.

To be most effective, the mentoring relationship should have an agreed-upon structure and focus. The mentor and mentee should discuss these parameters:
- What are you going to focus on during the time you spend together?
- How often will you meet?
- How will you meet and communicate—in person, over the phone, online?
- How long will the relationship last?

Board of Directors and Advisory Board
At every stage of your company’s life, you will need input from inside and outside the company. If your company is organized as a corporation, it must have a board of directors. The board is the managing agent for your company. It makes big-picture decisions and elects officers. In many states one person can be the sole owner of the stock in a corporation and the sole director on the board. A full board of directors, however, brings the advantage of ideas from many minds. The board of directors usually includes key members of the management team, including the CEO, investors, and independent outside advisers.

Tip
After you have established a board of directors or advisory board, use it! Have regular board meetings with specific agendas, outcomes, and purposes. Talk with directors between meetings about management issues. Your board exists to offer guidance and direction.
Some prospective board members may be reluctant to serve since the trend by creditors or disgruntled stockholders is to sue board members for their decisions or lack of oversight. Insurance is available and perhaps necessary to persuade members to serve on a formal board of directors.

Many small businesses can’t afford to hire a professional management team nor does their legal structure require a formal board of directors. So how do they get the expertise of a chief financial officer or marketing vice president? Form an advisory board, says FastTrac® graduate Jim O’Dowd.

Founder and president of OEI Telcom—a Franklin, Tennessee, company that installs telephone and voicemail systems—O’Dowd organized his first advisory board in 2002, and wishes he had done so earlier. OEI Telcom is on track for a 15 percent increase in revenue this year, and O’Dowd chalks up much of this success to his advisory board.

Unlike a formal board of directors, an advisory board is usually a group of business experts who do not directly work for the company they are advising. Entrepreneurs use advisory boards in many ways, but the ultimate goal is to get ideas, advice, and direction from these experts.

Some business owners may view a board as a bureaucratic hindrance or threat to their control, says Jana Matthews, founder of The Jana Matthews Group, a Boulder, Colorado, firm that helps CEOs become better leaders and achieve long-term growth for their companies.

“To avoid that perceived loss of control, some entrepreneurs will not appoint a board of directors at all, or they populate it with friends and family who won’t give them a hard time or ask difficult questions,” explains Matthews.

Failing to form a board or allowing it only rubber stamp approvals provides little value to your company. Just as you need to find and hire people smarter than you, you also need to find board members who complement your weaknesses and can help your company grow.

“The right board of directors can open new doors for you and can help you avoid trouble,” Matthews says. “Yet you’ll need to invest some time and effort to make sure you choose the kind of board members who can add value to your company.”

Advisory board members may be bankers, marketing consultants, industry experts, financial consultants, customers, or other successful entrepreneurs. They may meet monthly, quarterly, or as you need them. They are usually compensated in some way, although compensation is small—a meal during the meeting or a small payment per meeting. Few advisers do it for the money. Many entrepreneurs attribute their success to the help that they received from mentors and advisers. Now, they feel it is their turn to give back and help someone else.

An advisory board doesn’t have the legal status or liability of a formal board of directors, but it’s an invaluable source of advice. Specific benefits include:

- **Accountability**—An advisory board forces you to be accountable by presenting regular progress reports at meetings.
- **Brainstorming**—Advisory board members bring new insights. For example, as a telephone systems installer, OEI wasn’t generating much recurring revenue. A board member

**Tip**

We find comfort among those who agree with us—growth among those who don’t.

— Frank A. Clark
suggested maintenance contracts, and today revenue from OEI’s Service Protection Plan (SPP) represents a significant portion of the company’s revenue. “We have very few claims, so the SPP revenue is almost all profit,” O’Dowd says.

- **Sales leads**—One of OEI’s biggest sales during second quarter this year resulted from a board referral. The prospect, a dermatology clinic, was located in an area that O’Dowd might not have discovered otherwise. “The board member put me face-to-face with the doctor who made the decision and gave a glowing recommendation on how good we are to work with,” says O’Dowd. “The sale was 90 percent closed before I ever walked in the door.”

To get started, seek people who offset your weaknesses. For example, O’Dowd wanted help with financial management, so he asked his CPA to join the advisory board. Because his ultimate goal is to sell OEI, he recruited a board member from a large consulting company that specializes in business valuation and sales. Establish term limits so board members understand their commitment. O’Dowd says, “Our members receive $100 per meeting. Granted, that’s not a lot, but at least it’s some recognition that their time is valuable.”

“Advisers are essential for entrepreneurs,” says Barnett C. Helzberg, Jr., former chairman of Helzberg Diamonds®, a family jewelry business begun in 1915 and sold to Warren Buffett’s Berkshire Hathaway® in 1995. Founder of the Helzberg Entrepreneurial Mentoring Program in Kansas City, Missouri, Helzberg says, “The best advice comes from knowledgeable third parties who aren’t afraid to tell it like it is.” He adds, “Cherish these people. Their expertise will help you build your company. Play your cards right, and they will also become friends who will help you build your life.”

An advisory board is most useful in providing strategic ideas or feedback on increasing revenue and building your business, explains Auren Hoffman, a serial entrepreneur and chairman of the Stonebrick Group, a San Francisco investment firm.

Advisory board members are not involved in the details of your company. Hoffman says, “You go to them, as you would an old high school friend whom you don’t see often, to catch up and pick their brains—for a view of your landscape from 20,000 feet.”

In contrast, a board of directors has legal authority. Members can provide guidance on a day-to-day basis about how to navigate choppy waters such as a lawsuit or the sale of your company. “These people give you a view of your business from 200 feet,” Hoffman adds.

Give careful thought to whether you need a board of directors or an advisory board. Remember, certain corporate structures require a board of directors who will have legal obligations to fulfill.

### Community Resources

Small Business Development Centers, chambers of commerce, entrepreneur groups, colleges and universities, and libraries are some community resources that may be helpful to you as you grow your business. Counseling, classes, research, referrals, and peer groups are other resources from which you may benefit. As you build your network, be sure to include persons from organizations that provide services and community resources for entrepreneurs. Information, connections, opportunities, and ideas are some of the benefits that will help you grow your business.

### Recruiting and Hiring Capable, Self-Motivated People

You can’t typically grow your business without growing the number of people with whom you work. Your success will depend on your ability to put together a team of highly qualified
people who are committed to the goals and objectives of your firm. If your business is in an early stage of growth, you will most likely be the person doing the recruiting and hiring. As your business grows, it will be important to hire the right top managers, as these managers will recruit and hire the staff. Plan a method for recruiting and hiring the very best people you can find. Such a plan requires four strengths:

- An understanding of how hiring will support your business strategy
- A philosophy of whom to hire and recruit
- An employment package that can entice superior employees
- A step-by-step hiring process that follows your state’s and federal hiring laws

As we learned in Module 3, organizations with a solid business strategy are more likely to succeed, but they have to align their business operations to their strategy. Nothing is more important in this regard than your hiring and recruitment efforts. When you begin thinking about hiring, ask yourself why you’re considering it and make sure that your rationale is aligned with your strategic objectives.

Your business will benefit if you know what you’re trying to accomplish in hiring. For many entrepreneurial businesses, hiring capable, self-motivated employees provides a competitive advantage. Prospective hires should have not only great technical skills but also the motivation to make the business a success.

Look for employees who:

- Embody the company’s values.
- Work hard and work smart.
- Have the specific skills required.
- Learn quickly when new skills are needed.
- Are able to work with little supervision.
- Take initiative to make things happen.
- Are comfortable in the uncertainty of an entrepreneurial situation.
- Are flexible to business needs and changing requirements.

The key in hiring for your company is not necessarily finding people who thrive in uncertainty but rather finding people who thrive in the kind of organizational culture your company strives for. Resist the urge to hire people just because they share the same personality traits and background as you. Businesses benefit from having different points of view to challenge and develop the company into the future.

Ewing Marion Kauffman offered his personal twist to the talent equation with this advice to entrepreneurs: “Hire people who are smarter than you! In doing so, you prevent limiting the organization to the level of your own ability—and you grow the capabilities of your company.” Kauffman also said, “If you hire people you consider smarter than you, you are more likely to listen to their thoughts and ideas, and this is the best way to expand on your own capabilities and build the strength of your company.”

**Tip**

If you are not able to build an entrepreneurial organization of productive people, your business will not grow beyond your own abilities.

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**Tip**

It used to be that the head of the organization was the intellectual one who made all the decisions, who came up with the good ideas, good thoughts, and good suggestions. That’s not true anymore. Today you will find ability at all levels you should be drawing on.

—Ewing Marion Kauffman
Finding qualified candidates is sometimes difficult because of competition, changing workforce demographics, and workers’ values. To be successful, you may need to be open-minded and creative. Strategies to attract the best talent include:

- Providing good management.
- Offering profit sharing and equity partnerships.
- Providing generous compensation packages.
- Having flexible work rules including job sharing, working at home, and flex-time.
- Providing challenging work assignments and learning opportunities.
- Using temporary help and contract labor and hiring the disabled and seniors.
- Offering strong health and benefits packages.
- Doing socially-responsible work.

Interviewing and hiring employees can be difficult and time consuming. Entrepreneurs can gain confidence in their final decisions by following some of these hiring guidelines:

**Use Applications**—Before interviewing applicants, consider having them complete and sign an employment application form, even if they have a resume. As a legal document, the application form must conform to state and federal regulations. For example, it generally must specify if employment with the firm is “at-will,” which means that employment can be terminated at any time. Also, this application form must give the employer permission to verify information submitted by the prospective employee. Human resources consultants can assist you with the development of legal applications.

**Screen**—Save time conducting interviews by screening applicants beforehand using information provided on the application form. Look for unexplained breaks in employment, omissions on the application, career changes, and reasons for leaving other employers. Salary history, professional affiliations, and overall professionalism in completing the form can also give clues about the applicant.

**Interview**—Determine what you are looking for and develop interview questions in advance. Develop questions that ask interviewees to tell you how they would respond to real workplace situations. Ask every interviewee the same set of questions. Rate their answers in some systematic way. Add up the scores. Use this scoring in combination with other information, but don’t rely solely on the interview as the critical factor in hiring. Research shows that human beings aren’t very good at making judgments about people from interviews.

**Avoid Bias**—Be aware that we tend to judge people who are similar to ourselves more highly than those who are different from ourselves. This bias can cause you to hire clones who don’t add anything to your organization’s skill set. It can also create a lack of diversity, limiting the creativity and decision-making of your company. Recent studies have shown that persons tend to rate others more highly if they exhibit physical beauty or attractiveness, regardless of their actual qualifications; so beware of this tendency when interviewing. One of the best ways to determine whether someone can do the job is to ask them to demonstrate that they can do it. Have writers take writing tests, ask sales people to simulate a sales call, and have managers make difficult case-study decisions.

**References**—Always check references to verify the information with additional research. Studies show that about 30 percent of resumes contain some kind of false information. People who overstate or falsify their job qualifications may cause future harm to your organization or may be poor employees. Depending on the nature of your business and the type of job to be filled, a criminal background check can provide critical information about a prospective employee. A number of firms provide background checks on employment applicants.
The law prohibits businesses from asking potential employees certain questions or personal information on applications. Check with your attorney or human resources consultant about permissible areas of inquiry. In general, questions should relate to the applicant's ability to perform the job. Document all reasons for not offering a position to an apparently qualified applicant. Maintain records for at least seven years.

Apart from satisfied customers, a growing company needs skilled and competent managers whom founders can trust, says Donna Boone, president of the Potomac Swim School, an indoor swim facility in Ashburn, Virginia. Boone launched Potomac Swim School in 2003 and plans to open additional swim facilities in the Washington, D.C., area. That means finding managers with whom she feels comfortable sharing authority.

“This is a classic stumbling block for entrepreneurs seeking to expand,” Boone says. “In my case, I expect to promote from within, which means I must hire with an eye to developing managerial talent. No longer can I view employees merely as part-time swim instructors. Instead, I must look at them—and treat them—as potential managers, even partners. I must consider whether they are individuals as committed as I am to both swimming and the school and to learning the business from the ground up.”

**Helping Others Be Successful**

To create a successful work environment, you’ll need to make a special effort to understand the goals, dreams, and aspirations of the people working within your business.

It’s easy to focus on product development, customer service, or a marketing campaign. But remember: your employees will be the ones to actually develop the product, interface with customers, or implement your marketing campaign. Employees are your most valuable asset.

In order to respond to the interests and dreams of the people involved in the business, treat employees as distinct and separate individuals. Responding to individual needs will make it possible to create conditions in which an employee’s dreams will mesh with your vision.

In order to help your employees achieve their personal goals and give them a satisfying work experience, you have to spend time getting to know them. Many entrepreneurs fail to do this because they don’t see such time as valuable. Informal communication can help you learn a great deal and likewise can give your employees an opportunity to know you better.

In addition to helping your team members reach their own goals, you can find out what aspects of work motivate them. One entrepreneur attributes much of her company’s success in attracting and retaining excellent employees to its informal work environment and relaxed dress code.

Some businesses have prospered by letting employees work flexible hours. Although this policy will not be practical for all businesses, flexibility makes employees feel valued, which often leads to a more dedicated workforce. Other employees will be looking for recognition, achievement, growth, freedom, autonomy, or time with their families. Whatever your organizational needs, remember how motivations vary greatly from person to person and hire accordingly.
As you work to create a successful work environment, be intentional about who you depend on to lead and manage your business as it grows. Together, you will be setting the culture of the business—work ethics, compensation expectations, rewards systems, and measurements—to reach your vision and goals. Be sure the culture you are developing is a healthy one.

**Creating a Healthy Organizational Culture**

Some companies compete on price. Others compete by having the best products, service, or customer support. You considered many ways to create a competitive advantage in Module 3. One way to create or enhance your competitive advantage is to cultivate an organizational culture that breeds productivity, motivation, and respect. Some companies simply outperform their competition because they create a healthy organizational culture.

Creating such a culture isn’t just good for the bottom line, it’s also imperative for quality of life—for you, your team, and the community. Businesses that build healthy cultures are more fun, interesting, motivating, and provide better opportunities for all involved.

**In 1950 when Ewing Kauffman started Marion Labs from the basement of his modest home in Kansas City, he hoped to make enough money to support his family. By 1989 when Marion Laboratories, Inc., merged with Merrell Dow, the company had grown to be a pharmaceutical giant with global sales of nearly $1 billion. Kauffman called his employees associates and his leadership, hiring, marketing, and communication practices followed a simple philosophy of “treating others as you would like to be treated.” The concept shaped Marion’s corporate culture and had an enormous impact upon the success of the company. Another guiding philosophy of Kauffman’s was to “share the rewards with those who produce.” That profit-sharing promise paid off in a big way when hundreds of loyal Marion associates, including long-time managers, plant workers, and clerical staff who held shares of stock in the company, became instant millionaires with the merger of Marion and Merrell Dow. Although Kauffman died in 1993, his legacy lives on today through the Ewing Marion Kauffman Foundation, which is devoted to his passions for improving education and advancing entrepreneurship across America.**

Your company’s organizational culture begins with you. Employees and contractors follow your lead. If you walk-the-talk, your team will work harder and invest more of themselves in your business. If you treat people poorly or make shaky decisions, your team members will look for other work or will exert only enough effort to get through the day.

Some of the ways you can create a healthy organizational culture include the following:

1. Communicating values intentionally
2. Creating clarity of purpose, structure, and measurement
3. Setting goals and evaluating results
4. Recruiting and hiring capable, self-motivated people
5. Helping others be successful
6. Providing appropriate rewards, including monetary compensation

As you read these topics, ask yourself how well you’re doing and take notes about how you might change your leadership approach to transform your company’s organizational culture using some or all of these categories.
Communicating Values Intentionally
Successful entrepreneurs don’t take their organizational culture for granted. They build the culture they want by clarifying their own values, formalizing them in writing, and remembering to live them as they make decisions in their business.

Seth Riney started PlanetTran—an environmentally-friendly taxi service in the Boston area—because he thought he could create a better cab company. By using only hybrid vehicles he saves on fuel costs. By making decisions that support an environmental agenda, he keeps the company focused on its mission. By treating people well and emphasizing the important role PlanetTran can play in changing people’s attitudes toward automobiles, Riney has inspired his workers to commit to customer service and company loyalty.

In Module 1 you identified the core values you want your business to embrace. How will you articulate those values to your team and your customers?

Some people think that communicating values involves telling employees what to do, creating policy manuals, and setting rules. But values are communicated more successfully in day-to-day actions. If you want an organization that listens to customers, you have to be a role model by listening to your team, your vendors, and your customers. If you want a business that is driven to increase revenues, you have to set sales goals, initiate brainstorming sessions on sales-related issues, and reward those who help increase the sales numbers. If you want to develop a company where teamwork is valued, you have to be a team player yourself.

Likewise, your management team must model the values of the organization. You can personally walk-the-talk all you want, but if your top managers act counter to the message your employees will notice the discrepancy and grow skeptical about the importance of those values. You need to hold everyone accountable and bring values into each deliberation. For example, if your top salesperson acts against your business’s core values you should not let that behavior continue, even if you have to risk your sales numbers in the short term. Remember, it’s easy to stick to your values when no pain is involved. It’s a different story when your values are in direct conflict with your self-interest.

Values are one of the most important drivers of entrepreneurial success, but most of us forget to reflect on them. To evaluate where your business is right now in its quest to align itself with its core values, turn back to Action Step 1.2 on pp. 29–30 and ask yourself how well your business exhibits each one. How well do you live this value now? Going forward, how can you better live this value at work? How can you encourage your team to live by this value at work?

Creating Clarity of Purpose, Structure, and Measurement
Organizations thrive when they are clear about what needs to get done, who needs to do it, and how it should get done. With clarity, everyone can pull together for a common cause. Without clarity there is wasted effort and even chaos. In his analysis of Ewing Kauffman’s company, Marion Laboratories, Gerald W. Holder attributed the organization success to an entrepreneurial leadership team that focused significant energy on creating clarity throughout the work force. The leaders of Marion Labs followed three imperatives: clarity of purpose, structure, and measurement.
Clarity of purpose—People need to know why the organization exists. They want a reason to give their enthusiastic support. They want to be part of an organization that is the first or best at something, does what no other organization has ever done, helps people solve problems, or helps people lead better, safer, healthier or more productive lives. Do not expect anyone else to get excited about “making you rich.” As one entrepreneur put it, “I want my people to get rich because I have set up a system whereby if they get rich, so do I.”

*What you can do:* Have a clear sense of what you want your company to stand for and accomplish. Communicate your vision regularly. Ensure that goals and decisions are consistent with this vision. Remind your management team and employees that decisions and actions need to be consistent with the overarching vision.

**Tip**

Make sure people have access to information that measures performance. This freedom will cultivate a healthy productivity in which the employees understand what they are working towards and why.

Clarity of structure—People need to know their roles and responsibilities as well as those of others in the organization. This knowledge and confidence allows them to concentrate on their own job and give it their full energy while recognizing the importance of working as a team.

*What you can do:* Ensure that job roles support the company’s direction. Job descriptions should include goals and performance objectives aligned with the vision of the company.

In a rapidly growing venture, the opportunities for promotion are likely to be great. For example, a sales representative may become a manager in a very short time. Discuss the organization’s structure and possibility for advancement opportunities with potential employees. Some may accept a low-paying position at first if they will be given more responsibility and compensation in the near future.

Clarity of measurement—Knowing how to measure the results in a business is essential. Explain to people within the organization what is being measured, how it is being measured, and why it is being measured. This clarity lets them know where to focus their effort.

*What you can do:* Develop clear sets of performance measurements for each area of your company and for each individual. Acknowledge and reward individuals for meeting those goals. In Module 8 Managing Operations for Growth, you will have an opportunity to work on performance measures for your business.

Compensations and Rewards

Many people are motivated by money—at least for a period of time. But the motivational power of money often wears off as employees simply get used to their current level of compensation. Many studies have confirmed that as long as employees are paid competitively, money is not the main factor that leads to job selection or performance.

Ultimately, most people are motivated more by the work they do and the environment in which they work than by the money they earn. Therefore, the compensation and rewards system you offer to employees should include both monetary and non-monetary ideas.

Utilizing Monetary Compensation

Growing businesses that struggle with cash flow issues and “making payroll,” will want to think creatively about how to provide monetary compensation and rewards to their management and staff. When Ewing Kauffman managed Marion Laboratories, he paid his managers, directors, and officers salaries slightly below what competitors were offering, but offered profit-sharing, paid generous bonuses for high performance, and added benefits when the company did well.

Similar techniques are available to you in terms of end-of-year, team-performance, and individual bonuses, profit-sharing, stock options, phantom stock, and stock warrants. All of these plans can have their pitfalls, and all must be tailored to your particular situation. Seek
expert assistance from a compensation specialist and a lawyer and keep your plan aligned with your company’s values.

Remember, when establishing your compensation and reward policies, employees should be compensated for the work they do at or near competitive salary levels. Also, monetary compensation above and beyond competitive levels may not be motivating if the recipients really value other things, like time with their family.

Growing companies that cannot afford to pay the same salaries as an established corporation may offer their key employees a form of ownership in the company. That way, if the company is successful, the employees will share in the success.

Be careful to avoid these pitfalls:
- Diluting your controlling interest in the venture
- Rewarding some people while alienating others who are also productive
- Prompting the wrong behaviors or the wrong values
- Diminishing a sense of camaraderie and teamwork
- Increasing your tax burden
- Bickering over accounting practices for stating profits
- A one-compensation-plan-fits-all mentality
- Enabling disgruntled ex-employees to own significant stock

Compensation systems create consequences—whether they are intended or not. You must make a careful decision about how you are going to pay your employees. Even if you pay straight salary or hourly wages you’ve still got a monetary compensation system. The right compensation system can go a long way to building the kind of company you desire.

Providing Rewards
Effective reward systems include all forms of monetary compensation plus a wide variety of other motivators that are important to people in a work setting. You will be surprised at the benefits your company will reap when you reward good performance with job assignments, recognition, growth and learning, additional responsibility, trust, authority, and autonomy.

The effectiveness of any reward system requires two primary factors. First, the recipient must perceive the reward as a positive event, and second, the reward needs to encourage the desired behavior. The desired behavior must be consistent with the strategic goals of the company. It is your responsibility as the entrepreneur to make sure the reward system is set up to support the right behaviors.

Tip
Seek help from a human resources expert when developing your compensation system.

Tip
If rewards are given randomly or employees lack an understanding of which behavior is being rewarded, the rewards may encourage the wrong behavior or simply have no value.

To make this two-part principle work for you, you’re going to have to understand rewards from the perspective of your workers, which requires you to spend time with your team and learn what’s important to them. Monitor the results of your rewards to see if they’re really having the effect you want them to have. Remember, what you perceive as rewarding may not be rewarding to your employees. For example, many companies reward salespeople for their efforts by basing some or all of their compensation on a percentage of the dollar amount of sales revenues. This approach is a proven winner in most cases, but some companies—notably those who want to have their salespeople act as consultants to their customers—have found that poorly conceived commissions can push salespeople away from their role as consultants, making it less likely that the client will turn to the salesperson in the future or that big-ticket projects will be developed.
Instead of relying solely on monetary rewards, try some of the following approaches to increase motivation and productivity:

**Say thank you**—Acknowledge people for their good efforts and superior results. You may be surprised what sincere acknowledgements will do. Consider both public and private acknowledgements but keep your employees’ preferences in mind.

**Share the big picture**—Employees work smarter and enjoy their work more when they know how their job fits into the company’s success. Many companies have found success by sharing their financial performance with employees and showing them how they can help improve it.

**Treat people fairly**—The world isn’t fair, but most people hope it will be. Treating people fairly means treating everyone with respect, rewarding successful performance, and critiquing unsuccessful performance.

**Create a learning attitude**—You will make mistakes as you lead your organization, but that’s okay as long as you learn from them. Your team members are going to make mistakes too. Be a role model by discussing your mistakes in fact, make the discussion of mistakes a regular part of your meetings. The point is not to focus on mistakes but on the lessons learned for future applications.

Consider the following three questions to help you learn from a mistake:

- What did we do right?
- What did we do wrong?
- What can we improve next time?

Using these questions at every staff meeting and at the end of every project will help create an organizational culture comfortable with the truth, ready to acknowledge success, and open to learning and improvement.

**Celebrate successes**—When the company wins a big contract, finishes a large project, or reaches an important milestone, bring everyone together to celebrate. When individuals or teams do well or reach milestones, acknowledge their results as well. People want to feel part of a successful company.

**Tip**

The best entrepreneurs are the ones who fail quickly and get on with learning how to do it better.

—Howard Stevenson and D. E. Gumpert

**Increase responsibilities**—When people perform well, provide them with opportunities for advancement, increase their responsibilities, allow them more freedom to make decisions, or give them larger portions of the budget to control. Beware not to punish people by overloading them with too much work—and don’t assume that everyone will find new challenges rewarding.

**Trust and ask for input**—When you show others that you trust them, they begin to do things on their own initiative. They create energy for your organization. If you look over their shoulders constantly, you’ll get employees who will only do what they are told.

Showing trust means asking for help in making important company decisions. When a major Detroit car manufacturer changed its management approach, one of the workers said, “I’ve been working for this company for twenty-seven years, and before the recent changes, not once in that time did anyone ask me what I thought should be done. For the first time they are now receiving the benefits of my head, not just my hands.”

**Tip**

If you don’t take some risks by enabling your employees to try new things, they’ll take their motivation elsewhere.
Avoid micromanaging—Avoid the tendency to be consistently involved in every decision and every task. Remember that any given outcome can be achieved a number of ways. Encourage your associates to experiment by trying different ways to improve a task or solve a problem. Don’t micromanage! Agree on the goals and let the employees figure out how to meet those goals.

Rather than spending great energy trying to prove that an employee is wrong and the boss is right, successful entrepreneurs say, “That way is not working; we should try something else.” Establishing an experimental, learning attitude can turn early failures into success. An enthusiastic, “We are making this up as we go along” attitude can keep people looking for ways to improve the way they get things done.

Leading Change
Successful entrepreneurs don’t just manage the status quo. Entrepreneurial business situations are often in flux—it’s the nature of running a business. But smart entrepreneurs don’t just manage their way through the chaos. They figure out where they want to go and utilize specific techniques to champion the changes needed to meet their goals and achieve their vision.

Your company may be the small dog in a pen filled with pit bulls, elephants, and hippopotamis. You may be at risk of being trampled, but you’ve got one killer asset that they can’t match—a smaller company’s ability to champion change.

You have the advantage over large organizations in which change is extremely difficult because it pushes against entrenched business practices and is resisted by powerful people and departments who might be hurt by it. The very systems that enable big companies to work efficiently inhibit them when sudden change is required.

With a growing business, you realize that change is part of the flow of everyday life. Take advantage of your agility and quickness.

The Change Process
Because change is part of entrepreneurship, it’s worthwhile to examine the change process. When your business is growing, the changes you decide to make to achieve your vision and goals can affect your team in various ways.

Change is not easy because the by-product of change is uncertainty. When people are uncertain they can become anxious. Champions of change understand this and make accommodations to help everyone feel more comfortable and to engage them in the changes that will be taking place.

Between the time a successful change effort begins and ends, your employees will undergo some predictable stages. At the beginning of the change effort, they build coalitions according to how they perceive the coming changes. At this stage more people may exhibit positive attitudes because the real effects of the changes are not yet apparent. As the changes are implemented, you will encounter difficulties working them out. Morale can lag, and the strength of your team’s character will be tested. Small successes caused by the changes can bring attitudes and productivity up again until your business eventually reaches the goal the changes were intended to achieve.

This graph shows the progression for a successful change initiative. It represents the enthusiasm of those who are championing or supporting a particular change effort. Note that enthusiasm is often at a modest level at the start as some are excited and some are afraid. Difficulties always arise and must be overcome.

Eventually, a successful change will become part of the everyday routine. Enthusiasm seeks only after considerable effort and signs of success.
The front line experience of your employees makes them one of the best sources of ideas for changes to improve your business and help it grow. For suggestions on how to tap this valuable resource, read A Closer Look @ Brainstorming Change, p. 288.

The Nature of Change
Before you initiate a significant change in your business, consider these important aspects concerning the nature of change:

- Change efforts are risky and may not create the desired results.
- Not changing is risky because your competition gains the advantage.
- Change efforts almost always encounter obstacles. As the graph shows, even successful change efforts face difficulties.
- Everyone associated with a change effort needs to understand that difficulties will arise and must be overcome. If not, predictable morale problems may sink the change effort.
- Champions of change must educate others about the nature of change.
- If the change champions are not at the highest levels of the organization, their efforts will benefit greatly from the support of senior management.

Being an Inspiring Leader
To champion change and guide your organization to new levels of growth, management team members and employees must be willing to follow your lead. To do so, they need to view you as the kind of person they’d like to follow. This doesn’t mean you have to make great speeches and have unfailing wisdom. It simply means that you should strive to be a person of integrity who creates a healthy workplace culture.

Just as the mantra in real estate is location, location, location, in leadership it is relationships, relationships, relationships. Relationships are built of honesty, integrity, and mutual respect, the cornerstones of a healthy organization and the bedrock of effective leadership.

Complete the following Leadership Scorecard to reflect on how you are perceived as a leader.

Leadership Scorecard

1. Rate yourself on the statements on the Leadership Scorecard, on p. 269.
2. Ask your employees, contractors, vendors, and/or customers to rate you on the Leadership Feedback Sheet on p. 270. Ensure complete confidentiality and anonymity.
3. Compile the results into the appropriate cells of the Leadership Scorecard by averaging your results on each question. In other words, if you give the Leadership Feedback Sheet to four of your employees and get a 3, a 4, and two 5’s on the first question, you would add those numbers and divide by the number of people responding (3 + 4 + 5 + 5 = 17 and 17÷4=4.25) and put the result into the appropriate cell in the Leadership Scorecard.
4. Review the differences between your ratings and the average ratings of others. On which questions do you see discrepancies? List them.

Why do you think those discrepancies exist?
5. Note that others’ perceptions may result from your consistent long-term behavior or from an important recent event. Others’ perceptions could be mistaken, but they are what they are. How will you know whether discrepancies are big enough to be significant? Although no hard and fast rule applies, if your rating is different than the average of others by more than 0.75 then the discrepancy is probably notable. For example, if you rate yourself a 4, and others rate you a 3.5, that’s probably not a big difference. If they rate you a 3, that may be something to examine more closely.

Does your analysis of the results suggest some changes you could make in your behavior? What are these changes, and how will you implement them?

<table>
<thead>
<tr>
<th>Leadership Scorecard</th>
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<tr>
<td><strong>Item to Be Rated</strong></td>
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<tr>
<td>1. I keep all or most of the promises I make.</td>
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<tr>
<td>2. I treat people fairly and with respect.</td>
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<tr>
<td>3. In making decisions, I consider the impact on employees’ health, safety, and work-life balance.</td>
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<tr>
<td>4. I clearly demonstrate that I care for those around me.</td>
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<tr>
<td>5. I exhibit a fairly stable personality and avoid drastic mood swings.</td>
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<td>6. I provide a clear set of expectations for those who work for me.</td>
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<tr>
<td>7. I communicate regularly with the people I work with.</td>
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<tr>
<td>8. Those who work with me feel free to provide me with constructive criticism without fear of revenge or anger.</td>
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<tr>
<td>9. I listen to others and take their ideas into account when making decisions.</td>
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<tr>
<td>10. I practice what I preach.</td>
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<tr>
<td>11. I insist on legal and ethical business practices.</td>
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6. Regardless of the results, DO NOT be defensive and DO NOT seek revenge or retribution. These actions will discourage others from giving you feedback in the future, and you don’t want to lose a valuable source of information. The best thing you can do is to thank people for their input and make changes that will benefit your company as a whole.
Hand out this form to employees, contractors, and customers. Insist on complete confidentiality so that people feel free to give you honest feedback. Create a process so you will not be able to identify who gave you specific feedback. This form is available at fasttrac.org/resources.

### Leadership Feedback Sheet

Please complete this anonymous survey. I am seeking your honest feedback to improve my leadership skills and my business.

1=Strongly Disagree   3=Neutral or Don’t Know   5=Strongly Agree

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<thead>
<tr>
<th>Rate the person on the following statements</th>
<th>See rating scale above (circle one)</th>
<th>Please provide clarifying notes:</th>
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<tr>
<td>1. Keeps, or tries to keep, promises</td>
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<td>2. Treats people fairly and with respect</td>
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<td>3. In making decisions, considers the impact on employees’ health, safety, and work-life balance</td>
<td>1 2 3 4 5</td>
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<td>4. Clearly demonstrates care for others</td>
<td>1 2 3 4 5</td>
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<td>5. Exhibits a fairly stable personality and avoids drastic mood swings</td>
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<tr>
<td>6. Provides a clear set of expectations for employees and other team members</td>
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<td>7. Communicates regularly with co-workers</td>
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<tr>
<td>8. Creates an atmosphere in which constructive criticism can be given without fear of revenge or anger</td>
<td>1 2 3 4 5</td>
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<td>9. Listens to others and takes their ideas into account when making decisions</td>
<td>1 2 3 4 5</td>
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<tr>
<td>10. Consistently practices what he or she preaches</td>
<td>1 2 3 4 5</td>
<td></td>
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<tr>
<td>11. Insists on legal and ethical business practices</td>
<td>1 2 3 4 5</td>
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Evaluating Your Business’s Legal Structure

One of the many roles you will have to play in your business is that of security guard. You have to make sure that the company remains safe—nothing enters that could harm your business and nothing leaves that could reduce its value. The more you can use legal protections to safeguard your business, the easier this task becomes.

There are many ways to protect the business, its assets, and employees—one critical way is to conduct business within the most appropriate legal framework. The legal framework you use to support your business can affect your tax payments, legal liability, and potential for future investment.

As an entrepreneur, you must make decisions and take legal actions to structure your business. Otherwise, the law will make those decisions for you, and that can be detrimental. Even if you’ve never officially selected a legal form for your business, you are operating within the parameters of a legal form. States typically hold undeclared businesses to be sole proprietorships or partnerships, leaving you personally responsible for debts and injuries.

Instead of ignoring this issue, take the time to select an appropriate legal structure after consulting an attorney and accountant. If you are in business, you’re currently operating under one of the following legal structures:

1. Sole proprietorship
2. Partnership
3. Corporation
4. S corporation
5. Limited liability company (LLC)
6. Nonprofit corporation

The important question now is whether your legal form is appropriate for your business and its plan for growth. The factors that affect this important decision are listed below. Read these carefully and then complete My Business’s Legal Form to see if you should talk with a lawyer and accountant about changing your current legal structure.

Factors Affecting the Choice of Legal Structure

While you should consider many factors in choosing the legal structure of your business, not all factors will apply to every business. Several key issues, however, will apply to most:

**Control**—Who is the decision maker? The decision maker will control management, determine who receives profits, decide whether to get loans or solicit investors, and be solely responsible for the company’s financial losses. For a more detailed treatment of maintaining control against hostile insiders, see A Closer Look @ Protecting Business Interests on pp. 289–302.

**Taxes**—Tax liability is a major concern for business owners. The amount of taxes paid yearly can make or break a business.

**Liability**—Some legal structures do not protect personal assets from business debts. If you do not want to personally pay the debts of your business, consider a legal structure that will protect your personal assets.

**Transferability of ownership**—Depending upon the legal structure, one person’s ownership in a business may be transferred to another owner in whole or in part simply by the exchange of a piece of paper.

**Longevity of the business**—Not all business forms are perpetual. Some forms of business cease when the entrepreneur exits the business.

**Raising capital**—Simple entities such as sole proprietorships and general partnerships are restricted in their ability to raise capital.
Most often, entrepreneurs are concerned with all of these important issues. The key is to identify the legal structure that best meets your needs and the needs of your business as it grows. This tough decision should not be made without adequate counsel from an attorney, an accountant, and other advisers.

In an ideal world, you would select a legal form of business understanding every legal and tax implication. The reality is that you must rely on the advice of your attorneys and accountants to make this decision. Attorneys and accountants can anticipate many situations based on their experience and on the information you provide. Still, the legal structure of the business is your decision to make and live with. Use My Business’s Legal Form to check that the structure you operate under best covers the factors you are concerned about from the list above and best aligns with your business’s strategy and goals.

The legal form of your business can’t be an afterthought. Your profits, your peace of mind, and even your business may depend upon using the right structure. Schedule appointments with your lawyer and accountant now to review your company’s legal form.

### My Business’s Legal Form

Use the steps below to help decide whether your current legal structure is best for you. Then get help from an accountant and lawyer. Ultimately, however, this decision is yours. You need to be informed. In Step 1, answer the questions as honestly as you can, given what you know about yourself and your business right now. These answers will help you think about what is important to you in evaluating your legal structure. There are no right or wrong answers, only your opinion on the topic. Then use your answers in Step 1 to help you complete Step 2.

#### Step 1 Answer the questions

Use the chart below by circling Yes, Maybe, or No.

a. Do you want to have control over your business’s direction and decision-making?  
   - Yes
   - Maybe
   - No

b. Are you willing to give up some control for the potential of higher rewards?  
   - Yes
   - Maybe
   - No

c. Do you care about how the profits are disbursed—whether they flow directly to you, or whether they go to shareholders, or whether they are retained in the business? Keep in mind that this decision has tax implications.  
   - Yes
   - Maybe
   - No

d. Are you willing to be personally liable for debts or injuries caused by doing business?  
   - Yes
   - Maybe
   - No

e. Will you need to raise money from outside sources to get your business started or help it grow?  
   - Yes
   - Maybe
   - No

f. Do you have time to fulfill extra reporting requirements needed for some types of business structures?  
   - Yes
   - Maybe
   - No

g. Will you need to have flexibility to change the business structure as your business changes and grows?  
   - Yes
   - Maybe
   - No

h. Do you care if the business survives after your death or the death of one of the other owners?  
   - Yes
   - Maybe
   - No

i. Will your profit margins be so thin or your need for profit so high that tax considerations will drive the type of business structure you choose?  
   - Yes
   - Maybe
   - No

j. Might your business qualify to be a nonprofit organization?  
   - Yes
   - Maybe
   - No
My Business’s Legal Form continued

Step 2 Circle the cells within the Legal Structures Comparison Table below that most reflect your concerns based on the questions in Step 1 above.

Legal Structures Comparison Table

<table>
<thead>
<tr>
<th></th>
<th>Sole Proprietor</th>
<th>Partnership</th>
<th>Limited Liability Company (LLC)</th>
<th>S Corporation</th>
<th>C Corporation</th>
<th>Nonprofit Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Do I control the business?</td>
<td>Yes. You are in charge.</td>
<td>Only if your share of the partnership is greater than 50%.</td>
<td>Only if your share of the LLC is greater than 50%.</td>
<td>Only if you control more than 50% of the shares of stock.</td>
<td>Only if you control more than 50% of the shares of stock.</td>
<td>Only if you control a majority of votes on the board of directors.</td>
</tr>
<tr>
<td>b. What happens to the profits?</td>
<td>Profits are all yours.</td>
<td>Profits are split between you and your partner(s) as detailed in your partnership agreement.</td>
<td>Profits are split as detailed in your operating agreement.</td>
<td>Profits go directly to the owners, split as a percentage of shares owned.</td>
<td>Profits belong to the corporation and may be paid to shareholders as dividends.</td>
<td>Profits must be retained. So in some sense, there are no profits.</td>
</tr>
<tr>
<td>c. Am I responsible for financial obligations?</td>
<td>Yes. You have unlimited personal liability for the business.</td>
<td>Yes. You and your partner(s) have unlimited personal liability.</td>
<td>Your liability is limited to the assets you invested in the business.</td>
<td>Not directly. Liability is generally limited to the assets of the business.</td>
<td>Not directly. Liability is generally limited to the assets of the business.</td>
<td>Not directly. Liability is generally limited to the assets of the business.</td>
</tr>
<tr>
<td>d. Is money relatively easy to raise?</td>
<td>No.</td>
<td>No.</td>
<td>Somewhat. Money can be raised from members.</td>
<td>Yes. Money is easier to raise.</td>
<td>Yes. Money is easier to raise.</td>
<td>If approved, nonprofits can receive tax-deductible donations.</td>
</tr>
<tr>
<td>e. Is it relatively easy and inexpensive to get started and fulfill the legal requirements on an ongoing basis?</td>
<td>Yes. Using this structure is relatively easy.</td>
<td>Yes. Using this structure is relatively easy.</td>
<td>LLC’s are among the easiest and least expensive business structures, however operating agreements vary from state to state thus raising complexity.</td>
<td>More difficult. Corporations require some investment in time and money to start and to fulfill legal obligations.</td>
<td>More difficult. Corporations require some investment in time and money to start and to fulfill legal obligations.</td>
<td>More difficult. Corporations require some investment in time and money and the IRS approval process is complex.</td>
</tr>
<tr>
<td>f. Can I easily change the legal structure of the business?</td>
<td>Yes. But it requires closing the existing form and starting another.</td>
<td>Yes. But it requires closing the existing form and starting another.</td>
<td>No. It is very difficult to change from an LLC to another structure.</td>
<td>No. It is difficult to change from a corporate to non-corporate structure.</td>
<td>No. It is difficult to change from a corporate to non-corporate structure.</td>
<td>No. It is difficult to change from a nonprofit to a profit structure.</td>
</tr>
<tr>
<td>g. What happens if one of the owners dies?</td>
<td>Your business dies when you die.</td>
<td>Partnerships die, unless otherwise specified in the partnership agreement.</td>
<td>LLCs can survive if specified by agreement or vote.</td>
<td>Corporations survive the death of an owner.</td>
<td>Corporations survive the death of an owner.</td>
<td>Nonprofits survive the death of an owner.</td>
</tr>
</tbody>
</table>

Step 3 Review the circles on the table to determine which structure delivers the most positive impact for your business. Take this information to a trusted legal adviser for review.
Summary

The purpose of this module is to enable you to see the strategic importance of your role in your organization—to lead, create a culture, change, and protect. In a growing business, you can’t do everything yourself. To be successful you need to develop a strong management team. Your decisions and actions as a leader will make all the difference in whether your organization meets its goals or falls short.

Key Things to Remember

- Your management team can bring new skills and competencies into the business.
- Your role will change as your business grows.
- One of your most critical jobs as an entrepreneurial leader is to keep the organization healthy, strong, and engaged.
- Your leadership sets the tone for the organizational culture.
- You can understand the nature of change and mobilize your organization to champion change projects.
- Your legal structure can enhance or hinder your business’s ability to fulfill its goals.

In Module 8 Managing Operations for Growth, you will explore your everyday business operations and how you can use processes and measurements to improve the performance of your business.
Activity 7a: Approaching Change

Practice approaches to presenting change to your management team.

Directions
Read each scenario and be prepared to answer the questions in group discussion. These questions may have more than one good answer. Pick the one answer that you think is best. By comparing and contrasting the benefits of each answer, you will discover something about your own tendencies in managing.

Scenario 1: Organizational Culture
You just decided—after getting input from your management team—that you’d like to change the culture of your company to encourage more accountability and higher standards of performance. Some members of your management team support this initiative because they want all the employees to be highly productive and effective. Others are worried that your company will lose its informality and family-like feel. In order to be successful in creating more accountability, what must you do?

a. Coach the management-team members who are reluctant to change.
b. Replace the management-team members who are reluctant to change.
c. Let all employees know that more accountability will be required and let them know why this initiative is critical.
d. Rewrite all job descriptions to include specific goals for which each employee will be held accountable.

What’s the one best answer?

Why?

Scenario 2: Strategic Planning
Your business is growing wildly, and you need to assess how staffing and management team needs may have changed along with your business’s growth. Which of the following is the best way to approach this process?

a. Analyze how growth has influenced a need for different skill sets within your organization and decide what structural and staffing changes need to be made.
b. Hire a consultant to study the current organization and make recommendations for organizational and staffing changes.
c. Share information with your management team about the current and anticipated growth for your business and involve them in developing the Management and Organizational Plan to accomplish this growth.
d. Meet with one or two key members of your management team to develop a Management and Organization Plan to meet anticipated growth projections.

What’s the one best answer?

Why?
### Activity 7a: Approaching Change continued

#### Scenario 3: Managing Change Initiatives
Your business has been successful at creating roto-molded kayaks and canoes, but you’ve concluded that growth is needed. You’re pretty sure that expanding into sailboats will reap rewards in the long-term but funding has not been forthcoming. You’ve run the numbers and you think you might be able to fund prototype and manufacturing set-up yourself, but you are hesitant about taking on additional labor costs until you have at least some proof of concept. How should you proceed?

- Assign your senior molding manager to lead the prototype development project. Offer funds to hire outside experts on an as-needed consulting basis.
- Hire an outside expert in sailboat design (as a contractor) to lead the prototype development project.
- Hire an outside expert in sailboat design (as a full-time employee) to lead the prototype development project.
- Lead the prototype development project yourself. Hire outside experts on an as-needed consulting basis.

What’s the one best answer?

**Why?**

#### Scenario 4: Human Resources Planning
You and your management team are working on a new business plan because your original one is out-of-date and you want to expand your geographic reach to Europe and South America. You’ve decided to start over from scratch, but you’re getting stuck when you think about personnel. What’s the first high-priority thing you should do when thinking about how to define your management and human resources practices?

- Engage the help of a lawyer or human-resources consultant to help you outline a plan.
- Outline the values you want the organization to use as guiding principles in all decision-making.
- Consider how your global aspirations will affect your staffing and consulting needs.
- Get feedback from your management team on your own management strengths and weaknesses.

What’s the one best answer?

**Why?**
**Action Step 7.1: Create Job Descriptions**

Identify specific responsibilities and allocate the time to be spent on them for the entrepreneur and the management team.

**Directions**

Read the following and complete the steps below. The outcome of this Action Step will be information that can be incorporated into job descriptions for the entrepreneur and key employees.

A job description is a summary of the most important features of a job, including the general nature of the work performed (duties and responsibilities) and level (skill, effort, responsibility and working conditions) of the work performed. It sometimes includes job specifications and employee characteristics required for competent performance of the job. A well crafted job description should describe and focus on the job itself and not on any specific individual who might fill the job.

The job description starts with a clear understanding of the goals and objectives for each particular job. For example, someone in the organization is or wears the hat of the Human Resource Manager. The goal of this position is to attract the most qualified employees and match them to the jobs for which they are best suited. A second goal is to effectively use employee skills, provide training to enhance those skills, and maintain employees’ satisfaction with working condition and their jobs.

As with any position, there are dozens of responsibilities that could be included in a person’s scope of work, so a written job description is important for this member of the team to understand their specific role. One might begin with the following:

*On Demand Technologies, Inc.*

*Human Resources Manager*

*Job Description*

- Recruit, interview and hire new employees as requested by the president.
- Conduct new employee orientation.
- Answer questions relating to benefits, hours worked, vacation and sick leave policies.
- Ensure compliance with the policies, procedures and legal requirements that have been established with top management.

Even the entrepreneur would benefit from a job description. Where is your time spent? What do you do each day? Is more time spent on one task than is justified? Are you doing the same job you have authorized someone else to do? Should some of what you do be done by someone else?
**Action Step 7.1: Create Job Descriptions** continued

A. **Brainstorm goals and objectives of CEO position.**

B. **Brainstorm tasks.** Use index cards to record exactly what you do each day. Create one card for each activity. For example:

- **Read mail**
- **Review Sales Report**

C. **Obtain feedback.** Use your small groups to review and discuss your tasks, adding cards for those items suggested by other group members.

D. **Sort the cards into categories and create a general description.** Use a different color card or ink for the general description of the activities for each category. For example:

- **Communicate with Management Team**
- **Speak with Jim, Sales Manager**
- **Read and respond to sales related e-mails**
- **Review sales report**
### Action Step 7.1: Create Job Descriptions

**E. Connect tasks with time.** Record the category headings in the left column. Determine what percent of each week’s time should be spent in each of these activities. As you review your responsibilities and tasks, record any action that comes to mind that would improve your allocation of responsibilities and tasks.

<table>
<thead>
<tr>
<th>General Description</th>
<th>Preferred Allocation of Time (% of 40 hours)</th>
<th>Action to Take</th>
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</tbody>
</table>
Action Step 7.2: Prepare My Management and Organization Plan

Establish that my business has the management expertise it needs to be a success.

Directions

Complete the Management and Organization Plan for your business and include any changes you plan to implement in your management and hiring practices. Be sure to highlight how these changes align with your business strategy.

A. Use the business planning template. For this action step, you will use the Business Plan Template document you started in Action Step 3.2 Write My Executive Summary. Go to the Management and Organization Plan in the template to insert your information.

Each section of the template contains headings with questions in hidden text which will not be printed. Consequently your answers should incorporate the questions. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. Answers all of the questions that apply.

B. Respond to the questions and statements below. Turn your responses into complete sentences and paragraphs to complete the first draft of your Management and Organization Plan. If you cannot answer a question completely, answer as well as you can or make a note to do further research and determine the answer later in the program.

Management and Organization Plan Questions

Management Team
What is the role of the entrepreneur?
Who are the key management personnel, and what are their job descriptions and prior experiences? Illustrate each management function you will keep or change, even if you are the one performing all these functions.
If changes in the management team are planned, what experiences and qualifications are desired for future management positions? When and how will these be filled? If you and your management team as a whole lack the needed credentials or experience, explain how these deficiencies will be overcome with assistance from a board of directors, an advisory board, contractors, consultants, attorneys, accountants, or other outside help.

Compensation and Ownership
What is the compensation package for the entrepreneur and the management team?
What are their salaries, benefits, and bonuses?
What portion of the business is owned by the entrepreneur and management team? Include any warrants and stock options.

Board of Directors/Advisory Board
Who will serve on the board of directors and/or advisory board? (Include names, compensation, and any ownership in the company.)
What are their qualifications related to the business?

Infrastructure
Who are the key outside advisers such as accountants, lawyers, or consultants and what is their compensation?
What expertise will they provide? (Include strategic alliances, computer technology, management, marketing, and specialists in product or service issues.)
Action Step 7.2: Prepare My Management and Organization Plan

Management and Organization Plan Questions continued

Contracts and Franchise Agreements
What are the company’s management contracts, non-compete agreements, franchise, or other contractual agreements?

Recruitment and Selection of Employees
What is your plan to find and hire self-motivated people for your business?
What are the required qualifications, duties to be performed, and interview and hiring guidelines to be followed?

Employee Reward and Incentive Plan
What system for employee rewards and incentives will be in effect?
What is the incentive plan? (Include special recognition awards, lump sum awards, bonuses, stock options, profit sharing, deferred compensation, commissions, teamwork, and flexible hours.)

Communication and Change
How will you communicate your business’s core values, expectations, and change initiatives?
What system will you use to assure clarity of communication throughout your business?

Organization
What is the legal form of organization?
How is the company organized? (Include organization charts.)
Finalize My Management and Organization Financial Projections

Finalize the financial projections associated with my company’s management and organizational activities.

Directions
In Action Step 4.2, you used the Financial Template to create an initial budget that you have used to compile financial information throughout the planning process. You have updated this financial information using Action Step 5.3 and Action Step 6.7. This action step will help you further update your budget to reflect the costs associated with your Management and Organization Plan.

A. Review your initial budget. From the Worksheet tabs or the Print Options tab, print the following worksheets to review your latest figures:
   • Inventory Worksheet (for companies that sell products)
   • Operating Expenses Worksheet
   • Capital Budget Worksheet

B. Analyze the figures associated with your Management Plan. Each projection should reflect facts collected either from the company’s own historical financial statements or from outside sources. Look at the following list of possible costs associated with a company’s Management and Organization Plan.

As you review this list, analyze your own figures. Have you included each cost item that applies? Are the projected costs supported by adequate research from trusted sources? If you can answer yes to both of these questions or if the cost does not apply to your business, place a check in the boxes below. For those items that do not receive a check, research additional sources to identify changes that might be necessary to more accurately represent this figure in your final budget.

Remember:
The Financial Template contains all projected costs for your business entered into three main worksheets—Inventory, Operating Expenses, and Capital Budget. No specific worksheet lists management costs. Therefore, categories on each worksheet may contain figures associated with management as well as other costs of doing business, such as marketing. For example, Telephone Expenses may include the basic costs of the office telephone system as well as the costs of the toll-free sales and marketing line.

If you have production costs, direct costs associated with production are entered on the Inventory Worksheet, including the production manager’s salary. Be careful to only include this salary expense in the Inventory Worksheet, avoiding a duplicate entry on the Operating Expenses Worksheet.
Finalize My Management and Organization Financial Projections

Inventory Worksheet
- Payroll Expenses – Salaries, wages, and payroll taxes of production manager
- Subcontracting – Cost for work performed by others outside the business

Operating Expenses Worksheet
- Licenses & Fees – Includes entity filings and governmental compliance
- Meals & Entertainment – Board of directors, advisory board, and celebrating victories
- Miscellaneous – Meeting room rental and support personnel for board of directors, advisory board, or management team retreat
- Outside Services – Marketing, human resources, risk management, sales representatives, distributors, engineering and design, import/export brokers
- Payroll Expenses – For additional management team members
- Professional Fees – Ongoing consultations with attorney and accountant as needed
- Travel – For management team members, board of directors, advisory board

Capital Budget Worksheet
Costs associated with the addition of management team members in the following categories:
- Computer Equipment – For management members
- Furniture – Desks, chairs, file cabinets, waiting room, display cases, bookcases, and other furnishings

C. Make appropriate changes. Based on the new information available, enter changes into the Inventory, Operating Expenses, or Capital Budget Worksheets to more accurately represent projected costs for your Management and Organization Plan in the Financial Template.
A Closer Look @ Using Consultants and Contractors

While a large corporation normally employs a multitude of professionals on its staff, an entrepreneur cannot afford such luxuries. Successful entrepreneurs rely on outside resources for their infrastructure, especially in early stages of growth. This practice can be less expensive and time consuming than hiring a big staff to do all the work.

Entrepreneurs should learn to use this infrastructure effectively. The successful entrepreneur continually works on building networks of other business people. Those who are located in large cities will find it easier to identify resources and get competitive pricing. Ventures located in less populated areas may have fewer options. In this case, the entrepreneur may need to spend additional time securing resources.

Consider the following statements and questions to help you discern whether or not you may need outside consultants, contractors, or advisers.

<table>
<thead>
<tr>
<th>Need for Outside Consultants, Contractors, or Advisers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Step 1</strong> You may need outside consultants, contractors, or advisers if one or more of the following are true:</td>
</tr>
<tr>
<td><strong>General Considerations</strong></td>
</tr>
<tr>
<td>1. I know of opportunities I can’t pursue or problems that can’t be solved because my organization doesn’t have the expertise it needs.</td>
</tr>
<tr>
<td>2. Tasks not getting done that are small, self-contained, and easily managed might be outsourced without too much effort or cost.</td>
</tr>
<tr>
<td>3. My team is overworked, overwrought, or overtired and needs a temporary reprieve.</td>
</tr>
<tr>
<td>4. I need to use consultants to ensure that my employees and I have considered alternatives to my current business practices and technologies.</td>
</tr>
<tr>
<td>5. My team needs to learn special on-the-job skills from an outside expert who could be brought in as a temporary mentor/coach.</td>
</tr>
<tr>
<td>6. My company needs to focus on its core competencies quickly to take advantage of new opportunities or to keep pace with competitors.</td>
</tr>
</tbody>
</table>
### A Closer Look @ Using Consultants and Contractors continued

#### Need for Outside Consultants, Contractors, or Advisers continued

<table>
<thead>
<tr>
<th>Specific Questions</th>
<th>Circle the response that answers the majority of questions in each category.</th>
</tr>
</thead>
<tbody>
<tr>
<td>7. <strong>Training</strong> – Does my team need to be formally trained by outside professionals? Would my managers benefit from leadership training? Would my team benefit from software training? What other training would increase productivity? Would my company benefit by implementing a formal training needs assessment?</td>
<td>Yes</td>
</tr>
<tr>
<td>8. <strong>Accounting</strong> – Does my accounting system need to be updated or improved? Would it be useful to bring in outside professionals to help? Would it be better to outsource the accounting function?</td>
<td>Yes</td>
</tr>
<tr>
<td>9. <strong>Marketing and Public Relations</strong> – Could I take greater advantage of marketing and public-relations opportunities by using marketing or public relations firms or consultants?</td>
<td>Yes</td>
</tr>
<tr>
<td>10. <strong>Website</strong> – Could my website be improved to enable my company to more easily update and maintain information? Could my website be redesigned to help my customers find the information they need? Could I add functionality to sell my products and services online? Could I improve the methods I use for driving people to visit my website?</td>
<td>Yes</td>
</tr>
<tr>
<td>11. <strong>Information Technology</strong> – Is my technology infrastructure reliable and up-to-date? Might it be evaluated for improvements or outsourced to a better provider?</td>
<td>Yes</td>
</tr>
<tr>
<td>12. <strong>Manufacturing</strong> – Are my manufacturing practices efficient, cost-effective, reliable, and flexible? Could a consultant help me find efficiencies or create quality improvements?</td>
<td>Yes</td>
</tr>
<tr>
<td>13. <strong>Human Resources</strong> – Are my human resource practices legal and effective? Could a human resources professional help me ensure compliance and improve employee productivity/satisfaction?</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Step 2** After reviewing the statements and questions above, write down some action plans you might use to contract help from outside. After brainstorming some action plans, continue reading below to improve this process.
A Closer Look @ Using Consultants and Contractors

Just as with hiring internal managers and staff, using external support requires careful planning and selection. Initially, you may struggle with such decisions because of a lack of familiarity with the process and the kind of help that can be provided. Over time, you can learn how to better assess your needs and the competencies of providers.

Selecting Consultants and Contractors—The following worksheet on p. 287 will enable you to think through some of the most important issues as you search for outside help. Make copies and use it to rate each provider you review.

Before you select a consultant or contractor, determine your budget, scope of work, timeline, measures for success, and other resources available—such as computers or workspace—to support the people who will do the work. Don’t forget that the work of consultants and contractors will have to be managed by someone inside your firm. One rule of thumb suggests that for every eight hours of work that outsiders do, you’ll have to devote at least two hours to set goals, clarify the task, provide information, and monitor the work. Use the worksheet to guide you in the selection process.

Paying Consultants and Contractors—You also need to consider how you will structure payment as well as the tax implications of using an independent contractor instead of an employee. The IRS may want to know if the person is truly an independent contractor. They look at the work relationship that exists between the business and the person performing the services.

The general rule is that you have the right to control or direct only the result of the work done by an independent contractor and not the means and methods of accomplishing the result. If you dictate how a job is to be performed, you may establish an employer-employee relationship.

For example, if you train a person how to do his work or tell a person the hours he will perform the work for you, you are treating him like an employee. Additional explanation of independent contractors can be found at www.irs.gov. The Internal Revenue Service relies on the facts in each case. It does not recognize the validity of any written agreement between the parties. Anyone can get a ruling from the IRS by completing Form SS-8.

You need to correctly determine whether the person who is providing a service is an employee or independent contractor. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors. If you incorrectly classify an employee as an independent contractor, you will be responsible for employment taxes for that worker plus a penalty.
### A Closer Look @ Using Consultants and Contractors continued

#### Selecting Consultants and Contractors Worksheet

<table>
<thead>
<tr>
<th>Consideration</th>
<th>Questions to Ask Provider</th>
<th>Notes on Each Provider</th>
</tr>
</thead>
<tbody>
<tr>
<td>Some external providers do one thing and do it well. Others can help you figure out what you really need.</td>
<td>What do you typically do for your clients? How do you approach your work? How will you go about assessing my specific needs?</td>
<td></td>
</tr>
<tr>
<td>Large external providers may have many areas of expertise but may not give you individual attention. Small external providers may give you individual attention but offer less areas of expertise.</td>
<td>What is the size of your firm? What types of accounts do you handle? What percentage of your work is done with companies that are the same size as mine? Who will be handling my account, senior management or junior associates?</td>
<td></td>
</tr>
<tr>
<td>Firms who have dealt with your type of business, geographic area, industry, and similar issues of your company are more likely to have the specific expertise that will help you.</td>
<td>I have this issue: ______________. How often do you deal with this issue? I’m in this state or town: ______________. How often do you service businesses in this area? I have this type of business: ______________. How often do you service businesses in my industry? I’m an entrepreneurial business. How often do you handle an entrepreneurial business?</td>
<td></td>
</tr>
<tr>
<td>Some firms may be extremely busy and may not have time to deal with your particular issues. Others may generally be more responsive or may have slack in their schedule.</td>
<td>What timeline will you be able to keep in dealing with my issue? What happens when I need you? When can you begin work on my project? When will you complete my job?</td>
<td></td>
</tr>
<tr>
<td>Every organization has different ways of handling their work. You’ll want to make sure that the firms you hire utilize processes that you will be comfortable with. For example, firms differ in their approaches, their values, their concern for others, and their ethics.</td>
<td>Present prospective providers with one or more scenarios and ask how they would respond to those situations and issues. Evaluate their responses to determine if their methods would provide a comfortable fit with your business and your personal methods and values.</td>
<td></td>
</tr>
<tr>
<td>Fee structures vary widely between firms, as does the ability to be flexible.</td>
<td>How do you get paid? What is the typical range? What special arrangements have you made in the past to help your clients save money? What flexibility do you have in the way our deal is structured?</td>
<td></td>
</tr>
<tr>
<td>Firm-specific considerations may be added here.</td>
<td></td>
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</tbody>
</table>

It may be helpful to verify the information provided by speaking with references or asking your network.
A Closer Look @ Brainstorming Change

You are not the only member of your organization who has ideas about change. Often your employees, management team, contractors, or vendors are bursting with ideas for how you could do things better. Consider these steps for brainstorming change:

1. If you don’t hold regular meetings with your staff, start doing so. Weekly or bi-monthly meetings are essential to encouraging idea generation.

2. In preparation for an upcoming meeting, give your employees or your management team an assignment to brainstorm at least five innovative ideas on a particular question such as growth, a specific problem, or business function. Some pertinent ideas follow but feel free to create your own. You’ll be better off if you focus on only one question per meeting.
   - What can we do to better serve our customers?
   - What can we do to cut costs?
   - Our company mission is____________________. In what ways could we better meet that mission?
   - What market opportunities are we missing?
   - We have this problem: __________________. What innovative ways can we solve it?
   - Ask each person to bring a list of five or more prospective innovations to the meeting.

3. At the meeting, tell everyone the rules for brainstorming:
   a. Accept all ideas as good.
   b. Do not criticize.
   c. Do not worry about feasibility.
   d. List as many ideas as you can.

4. List the ideas on flip chart pages or a white board so they are visible. Encourage everyone to participate and to piggy-back on one another’s ideas.

5. If you still have time at this meeting after all the ideas are listed, prioritize the list. It is now okay to respectfully criticize ideas but don’t criticize the people who offered them. Develop a short list of items for possible implementation.

6. Make decisions about which ideas, if any, to pursue. Ask for volunteers (or select specific employees or teams) to champion the change efforts and begin implementing them.

7. Test each idea to ensure it supports your company’s mission and values and to find out if it is logistically and financially feasible.

8. Set specific dates for the completion of a change plan or for further discussions.

If employees understand that change and innovation are a normal part of your business, they will begin to look for opportunities as they work.
A Closer Look @ Protecting Business Interests

As you grow your business, you will want to ensure that you are protecting your interests and those of your business. The first step is to develop an awareness of the legal problems that are inherent in starting, operating, and growing a business. While scores of legitimate individuals and organizations are willing and able to assist entrepreneurs, naive entrepreneurs can make serious blunders that cost them dearly, even to the extent of losing their business.

The more valuable a business becomes, the more likely the owner will be under attack by those who seek to steal the results of his or her efforts, using whatever means they find open to them. Clearly, it is wise for entrepreneurs to protect themselves against unscrupulous individuals. They must safeguard their interests not only by being watchful but also by having a certain degree of legal protection in place as their business grows and increases in value.

Tip

Greed and the desire for power are the most common causes of "squeeze outs."

Forces Contributing to the Squeeze Out

In some ventures, founding people have been squeezed out somewhere along the line. As time passes relationships change, fortunes come and go, talents and skills become clearer, the needs of the business evolve, and greed surfaces. Things change. When they do, you want things to change your way, not someone else's.

Although you can take defensive measures to protect your interests in an enterprise, it helps to understand the basic forces causing squeeze outs: greed and power. Recognizing these forces and their warning signs can help you avoid a squeeze-out situation.

Greed

Unquestionably, greed heads the list of reasons underlying squeeze outs, despite the protests to the contrary of the person wanting to take over the business. The squeezer may be able to conjure up a noble justification for eliminating certain business associates. For example, Frank owned 40 percent of a prosperous rock quarry north of a small town in Indiana. The remaining 60 percent was owned by Ralph, a multimillionaire building contractor who was by far the rock company's number one customer. While Frank drew a salary for his work as general manager, the board of directors, controlled by Ralph, declared no dividends. The ostensible reason in the corporate minutes was that the money was needed for future expansion. Privately, Ralph made it clear that he didn't want any cash dividends from the company because Uncle Sam would take most of them in income taxes.

Since Ralph was already extremely rich, he didn't need the cash. Frank, on the other hand, had a growing family and wanted to enjoy the financial fruits of his work. Ralph refused. After several years of continual discussion on the matter, Ralph finally, in private, looked Frank squarely in the eye and said, "Frank, you can't be this stupid. Hasn't it dawned on you that you'll never get any money out of that rock company? I control it. The only way you are ever going to see a dime is to sell your stock to me. I'll give you $200,000 for your stock right now."

This offer represented selling out for the equivalent of about 5 cents on the dollar since the company was worth about $4 million. Frank objected, of course. After consulting his lawyer, Frank decided to take the $200,000 and be happy that Ralph was even that generous. Not only was Frank posed with some serious legal obstacles in the Indiana courts to forcing a dividend payout, he was reminded that Ralph had the power to fire him as general manager, causing him to lose his salary. Moreover, Ralph's company was the rock company's biggest customer. Ralph had Frank in a situation that made him powerless.
This case clearly identifies the problems minority stockholders can have in a profitable company under the control of one major stockholder. The brutal truth is that the minority stockholders’ interests are generally worth only what the majority stockholder says they are worth. On some occasions a minority stockholder can successfully obtain relief through court action. Such instances, however, are rare exceptions for a number of reasons:

- If the majority stockholder is legally astute, he or she will avoid any cause for legal action.
- The majority stockholder often has other strangleholds on both the corporation and the minority stockholder.
- Litigation is expensive and hard to justify in light of the odds of success and the time required for the legal process.

Typically, the minority stockholder is not wealthy and is pressed for money, so legal remedies are often not a choice. The individual needs the money quickly and will settle for a fraction of the value of the company. For example, Frank was willing to settle for his $200,000 in hand rather than gamble on a larger sum years down the road. Frank's decision was sound. The $200,000 probably represented more than Frank could get any other way.

The courts’ general attitude toward minority stockholders and their rights may be puzzling. The following may help explain the law’s reluctance to meddle unnecessarily in the affairs of a corporation:

- Basic legal premise is that the majority rules. The court reasons that the majority has the right to run the business as it desires so long as it does not violate the law in doing so.
- The law generally considers stockholders to be prudent businesspeople who buy the stock understanding the limitations of their minority position.
- Minority stockholders are not necessarily more virtuous than their majority counterparts. Don’t jump to the conclusion that a minority stockholder who is grousing about his or her treatment by the majority is justified. The minority stockholder could be the in the wrong.

Take note that a minority stockholder does have some nuisance value. The ownership of that stock gives the right to initiate a number of court actions to force the majority stockholder to account for the proper use of the company’s assets. The most vulnerable point at which to attack a majority stockholder is on the issue of how he or she is using the corporation’s assets. If a minority stockholder can show that the majority stockholder is using the company’s assets for personal benefit, then the minority stockholder gains some legal leverage in the situation.

Consequently, if you are the majority stockholder, you should realize the importance of dealing with your corporation at a professional distance. Smart entrepreneurs do not provide minority stockholders with the ammunition needed to go to court to claim that the company’s assets have been used improperly for personal benefit.

Greed in business can affect even the deepest friendships. Many times in the organizing phase of a business started by three or four friends, the chorus is loud and repetitive: “We don’t need all of these protective arrangements. We are good friends and nothing can pry us apart.”

Consider the case of three friends who went into business to start manufacturing a line of clothing. Their stock ownership was 60 percent, 20 percent, and 20 percent. One of the
A Closer Look @ Protecting Business Interests continued

20 percent stockholders was allowed his position initially in exchange for labor. The second 20 percent stockholder paid $25,000 for the stock, which was used to finance the venture. The majority stockholder paid $40,000 for his 60 percent interest. Three years later, a large manufacturer initiated contact with the majority stockholder to purchase the company, which had grown into a highly profitable business. The initial offering price was $1 million. The majority stockholder became greedy. He told the working minority stockholder that he was not going to let the $25,000 investor receive $200,000 for his stock after only a three-year investment. He considered the dividend an excessive rate of return for the nonworking investor. Consequently, the majority stockholder began squeezing out the $25,000 investor. A few years later he bought out the remaining stockholder and is now sole owner of a company worth about $3 million. Bear in mind that these three men were the closest of friends and that the minority stockholder who was originally squeezed out had done many favors for the majority stockholder. Greed has a way of overriding all considerations. It is fascinating and frightening to observe the behavioral changes in the majority stockholder when he learned how much money was on the table. In essence, the reasoning was that for $3 million he could find a new friend.

Power
Most political and business leaders hold their positions because of tremendous power drives. These leaders want to be in control. Although the quest for power can be a positive motivator, for some people the drive for power overshadows their values and becomes an issue. Powerful people are admired and receive all sorts of benefits. Power is fun, rewarding, and gratifying to the ego, but the drive for power can also corrupt.

Ownership interests in small corporations are often evenly divided. The situation in which three owners each own one-third of the business can lead to trouble. For example, three men came out of the Vietnam War as buddies whose bonds of friendship had been forged under fire. They thought nothing would ever pry them apart. Together, they started a small chemical compounding business in Denver shortly after they graduated from college. Each owned one-third of the business. While the product and concept were sound, the initial sales manager wasn’t. As a result of his lack of knowledge about the industry into which they were trying to distribute their product, the company lost $100,000 in its first year of operation. It was insolvent, and to continue operations it needed cash.

Fortunately, one of the three had accessible funds from his wife which she was willing to loan to the company on a one-year note at a reasonable rate of interest. The sales manager was fired and replaced with someone with the needed experience in the industry. Operations were turned around during the second year but not to the point that any cash was available for paying off the note. At the end of the year, the stockholder who had loaned the company the money and who was also its president quietly made to the board of directors what seemed to be a reasonable proposition: “As you know, the note for $100,000 is due this week. The company does not have the cash to pay it. The banks are unwilling to lend us the money. My wife is unwilling to extend the note. Naturally, she has no desire to take this company to court for collection. As the company’s major creditor, she could take over ownership of its assets, which would include the product patents and trademarks. She doesn’t want to do that. What my wife is willing to do is accept more of the company’s stock in exchange for the note. Right now the book value of the stock is negative, as you well know, but she would be willing to trade the note in exchange for 100,000 shares of common stock. That’s the proposition for you to consider.”
A Closer Look @ Protecting Business Interests continued

The takeover was all very quiet and polite. The other stockholders realized they had no bargaining position. Their buddy’s wife could go to court and do exactly what she said. The company had no funds with which to defend itself. The remaining two stockholders had been given their positions as production manager and treasurer in exchange for their modest initial capital inputs. The offer was accepted. The net result gave the president control of roughly 60 percent of the stock. He was now in total control. The next week, his production manager buddy was invited to leave the company. The remaining buddy accepted the reality of the situation. He recognized the power of the president and followed orders. His minority stockholder position was worth whatever the president ultimately decided it was worth.

These situations illustrate the danger in refusing to set up your business relationships in a way that recognizes you may later have a falling out with even the closest friends. Yet experience indicates that a very high percentage of such relationships eventually crumble as the interests of the parties diverge. Consequently, you should organize your company in a way that will protect the interests of the people contributing to it.

Warning Signs

If your business associates insist that such mutual-protection arrangements are not needed, try to discern their motives. Are they really that naïve? Are they setting you up for a later power struggle? Consider and be wary of the following signals in shareholder relationships:

**Inactive shareholder**—Often a new enterprise is formed by one, two, or three people who intend to work in the company in addition to contributing money. But they also need money from outside investors who will not be active in the firm. The working investors, through hard work and long hours, make the enterprise prosper. The company is worth a lot of money—and all because of their efforts, or so they believe. The working investors come to resent the outside investor who profits so handsomely from their hard work.

The squeeze is on “the person who didn’t contribute anything except a few dollars, but now look what we’ve done for him.” So the rationalization begins. Never mind the fact that at the beginning those “few dollars” were the ones that allowed them to go into business. Such memories are short and rationalized away: “We could have borrowed the money somewhere!” Why didn’t they? Such squeeze outs are easy if the outside investor has not used some protective tactics.

For this reason outside investors should not stay too far outside the company. They should consider participating to some degree and trying to appear as if they are part of the team. Such investors should always provide the potential squeezer with a buyout price that meets the investor’s goals. Otherwise the investor may get nothing by being frozen out—no dividends, no benefits, no market for stock.

**Death or change in status among stockholders**—One group begins a business. The associates are happy with their relationships, but one of them dies. The survivors may not care to be in business with the person who inherits the stock, so the need for a buyout is apparent, as well as life insurance to furnish cash to execute the buyout.

The situation also occurs where one of the originators of the business is involved in a divorce. The spouse of the originator is awarded some or all of the interest in the business. Imagine how that business now operates with owners who have just been through a divorce and possibly an acrimonious property dispute. Consider placing restrictions on transferability of interests or a buyout arrangement with triggers to permit those in the business to force a buyout of spouses.
A Closer Look  Protecting Business Interests continued

Also consider the prolonged illness or disability of one of the founders. The success of the business is dependent on the daily involvement of all the founders. For how long will the other founders do the work of the ill or disabled partner and continue to pay salary as well as represent that person’s interest in the business? Perhaps they need to hire others to take up the slack or to induce someone else to become an owner to obtain his or her talent. Include agreements for such circumstances before they arise.

Note that buyout agreements are not designed to cheat anyone or treat them unfairly but rather to provide for changes in business and personal situations which happen everyday. If you make these agreements during a time in the business when relationships are good, people tend to treat everyone in the changed circumstance fairly. After all, you never know which side of the transaction you will be on. Without reasonable buy-sell and buyout arrangements, the survivors will likely initiate a squeeze out to remove the unwanted people from the firm. The close corporation is really a closed corporation—closed to all but those people who are wanted in it.

The aged founder who hangs on—As the song goes, “You gotta know when to hold ‘em; know when to fold ‘em.” Too many aging entrepreneurs don’t know when to fold ‘em and walk away. They love the game too much or just don’t see any reason for selling their shares. Why should they?

Younger people in the organization are often eager to furnish reasons. The older person is getting in the way of progress, so the younger members initiate a squeeze out. Henry Ford discovered the folly of giving stock to his wife and family; they combined to force the old gent out of the Ford Motor Company in favor of Henry III. Of course had they not been able to do so, the company would have probably gone under.

The drive of superior talent—Cream rises to the top, and talent demands its rewards. Should ineptitude, or the appearance of it, seem to block the rise of a talented individual, that person may try to squeeze out the hindrance.

People who perceive themselves as being talented at something can become overbearing and intolerant of people whom they consider less talented than themselves. Given the power in a business, they often drive out other people at an alarming rate. Moreover, people with such talent can be unreasonably jealous of other talent and will squeeze out anyone who threatens their position. If your business requires you to work with people of special talent, take extreme precaution to protect your interests.

Unreasonable minority shareholders or stockholders—Many squeeze outs are the result of the minority stockholders’ own behavior. They give the majority stockholders so much trouble that no rational person would tolerate them for long. In a close corporation, the stockholders are not adversaries; they are on the same team. If one or more stockholders cannot play team ball, some changes will be made.

Sometimes such behavior by a minority interest is designed to force management to settle with it on favorable terms. In one case, a minority stockholder who was also a director was consistently obnoxious. No one could understand how he ever became involved in the venture. He had put up $200,000 of the $3 million initial capital. He disagreed vigorously with everything, and on two occasions, other directors almost came to blows with him. Each time he would offer to sell his stock back, there were no takers. The company was failing due to their inability to work together, in part because the minority stockholder was blackmailing the other directors. The price for his ouster would give him his money back, and the directors at the table were sufficiently wealthy that they could have agreed to his offer. But they didn’t. He would go down with them.
A Closer Look @ Protecting Business Interests continued

Divergence of business interests—In the beginning of an enterprise, the initial entrepreneurs are usually possessed with one overriding interest—making the new venture successful. They bring to the venture an assortment of talents and money. Each is aware of the others’ outside business interests and accepts them as one of the conditions that exist when they start operations.

The reality of close corporations is that the founders tend to regard themselves as partners. They develop a strong camaraderie. They view their relationships as closer than fellow stockholders in a new corporation. They spend more time with their business associates than with their families, so it is not surprising that such relationships erode when one or more of the partners violate the implicit rules of partnership by excluding one of the others from some business opportunity. It happens in many ways.

Perhaps one of the partners simply invests some money in an outside venture that does very well without providing his partners with an opportunity to share in the venture. In one instance, a partner was made president of the local country club, to the great consternation of his golf-fanatic partner, who became incredibly jealous. The squeeze was on.

Popular shareholders in a group often will be offered business opportunities around town that are not offered to less popular members of the same group. Such situations are loaded with explosive potential for they can signal a beginning of the end of old relationships. As the individual spends more and more time on outside business deals, the offended shareholders reason—often with justification—that the stockholder is no longer playing a team game. He is not fully committed to the interests of their business.

In one such situation the two offended partners said, “Well, if he wants to play the lone wolf and go it alone, let’s accommodate him.” They accomplished the squeeze out easily because the close corporation had been drawn up without any protective agreements, even though excellent legal assistance had been used initially. The two partners simply fired the third party from his job as treasurer and excluded him from all managerial participation in the company. Since no dividends were paid in the organization (the stockholders were all employees of the firm and withdrew their profits disguised as salaries and expenses), the net result was that the third party was stripped of his investment. They did not even bother trying to buy back his 33 percent stock ownership.

Consequently, small groups of people going into business for the first time should understand that they are becoming members of a team and that they need to do everything possible to make certain their interests coincide. The minute a serious conflict of interest develops among the stockholders of close corporations, a squeeze out will be forthcoming.

Discovery of duplicity—Duplicity can occur in many forms. A squeeze out can work both ways, with the deceitful person being either the squeezer or the squeezed. In one example, an inventor of a chemical compound designed to temporarily fix cracked automotive engine blocks was able to begin a company to manufacture and distribute the product with money furnished by three investors—business professors at a Big Ten university. The company prospered through a large contract from the Army. The firm made a lot of money, which was kept in the corporation to finance its growth. Suddenly, at a board meeting, the inventor told the majority investors that unless they sold their stock to him for a sum equivalent to about 10 cents on the dollar, he would not renew the license he’d given the corporation for manufacturing and marketing the chemical compound.

The professors had been negligent in performing due diligence. They had failed to check that the inventor had assigned all of his patents and trademarks to the corporation. Instead, he had merely licensed them, and the license was running out. They felt they had no alternative...
A Closer Look @ Protecting Business Interests continued

but to give up their positions in the company because it had no future without the rights to make and sell the product. Unfortunately, in this case duplicity paid off for the deceiver to the detriment of the majority stockholders. In other instances, stockholders will go to extreme lengths to punish the inventor. The professors could have fought and won, but they weren’t up for the fight.

In another instance, the chairman of the board—who had invested $160,000 of the company’s $3 million initial capital—was discovered by his fellow directors to have illegally diverted money into his own pocket. When one of his friends wanted to invest in the company, the chairman would sell him some of his own stock instead of the company’s stock. He was divesting himself of his position in the company, while on the surface telling all his friends what a great buy it was.

Since the stock had not been registered with the SEC, it was not transferable without restriction. Moreover, the proper legends had not been put on the stock certificates to warn people not to transfer it. Because of several violations of the law, the offending minority stockholder was quickly forced to rectify his errors. Up to that time, most of the directors had considered him to be the good guy in the scenario. With the disclosure of his duplicity, relationships changed.

Part of the motive for duplicity in these cases is that initially the financiers demand the lion’s share of the stock for financing the company. The inventors get a substantial block of shares for transferring their patents and trademarks to the corporation. But under what terms and exactly what patents? Inventors have an advantage over financiers in that they may be aware of other patents and ways of getting around the patents. They may keep secrets in dealing with the financial people, whom they regard as having taken control of their “baby.”

Often such inventors reason, “I’ll go along with you now and give you what you think is control of the company, but when the time comes, I’ve got a few aces to play that you don’t know about.” They keep control of key bits of information, without which the corporation cannot exist. Patents don’t tell the whole story, and financiers ought to be wary in their dealings with such technically minded people. If the technical people walk out of a high tech venture, the majority stockholders often will have nothing left because the real business was in the mind of the inventors.

Legal arrangements can provide that future inventions be turned over to the company, specifying how the inventor will be rewarded. They might prevent certain disputes from developing.

Squeezing Out Business Associates
One of the reasons squeeze outs are so common is that they are so easy to accomplish. The parties have done little or nothing to protect their interests. Often, it is simply a matter of firing the person from his or her job in the company and then freezing the person out from all participation in the fruits of the enterprise.
Some common squeeze-out techniques are discussed below:

Termination as Employee
In many new enterprises, the stockholders all intend to obtain their rewards through salary and expenses. They have no intention of ever making sufficient profit that dividends can be paid, so when the majority stockholders want to oust a minority stockholder-employee,
A Closer Look  @  Protecting Business Interests  continued

all they have to do is fire him or her. In a few cases the courts might charge wrongful discharge, but for the most part, when majority stockholders want to get rid of an unwanted stockholder-employee the real reason is that they are unhappy with the person’s performance (or at least they can find reason to be unhappy with it).

**Defensive tactic**—If a person enters into a relationship with the intention that the investment also buys a job with the company, such a person would likely want the initial agreement to clearly state that if the person is discharged for any reason, the stock must be repurchased at an agreed-upon price. An ability to recover the investment immediately upon termination should be in writing.

Of course, such an agreement might be unwise from the company’s viewpoint, for the agreement might place a cash demand upon the company when the company could ill afford it. Wise management should be wary of tying its hands in dealing with employees. It would be very awkward to have to retain an unwanted or inept employee just because majority stockholders or the company did not have enough cash to buy out the employee’s stock interest. These matters can be difficult to solve because the various roles of contributors in a company often form a complex and tangled web of interests.

**Withholding Dividends**
The classic way to squeeze out unwanted minority stockholders is simply to withhold dividends. They can sit on their stock to the end of time, but they’ll get nothing for it. Moreover, sale of the stock is restricted. It has little value. This tactic, when properly executed by a majority management that knows what it is doing, is almost unassailable in court because it can be made to appear as if the company has only nominal earnings. Accumulated retained earnings have to approach truly gargantuan proportions before the courts will move to action. Some minority stockholders attack this freeze-out tactic by trying to get the IRS to declare the corporation has excessive accumulated earnings, thus forcing a dividend payout. Again, if management has availed itself of reasonable legal assistance—and in most squeeze-out undertakings, it usually has—forced payout is unlikely.

**Defensive tactic**—If a minority stockholder truly expects dividends to be paid on his or her stock, then perhaps he or she should think in terms of receiving a preferred stock in which the dividends are cumulative. Convertible bonds on which interest must be paid are another investment medium that avoids withholding. Stock dividends create a double-taxation situation, losing the firm’s cash to Uncle Sam. The convertible bond not only has to be repaid, but it also goes on the balance sheet as debt, not equity, and thereby reduces the firm’s ability to borrow money elsewhere.

Investors in a new enterprise often decline investing through the medium of buying stock in the company, preferring to purchase assets for the new enterprise and then leasing them to the company, thereby getting their income through rental payments rather than dividends. This tactic has several attractive tax advantages to both the company and the investor.

**Removal from Board of Directors**
It is often implicit in closely held corporations that all stockholders will be on the board of directors and privy to the inside workings of the corporation. A director has many legal rights and responsibilities not bestowed upon the stockholder. Minority investors often insist on a seat on the board as one of the conditions for making the investment. Therefore, in squeezing out minority stockholder-directors, one of the first moves is to remove them from the board. Management doesn’t want them where they can learn anything about the company.
A Closer Look  @  Protecting Business Interests  continued

Defensive tactic—Obviously, the major defensive tactic here is to place in the bylaws of the corporation a stipulation that each stockholder is to be a director of the corporation. If a company has too many such stockholders, then each minority investor will have to make a separate deal. Often a separate contract is made in which the minority investor is granted a seat on the board so long as he or she owns stock in the operation. The stock must be repurchased if for any reason the person is not elected to the board of directors.

Mergers
On a vastly more complicated level, minority stockholders can often be squeezed out by merging the company with another company wholly owned by the majority stockholders. The terms are not favorable to the stockholders of the old company, but what difference does it make to the majority stockholders? Since they own all of the new company, they are the beneficiaries of the merger. Such squeeze outs take a lot more legal finesse and are far more costly than the previous tactics discussed but are often necessary when squeezing out a number of minority stockholders who are neither employees nor directors of the company.

Defensive tactic—The key defense to merger tactics is to make certain that the corporation’s bylaws state that such mergers cannot take place without the approval of the minority stockholders. In a company with relatively few stockholders, the bylaws might even require unanimous approval of stockholders for any such mergers. In other instances, perhaps a two-thirds or three-quarters stockholder approval would be necessary for any such merger. The idea is that the minority stockholders must block the majority stockholders in their plan to transfer the assets of the company into a legal framework the majority stockholders own entirely.

The importance of every section of a company’s bylaws cannot be stressed enough. Despite warnings that entrepreneurs give serious thought to each and every provision in the corporate bylaws, many have not done so. Only after it’s too late do they start reading the fine print. Be warned that most of the standard bylaw provisions and most state laws, particularly those of Delaware and New Jersey, are set up for the benefit of the majority stockholders. Few provisions exist in such statutes for the protection of the minority stockholders.

Re redeeming the Shares
Redeeming the shares requires some extensive legal maneuvering but has been used successfully to squeeze out a number of minority stockholders. The game plan goes something like this: Under some form of reorganization, merger, or recapitalization, the common stock of a company is converted into preferred stock for an ostensibly sound business reason. One of the provisions of the preferred shares is that they can be redeemed at par value at the company’s discretion. Once this legal maneuver has taken place, the majority stockholders have within their power to take the minority stockholders out of the picture. Often the common stock is converted into preferred stock during troubled times. At the time, the minority stockholders are happy to have their positions seemingly improved.

Defensive tactic—Again, the defensive tactic for this squeeze-out maneuver lies in controlling the bylaws to such an extent that the majority cannot make the reorganization without the minority stockholders’ approval.

Use of veto provisions needs to be mentioned. In some extreme cases, minority stockholders have insisted upon and gained a veto power over all actions of management in regard to sale of assets, mergers, reorganizations, recapitalization, and the payment of all salaries and expenses. Naturally, management hates these constraints and is motivated to skirt them in some fashion. It is usually not smart to give people such a stranglehold. Wise entrepreneurs walk away from investors who insist on veto provisions. This is money they don’t want.
A Closer Look @ Protecting Business Interests continued

Watering the Stock
The classic squeeze-out maneuver from the early days of corporate capitalism was the watering of the corporation’s stock through the issue of additional shares of stock to the majority stockholders, thereby diluting the minority’s interest. Because this tactic was so widely used in the past, many corporations require that all stockholders have the right to buy such additional shares to keep their proportional interest in the company.

The preemptive option clause that exists in many corporate articles of incorporation and bylaws is designed to prevent the squeeze out of stockholders through the issuing of additional corporate stock. Note that this clause applies only to newly authorized shares. In many states, treasury stock and shares already authorized may not fall under these provisions. These are highly technical legal matters that vary state by state and should be carefully examined by minority stockholders whose positions might be threatened by such tactics. An entrepreneur must know, in detail, what the law provides in the company’s state of incorporation.

While the preemptive option clause sounds good, the reality may be different. How many minority stockholders want to put additional money into a company whose management is obviously trying to eliminate them? Moreover, astute managements often execute the stock offering at a time that is financially inconvenient to the minority stockholder. If one doesn’t have the money, one can’t buy the stock. Even with the preemptive option clauses in the bylaws, the tactic of issuing additional shares can be successfully used to dilute the position of unwanted stockholders.

Defensive tactic—Play the role of a venture capitalist and ensure that an antidilution agreement is executed stating that if additional stock is issued, your percentage of ownership cannot be diluted. Stockholders would receive additional shares that ensure they still have the same percentage of ownership.

Selling Corporate Assets
One of the more devilish ways by which majority stockholders can defraud their minority colleagues is by arranging the sale of the key corporate assets to a company totally under their control. In some of these instances all of the assets, trade names, and customers are neatly transferred to another corporate body for an inadequate consideration. The money is then distributed to all stockholders in proportion to their holdings.

Naturally, such sales may be regulated by corporate bylaws that require the approval of a certain percentage of the stockholders. The courts have not always dealt kindly with this tactic if it is apparent that management has appropriated the company assets unfairly. Such litigation usually comes down to appraising the fair market value of the assets. Nevertheless, the majority is able to sell off valuable portions of a corporation, within limits, to other entities in which it has a more substantial interest.

Minority stockholders who have been victimized by this tactic have a stronger case in court if it is worth their time and money to pursue it. Naturally, such transactions are often difficult to prove, and the problems of evaluation always hang heavy on the plaintiff.

Defensive tactic—As in many of the previous cases, one defense against such sales is to require such a high-percentage stockholder approval that the minority stockholders can block unwarranted sales. Another is for the minority stockholder to hold title to some key asset and lease it to the company.
A Closer Look @ Protecting Business Interests continued

**Dissolutions**
While it might seem strange that dissolving the corporation is a way of squeezing out unwanted stockholders, the tactic has been used in situations where certain stockholders felt they could acquire the assets of the corporation and be able to operate the enterprise once again without the unwanted stockholders. Naturally, this tactic is fraught with legal difficulties.

**Defensive tactic**—If the bylaws are of no help, all the aggrieved minority stockholder can do is try to assert his or her claims in court and trust the legal system. Frankly, the minority stockholders could be in trouble.

**Changing the State of Incorporation**
Often as a prelude to squeezing out unwanted stockholders, management moves the state of incorporation to one whose laws are more permissive to the subsequent squeeze-out actions. Without a doubt, the majority stockholders will always have noble and high-sounding reasons for changing the state of incorporation, luring the potential minority stockholders into relinquishing many of their legal rights. Still, the end result is that the unwanted stockholder will be eliminated.

**Defensive tactic**—This ploy can be thwarted by a bylaw provision that prevents changing the state of incorporation without the unanimous approval of the stockholders.

**Appropriation of Business Opportunities**
Being in control of a corporation, the majority stockholders (management) are able to appropriate for themselves particularly attractive business opportunities that would otherwise be made available to the company. Properly executed, such tactics are difficult to fight. It’s not feasible to devise legal blockages to force other people to make all of their business opportunities available to the corporation. The fact remains that the management holding the majority interest in a company can—in hundreds of ways each day—damage the interests of the minority stockholders, and little can be done about it.

**Defensive tactic**—For this reason potential investors in an enterprise focus keenly on the integrity of the entrepreneur. If the majority owners of a business are out to cheat their colleagues, they will find a way to do so. If investors don’t have complete confidence in the integrity of their business associates, they should stay away from the investment. This advice is easy to give but difficult to follow.

**Siphoning off the Money**
The target is, after all, the company’s money. The people controlling the money are normally in a position in which they can siphon it off through their salaries, expenses, and other means to the point that the minority stockholders’ interests are confiscated in the end. Unless the minority investor is able to institute and enforce real controls over the flow of money and goods out of the corporation, they can do little to stop such tactics if management has been clever and reasonable about siphoning resources for personal benefit.

**Defensive tactic**—Worried about this problem, investors often insist on total control over bank accounts and insist on active participation in financial management. But the question remains: if you have a reason to worry, why invest?

**Corporate Meeting Maneuvers**
Most shareholder meetings are routine. While the bylaws provide that proper notice must be given and the agenda provided, clever management is often able to place on the agenda...
seemingly innocuous items whose end result can be devastating to the minority stockholders’ position. Moreover, they often hold such corporate meetings at inconvenient times and places. If management knows its problem stockholders live in Los Angeles, it may decide to hold the corporate meeting in Burlington, Vermont. While the corporation may pay the transportation costs for the management, the minority stockholders are left to pay their own way. If they happen to show up at a potentially explosive meeting, the matter is passed by until the next meeting. Management will keep it up until the minority stockholders finally slip up or wear out. It is simply not feasible for most minority stockholders to attend the corporate meetings called by a hostile management.

Defensive tactic—Key to defending against such tactics is to state in the bylaws that all such meetings be at corporate headquarters at reasonable times. Simply remove the freedom of management to dictate location and timing of such meetings. Most corporate bylaws allow management to name the time and place of all meetings.

Buy-Sell Agreements
Throughout this discussion on protective tactics, buy-sell agreements have been suggested as one way of protecting the minority stockholders’ position. It may seem peculiar that these same buy-sell agreements can be one of the majority stockholder’s major tools for cheating the minority stockholder out of his or her just due. Quite simply, the stockholders agree to a seemingly fair pricing arrangement in the beginning, and the minority stockholder is bought out after the firm has prospered for a price lower than the true worth of the stock.

Defensive tactic—Make sure that the buy-sell agreement is reviewed annually by the shareholders who set the price for the shares. This business-valuation figure should reflect the true worth of the business.

S corporation
Situations in an S corporation deserve special treatment because they can pose squeeze-play problems for both the majority and the minority stockholders. Recall that the idea behind treating the corporation as a partnership for purposes of federal income taxation is to avoid paying a corporate income tax and to give the owners whatever tax credits have been earned, as well as operating losses. Two key aspects of the law pose problems for the stockholders. First, while they must pay tax personally on whatever income is declared by the corporation, they do not necessarily receive any cash with which to pay the tax. A cash flow problem can result. Minority stockholders can be placed under pressure by the majority stockholders, who are able to pay the taxes with money borrowed from the company.

Second, all stockholders must agree in writing to the S corporation treatment and can void their selection each year or have it rendered null and void by committing any one of several acts, such as selling their shares to a corporation (one possibly owned by themselves). The minority stockholder can block the majority by threatening to negate the S election, which can cause tax problems for the majority stockholders. Consequently, S corporations pose real problems among stockholders who are not getting along well.

Defensive tactic—Minority stockholders should execute a written document that stipulates the corporation will pay their tax burden on the S corporation’s distribution of profits. Also, all stockholders should have a written agreement stipulating that the S corporation cannot be null and void unless there is approval by 100 percent of the stockholders.
A Closer Look @ Protecting Business Interests continued

Partnerships
Since a partnership is a relationship by consent, it can be dissolved at any time by any partner simply declaring it so and asking for a settling of accounts. A financially strong partner can get rid of unwanted weaker partners at any time by settling accounts according to the articles of partnership and moving them out.

Tip
Avoid 50/50 ownership in any business. If the owners cannot agree, the business cannot act.

But the partner must be paid off. The courts are willing to examine the internal affairs of a partnership closely. If substantial money is involved, the squeezer-partner may use other, more devious tactics. The corporate form of organization is readily amenable to all sorts of squeeze plays. Therefore, the squeezer often suggests to his or her partners that their enterprise should be incorporated. A rational case can usually be built for doing so. Once incorporated, the squeeze out begins. Of course, the squeezer has seen to it that the corporate setting and bylaws are such that the squeeze out poses few problems.

Defensive tactic—if partners decide to incorporate the partnership, avoid becoming a minority stockholder by owning 50 percent or more of the stock.

Avoiding Squeeze Outs
For each squeeze-out technique, appropriate defensive tactics were suggested. Some additional defensive tactics are available to minority stockholders for protecting their interests:
- Refuse minority positions
- Control bylaw provisions
- Participate in management
- Specify buy-sell agreements

Refuse Minority Positions
At the top of the list must be your refusal to be a minority stockholder. Some people have a policy when investing in small, closely held companies to play the game only with 50 percent ownership or more.

Many venture capitalists also demand majority control for reasons that should by now be apparent. Why would entrepreneurs give up control of a venture for money? The answer is simple: it is the only option left. They have tried to get money on other terms and failed to do so.

In most cases, however, the factor that sells the deal is the provision of buy-sell clauses by which the entrepreneur can get rid of the financier by paying him or her off. Naturally, the price is high, but that is why the financier invested the money in the beginning.

Always remember that the financier may be at the mercy of the entrepreneur operating the company with the technical expertise and contacts that underlie the firm’s success. Most venture capitalists are not prepared or inclined to manage the enterprise. They simply want profits.
A Closer Look @ Protecting Business Interests continued

Control Bylaw Provisions
Minority stockholders can protect themselves by controlling the following key factors in the bylaws:
- Location of meetings
- Notice and agenda of meetings with provision that any deviation must be by unanimous consent
- Effective veto power over such matters as mergers, sale of corporate assets, payment of salaries and expenses, reorganization of the company, the state of incorporation, the issuance of securities, and the retention of earnings

Participate in Management
If you find yourself a minority stockholder, don’t be an outsider. As a condition of investment, make a place for yourself on the management team. If removed, you must be paid off by a previously agreed-upon formula. The condition should avoid fixed prices that invite a squeeze out in which the others can buy you out at a fraction of the worth of your holdings.

Tip
If you own any portion of a business, participate as fully as your interest permits.

Control bylaw provisions:
- Location of meetings
- Notice and agenda of meetings with provision that any deviation must be by unanimous consent
- Effective veto power over such matters as mergers, sale of corporate assets, payment of salaries and expenses, reorganization of the company, the state of incorporation, the issuance of securities, and the retention of earnings

Participate in Management
If you are a minority stockholder, consider an employment contract to assure yourself access to the corporate coffers to avoid being frozen out of the payoffs. As a condition for making a minority investment, you should be given a contract that provides for employment with a stipulated salary doing stipulated things. Settlement conditions should be spelled out in the event your employment is terminated. If you do not want to work daily in the company, you might consider becoming a well-paid director.

Such long-term employment contracts should provide for flexible compensation based on the index of what others in the corporation are being paid. It is not easy to draw up such a contract; you need legal assistance.

Specify Buy-Sell Agreements
Minority stockholders must realize that if a majority of the stockholders are dedicated to getting rid of them, the majority will find a way to do so, no matter how well the minority stockholders have tried to protect themselves. What the minority stockholders want is to make certain they get money for their position by allowing the buy-sell agreement to be the only way the majority can remove them.

The minority stockholder is in a difficult position in many cases, but their situation is not without protection if they use legal counsel to put the protections in place. Conversely, the controlling majority needs to pay careful attention to legal matters lest it provide opportunistic minority stockholders a chance to gain the advantage.

Be Alert and Seek Advice
You need to be alert to seemingly innocent changes sought by others concerning matters of organization, ownership, or governance of the business. Such changes must not be agreed to until independent legal advice is obtained. The vicissitudes of life and business must be anticipated. Agreements concerning the organization, ownership or governance of the business must be reached while those involved are in harmony. Independent legal, tax, and accountancy advice must be sought and followed to assure that all are treated fairly and that the business maintains its value and viability.

Tip
The business’s attorney, accountant, and tax adviser are not independent. They represent the business and not the owners.
When you developed your vision in Module 1, did you picture a business in which your daily operations run smoothly? Where you can take a vacation and not worry about what is happening back at work? Where excitement comes from landing a big customer rather than from putting out fires because work is not done correctly or on time? This module will help you improve your operations so that you can spend your entrepreneurial energies guiding the vision you have for growth.

As you plan for growth in your business, every new decision will affect your operations. In this module, you will assess your current operations and plan for expanding, standardizing, and measuring them to ensure that your products and services are not delayed or distorted on their way out into the world. This module focuses on the systems, processes, procedures, policies, standards, and measurements that will keep you from worrying about things that should be routine and efficient in your business.

The decisions you make can be documented in your Operations Plan, a part of the Business Plan. You’ll also project how these choices affect your profitability by updating your Financial Plan.

**Key Questions**

- What are the operational systems needed to support my business now and as it grows?
- How will I measure success?
- What performance standards and controls will I use to insure success?

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Supporting Operations and Growth

Just as your entrepreneurial role must evolve as the business grows, your operations must change and grow to meet the needs of your expanding business. Throughout this program, you have been concentrating on a vision and strategies for growth. The speed and volume of growth that you anticipate clearly affects the degree of shock to your business operations. Even a slow, steady growth plan will change the way you operate your business. As you consider the impact of your growth plan on your business, the next step is to scrutinize how this will affect operations. Ask yourself the following questions:

These questions and checklist lead you to the primary topic of this module on managing operations for growth. What impact will growth have on your current operations? How does a well-defined operations plan help you manage growth?

Creating or investing in operational systems up front is not enough. They must be supported with the appropriate resources to make them run effectively and efficiently on an ongoing basis. Not only will you need to consider levels of staffing and personnel, facilities and space requirements, and upfront cash flow, your growth strategy must include a look inside the operational functions of the business to determine if you have the necessary backbone to sustain and support the organization.

Tip
Understand that you will need to invest in your systems and replenish them on a regular basis.

For instance, if you need to hire additional staff, will your current human resources policies and procedures be able to support the addition of new personnel? Do you have a system in place—either an external service or an internal computer software program to accurately record compensation and benefits information? These factors should be addressed before the hiring process begins.

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<th>Question</th>
<th>Key Considerations</th>
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<td>What is required to grow?</td>
<td>Does the business need more space or more (sales) personnel?</td>
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<td>What financial goals are necessary to achieve my growth goals?</td>
<td>Are budgeting processes in place? Have key financial measurements been established?</td>
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<td>Do I have access to the team members and outside expertise necessary to achieve growth?</td>
<td>Will my current human resources policies and procedures be able to support the addition of new personnel? Do I have measurable, attainable performance standards for my management team and other employees? Are outside resources such as mentors, advisory boards, sponsors, and role models available to me and my management team?</td>
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<td>Do I have the market research necessary to implement my growth plan?</td>
<td>Do I have systems in place to conduct ongoing marketing research concerning the customers, their needs, and the best way to reach them?</td>
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<tr>
<td>Is my operations system in place and ready to support and manage growth?</td>
<td>Have I designed my systems using reasonable processes, procedures, and policies? Do I have the computer software needed to accurately record financial data, compensation, and benefits information?</td>
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The more you grow, the more documentation is necessary to capture information about new products and services. You will need to allocate financial resources for software and other tools so that your operations stay up to date. To ensure that these dollars are spent wisely, define your operational goals. Set systems in place that clearly outline your processes, procedures, and policies, and define performance standards and measurements so that all the members of your organization will know what expectations they will be measured by and how they fit into the larger picture.

**Defining the Operational Goal**

At the heart of operations are the systems and processes that keep information moving through a business and provide structure for those doing the work. In its simplest definition, operations are the things you and your team do on a daily basis to make your business run. At its most robust, operations implement the strategy and planning that supports business growth and development.

Webster’s Dictionary defines *operations* as 1) The act, method, or process of operating, 2) The condition of being in action or at work, 3) The power to act or influence; 4) a process or action that is part of a series in some work.

Of all the definitions provided, the third offers the greatest impact: *the power to act or influence.* This power is the goal of your operational planning. Let’s break it down.

Ask yourself the following questions and consider the impact your answers might have on what your business demands of you on a daily basis.

What if I:

- Had a specified way of going about daily business so that my activities rendered the greatest possible outcomes?
- Did not have to re-invent the wheel every time I wanted to repeat an activity?
- Did not lose valuable information each time someone decided to leave my company?
- Did not have to be physically present in my business to know that my team efficiently and effectively delivers our products and services and, most importantly, positively connects with our clients?
- Had a plan that could guide me through daily operational decisions and keep them aligned with my vision, goals, and strategy?
- Knew that everyone would know what to do should a disaster, either natural or otherwise, occur?

Now, ask yourself one more question: how might a specified operations plan influence my decision-making process regarding daily activities, business development, and growth?

A carefully defined operations plan will influence your activities and decisions because you will gain the ability to spend less time focused on how to get things accomplished. This leaves you more time to consider the vision and business strategies that will propel your business to the next stage. The goal of an operations plan is to make the business’s operations work so smoothly that you spend very little time on daily issues and can work more strategically on the business.

In this module you will explore everyday business operations and discover how they can effectively assist you in managing business growth. First, understand the benefits of embracing an operations plan and how well-defined operations can support your growth strategies.

**Tip**

Whether you are looking at improving how you currently run your business or planning significant expansion, the operations of your business are critical to your success.
Second, identify your own systems of operation and build a workflow to represent them. The word system, in this context, describes a major operational area of your business. The word workflow includes all the processes and procedures that make up a system. If you already have systems in place, you can make sure they are aligned with your business vision. If you have never really thought about operations from a workflow perspective, the activities in this module will present an opportunity to identify the systems critical to your success.

Third, align the workflow within each system of your business, determining measurement criteria to confirm that the workflow is indeed working.

Finally, document your operations in Action Step 8.2 Prepare My Operations Plan. When implemented, this Operations Plan will provide an easy-to-use roadmap to make sure your systems and workflow are continually aligned with your plans for growth.

Keep in mind that the Operations Plan is not an operations manual. The plan is merely the document that guides you to the goal, while an operations manual captures those documented policies, processes, and procedures. Consider taking steps to manage the risks that might impact your business should something go very wrong. A well-developed operations manual includes a disaster plan to protect the critical information housed in computers, to assure that employees can be reached after the disaster, and to facilitate the insurance claims process. Though we will not be completing an operations manual as part of this FastTrac® program, it is a highly recommended activity as you plan your growth strategies.

**Benefits of Structure**

It does no good to bring money in the front door if it runs out the back. Efficient operations keep that from happening. Documenting the way your business functions provides the following benefits:

- Gives new and existing employees a map to the systems within which they work
- Helps you identify bottlenecks in otherwise efficient workflow
- Helps build the business as an asset worthy of resale
- Aligns the many functional areas of business
- Provides measures and standards for doing business
- Creates consistency and stability
- Captures and manages intellectual property unique to your business
- Addresses the issues faced by a business should a disaster occur

Not only will documented processes save you money, they become a tangible asset with economic value as well. Good processes can make or break an acquisition deal. A great exit strategy can assist you in planning ahead for the eventual sale of the business. Many franchise owners will tell you they bought into the franchise because it had a proven process or formula for success. Its methods of operation had already been documented, tested, and proven profitable. These proven methodologies (operations) may be an invisible asset of your organization.

**Operational Systems**

What are the underlying systems that make up operations? Traditionally, operations have been defined by the world of manufacturing. Both manufacturing businesses and retail stores will more than likely have operational concerns such as facilities layout, inventory control, warranties and returns, service-level agreements, and security. In addition, manufacturers produce products, and products must have quality control standards. They also need a system for new product development.
Not all businesses are manufacturers, but many businesses need these same kinds of systems. Other operational needs may be specific to a particular type of business. For instance, the needs specific to a professional services business might include things such as sub-contracting relationships and contracts, proposal generation and presentations, and consultative sales processes. And what about the distributor that wants to open a second location? Wouldn’t sales flow more smoothly and quickly if the processes and procedures were clearly in place from day one without having to be recreated with every new level of sales?

**Aligning Systems with the Business Vision**

In a perfect business world, operations are designed to support the business’s vision and strategy. Without these critical elements, an organization has little to hang its operational hat on. Important questions must be addressed when defining the kinds of systems you will need to have in place. These questions include:

- What are my vision and goals and my strategy for reaching them?
- Will my current operational systems support the growth I want?
- Will growth cause my team to interact differently with customers and vendors? How will it change?
- What technology will be needed to reach my vision?
- How will I and my employees know we are successful?

As you design your operational systems you must consider your vision, goals, and business strategy and align your systems with them. For example, if one of the goals of your organization is to meet customer demand by fulfilling orders within 24 hours, but you have no system in place to ensure that delivery is made on time, you will probably not meet this goal. Additionally, customers will begin to question your reliability when products or services aren’t delivered in a timely manner. If delayed delivery becomes a normal practice, customers may begin to question the quality of the products and services you sell. Use My Operational Systems to begin identifying the critical elements needed to support your vision and business strategy.

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**My Operational Systems**

In Action Step 1.3 Identify Goals for My Business, you identified your goals. Using this information, think about what systems you will need to support your goals. Write some of the operational systems you believe you will need in order for your business to grow. You may start with what you need today at your current capacity and then look at where you want to go. Examples of systems needed for most businesses include:

- Receiving Orders
- Billing and Collections
- Accounting Functions
- Customer Service
- Distribution / Order Fulfillment
- Technology
- Production
- Product Development

---

- Other
- Other
- Other
Creating an Operational Systems Workflow

Each operational system will include policies, processes, and procedures for making that system work well. These aspects of system design create a natural workflow of information through the organization and assist in the management of knowledge.

The following illustration provides an overview of how processes, procedures, and policies interrelate. Keep in mind, this is just a broad overview. In reality, one policy may drive multiple processes, or each process may include many specific procedures.

Why should you document your systems’ policies, processes, and procedures? Without the constructive documentation of your business’s processes it is nearly impossible to know how well your business is running and whether the products and services you are delivering are actually meeting customer needs. Well-designed operational systems will support the vision and goals of your plan. Later in this module, we will discuss how you measure the success of your systems.

Another purpose for documenting operations becomes apparent when workers either leave or transition within the organization, taking with them a wealth of information that may be lost or set aside. As an entrepreneurial concern, you can either pay for the documentation of this information once in an operations plan or risk having to recreate it every time someone changes positions.

Much of the research available concerning today’s competitive global environment indicates that all businesses must recognize the importance of intangible assets. In fact, intangible assets such as the knowledge that resides in the minds of its workers can make up as much as 90 percent of the real value of an organization’s intellectual capital.
You’ve heard the adage that employees are a company’s greatest asset. It’s not just because they get the work done...but because of what they know. Each of your employees is building knowledge, abilities, and skills about your business. This can be a huge advantage—if you can keep the knowledge working for you. When people leave the company or even transfer to a new job within the company, this knowledge can be lost. You should protect this knowledge so that it can be transferred within the company and used again and again. Following are some ideas you can implement to find, build, and keep this knowledge working for you:

- Build a directory of expertise based on your management and employees’ expertise and backgrounds.
- Identify people within your organization that have key knowledge. Capture that knowledge and design ways to transfer it through training programs, job aids, apprenticeships, or mentoring.
- Design a system to maintain relationships with employees after they have left the company. In many cases, you may be able to continue to tap into their knowledge through consulting contracts.

A documented approach to operations helps you prove the value inherent in your company’s intangible assets. It also provides a way of using that value as you operate your business. It’s important not just to document this information but to share it with other workers. Read the following example to learn how one company uses shared knowledge to increase sales.

Developing formal processes and procedures helped a technology-consulting firm develop best practices. Their first step consisted of dividing the business into functional areas such as sales, finance, and human resources. Then they documented processes and established expectations for those areas. With a baseline, they could tell if they were improving. Using this information, they have established some best practices. For example, the sales team makes weekly phone calls in small groups, with each one taking a turn at the phone while the others listen. By observing the others’ techniques, the salespersons have polished their own style and have increased both the number of solid leads and client visits.

At the moment you embrace business growth, you tax the structure of your current business to support both current and future states. Generally speaking, if you cannot document the processes or procedures you rely on for current capacity, how will you know what changes you need in operations to achieve your vision of growth?

Additionally, where you employ workers, you must have predefined instructions for them to follow to achieve an appropriate level of positive interaction and business success. You can promote that interaction through process and procedural documentation.

Take a closer look at structural workflow. Begin at the system level. In the list of potential operational systems in My Operational Systems, accounting functions is one possibility and will be used in this example.
Processes

Processes—what we do—are related tasks that produce a particular output when completed. Processes under the accounting functions system could include accounts payable, accounts receivable, payroll, account reconciliation and financial reports. The Process Level illustration shows how these processes relate to each other in the accounting function system.

Organizational processes in a business’s normal workflow generally include:

- Material processes.
- Information processes.
- Human capital processes.

Material processes tend to be focused on the production of tangible products. These are more prevalent in a manufacturing environment, although many professional service companies that produce tangible products may want to consider documenting their material processes as well.

Information processes encompass all of the general work that flows through the organization on a daily basis. This area of process development will no doubt be the most robust and most common to any type of business. It will often include the development and maintenance of forms, job aids, and other tools used to drive customer requests through the company. Often, information processes can also be used to document the material processes.

Human capital processes include those tools used to assist in setting up the structure of teams and individual performance systems. Job descriptions, standards of performance tools, performance review tools, and career assessment and development documentation can be found in this arm of the process loop. Many of the ideas in Module 7 for creating a healthy entrepreneurial culture target human processes such as hiring, rewarding, and compensating employees or contractors.

Procedures

Procedures—how we do what we do—are what occur in the process. Procedures are the steps involved in a particular process. Using the example, look at the Accounts Payable process and take note of the series of procedures that make up accounts payable. You may have other procedures not listed here, but this example includes inputting bills, making vendor payments, making credit card payments, setting up automatic deductions, and printing payable reports as individual procedures in the process.

The second illustration shows a specific procedure broken down to the task level and, although simplified, the step-by-step approach of solid operations documentation. The following illustration is an example of the relationship between the identified procedure and its detailed tasks.
Taking Action  
Managing Operations for Growth

**Accounts Payable**

1. **Inputting Bills**
2. **Making Vendor Payments**
3. **Making Credit Card Payments**
4. **Setting Up Automatic Deductions**
5. **Printing Payable Reports**

**Procedure Level: Identify the procedure under each process**

**Making Vendor Payments**

- Invoice arrives from the vendor.
- Invoice is checked against the receipt for accuracy.
- Is the invoice accurate?
  - YES: Invoice is entered into accounting system for payment.
  - NO: Contact vendor to resolve issues.
- According to company policy invoice is selected for payment to vendor within 30 days.
- Paid invoices are filed in vendor hardcopy files for future reference.
- Complete A/P list is generated and reviewed.
- Are all invoices being paid within the 30-day window?
  - YES: Process Ends.
  - NO: Repeat process.

**Procedure Level: Detailed procedure at the task level**
Policies
Policies—why or when we do what we do—are the values and principles of the business that relate to specific procedures. Think of them as a foundation supporting the workflow documentation.

Policies are the underlying rules by which the organization lives. In the example above, the process is accounts payable; the procedures are all those tasks that occur under that process; and the policies are the written rules that explain why and when the organization makes payments for each procedure, if reports are to be run and distributed at a particular time, and other factors that relate to the procedures.

Examples of policies that directly relate to the Procedures Level illustration might include:

- All vendor invoices will be paid within 30 days of receipt of invoice, unless otherwise instructed by an officer of the company.
- All checks must be verified and signed by an officer of the company prior to being mailed.

Tip
Some policies can use a broad brush to encompass a general practice of the company while others may be directly related to specific processes and procedures and be very detailed.

The Value of Documenting Processes
Are documented processes, procedures, and policies really worth it? They are for business owner, Beth Hagan, who started her company in Illinois. Over sixteen years, Hagan built her enterprise into an eight-location quick print, high-speed xerography, graphic design, and blueprint company. She confirms that her Operations Manual was critical in the sale of her company, as it dispelled the perception that she was a “one-woman copy shop.” The manual helped the buyer see that Hagan had very specific procedures and depth of management at each store and each production center. This documentation was valued at $100,000 at the point the business sold.

But the real value of documenting your processes can be seen long before your exit strategy is implemented. Having processes documented and controls in place establishes your business’s readiness for growth, which means you can successfully handle an increased sales volume. Controlled processes will also save you money that can be lost through fraud, embezzlement, or employee theft.

Ask most business owners about losses due to their employees, and they will assure you it isn’t a problem. The facts, however, disagree. The U.S. Chamber of Commerce estimates that theft by employees of small businesses totals between $20 and $40 billion in this country each year. While it is difficult to believe that the person you hire to fill a trusted position in your company would actually steal from you, it happens every day in all kinds of businesses and in a variety of ways. It is estimated that up to 75 percent of all employee theft goes unnoticed.

A general rule of thumb is that a company can lose 1–2 percent of its sales to misdeeds mostly committed by insiders. Looking at your sales figure, you can easily calculate how much it can be worth to document your processes. By identifying the proper controls, you can prevent, reduce, or totally eliminate financial threats.
Align Workflow

Your company’s documented workflow will show the processes that give the company life. Since team members have their own work responsibilities, they need to understand how their job contributes to and aligns with the overall company workflow as well as its vision and goals. They need to understand the expectations you place on them to complete their work tasks. They also need to be given the appropriate resources to get the job done. Looking at workflow from their point of view can help you create a cohesive, productive work environment. Several actions can contribute to this cohesion including writing job descriptions, developing performance standards, conducting performance reviews, staffing appropriately, and designing controls.

Write Job Descriptions

Job descriptions outline the staff’s abilities and tasks necessary to carry out the business plan. Having descriptions in place for each and every position helps the business retain the best person for the job and maintain professional files. In Action Step 7.1 Create Job Descriptions, you began working on defining the roles and responsibilities for yourself and key employees. These descriptions not only streamline the workflow but also simplify the hiring process as described in Module 7.

Develop Performance Standards

Once the job descriptions are in place, it is important to break down the duties of each position into measurable action steps that can be quantified. If a team member knows in advance what is expected, how correct performance of that expectation will be measured, and how it ties back to the strategic goals of the business, the likelihood that the performance will be successful will be increased significantly.

Conduct Performance Reviews

Performance evaluations should be conducted on a regular basis to reinforce good work or to correct behavior if a team member’s performance is off track. You can design separate performance standards for daily functions and special assignments or projects. Some organizations schedule these reviews quarterly and use this formal process to develop their team. In any case, you’ll want to also give employees feedback frequently through less formal meetings.

The performance standards for individuals can be documented in the human resources files. Standards for the daily functional responsibilities may not require changes unless functions change. Special assignments and projects, however, will require regular updates as projects come up and are completed. Human resources consulting companies can help you establish policies and procedures related to human resources issues and assist with the interpretation of human resources law.

Staff Appropriately

A monthly staffing plan provides a roadmap for businesses to determine if they are appropriately staffed. In order to succeed, businesses often require that a few people perform several different roles. Keep in mind that adding personnel is a significant investment and responsibility.

One strategy that may prove helpful is to tie added personnel to specific projects that generate an income stream. In this way, at least part of their salary expense is covered through the added revenue. Make sure you realize profit in the numbers to make the project worthwhile. You don’t want your business to become a pass through for someone’s salary. After all, the object of business is to make money, profitably.
Design Controls

Controls are either administrative or financial. Administrative controls deal with the operation of the business and the quality of the product or service. Financial controls deal with accounting for the business operation. Controls, when adequately enforced, can help you save time and money.

<table>
<thead>
<tr>
<th>Controls can provide your business:</th>
<th>Example:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Security</strong> – Controls should be designed to protect the assets of the company such as cash, equipment, inventory, customer lists, technology, innovations, proprietary information, etc.</td>
<td>Computer sign-in names and passwords, equipment sign-out sheets</td>
</tr>
<tr>
<td><strong>Accuracy</strong> – Controls should assure that the correct amounts are recorded in the appropriate account in the right time period.</td>
<td>Two people checking for mathematical accuracy, document sign-off, monthly reconciliation of financial accounts</td>
</tr>
<tr>
<td><strong>Quality</strong> – Controls should ensure that the product or service meets specific quality standards including governmental requirements.</td>
<td>Some companies complete the ISO 9000 quality and standards certification program. This assures that control systems are in place.</td>
</tr>
<tr>
<td><strong>Confirmation</strong> – Controls should confirm that the transaction did take place and it was in accordance with procedures.</td>
<td>Review for appropriate information and approvals.</td>
</tr>
</tbody>
</table>

With all the advantages that controls can have on business operations, there can be some disadvantages, too. Sometimes, too many checks and balances make it difficult to complete the job efficiently, are very costly to maintain, and can produce low morale among employees. Care must be taken to establish controls that are necessary without constricting the actual work flow. Clear communication of the controls and how they relate to the overall company goals will also help make them effective.

Measuring Performance

An old adage says, “What gets measured, gets managed.” In other words, you cannot improve on something if you don’t know your status today. Baseline data provides a starting point, but you must continually measure success as time goes by to ensure quality and results. Measuring success is like flying an airplane and continuously checking the horizon compass to keep the plane on course.

Financial Performance

Performance is often measured in financial terms as entrepreneurs set specific financial goals concerning cash flow, profits, and overall financial performance. Module 9 includes financial tools and their explanations to develop these kinds of measurements.

In this module, you will review a variety of performance measurements that will guide you through your growth stage. Two key financial concepts contribute to effectively using financial analysis as a measurement tool: gross margin and operating expenses.

Gross Margin

Gross margin targets are particularly critical. They act as an initial snapshot of your profitability. A case could be made that gross margin is far more important than sales goals. Up to a point, would you really care what the sales volume is if you were handed a $5 million gross margin? In a quest to make sales volume, many firms cut prices to the extent that the resulting gross margins will not result in a profit. Remember—the key to profit is gross margin, so set a goal that is reasonable and achievable.
Every increased dollar in gross margin affects the bottom line in a significant way, but a dollar increase in sales volume may result in only a fractional increase in profits. In addition, the costs of the sales increase may exceed the results while the costs of getting a higher gross margin may be slight. Let’s look at an example of this concept.

Let’s say the ABC Company sells *Spice it UP!* fresh herb dispensers. It costs them $3.49 to manufacture this unique kitchen tool, but the market allows them to sell it for $19.95. That’s a pretty great margin—margin being the difference between the expense they incur to produce it and what they make when they sell it. As the new fiscal year approaches, the ABC team learns that the market is excited about this product; research indicates that they could raise the price of the *Spice it UP!* fresh herb dispenser to $24.95. That extra $5 represents profit because it will not cost the ABC Company any more than it already does to produce this product.

In some cases, the costs of production may even go down with higher volumes because the purchase of raw materials in greater quantities often demands better prices from suppliers. On the sales side, every dollar increase in sales may actually only generate a small increase of profit or, in some cases, no additional profit because with each sale ABC incurs added costs. Costs of sales might include marketing, brochure development and printing, travel costs for sales personnel, or expense accounts.

Simply selling more *Spice it UP!* fresh herb dispensers may or may not improve profit. Without a careful analysis of price and gross margin, this entrepreneur will not know whether increased sales will result in increased profit.

### Operating Expenses

If gross margin is the initial snapshot in profitability, the operating expenses are the second. Avoid the trap of thinking that operating expenses are all fixed. Even though they are called fixed, you still have some control over how much you spend on fixed expenses. Some expenses are variable. You should have greater control over how much you spend on variable expenses.

**Fixed costs** are those expenses that are always there, regardless of how much or how little you sell. For example, rent, salaries, and general overhead are considered fixed costs. As a rule, fixed costs do not change when sales increase. For instance, rent will not increase just because your sales efforts increase. Only if your growth demands more square footage will the fixed cost of rent increase. Likewise, administrative salaries don’t usually vary with increased sales activities.

**Variable costs** are those expenses that can increase as your sales increase, such as additional telephone usage, postage, supplies, and even printing and copy machine costs. While many expense plans assume a level amount of monthly expenditures for many general expenses, in reality they do go up with volume. Expenses in your operations plan must be supported with an explanation of how the amount was derived as well as the assumptions that go into calculating that figure.

Keep in mind that what goes up can also come down. Variable expenses can be lowered with careful planning. For instance, printing costs may be significantly higher if you print one brochure at a time rather than preparing and printing your marketing materials all at once. Something as simple as watching the amount of office supplies purchased on a monthly basis or reviewing the costs of telephone services to make sure the charges are competitive can make a significant impact on controlling your variable costs.

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**Tip**

The firm’s gross margin will establish the goals that will drive the action plans of almost every department. Gross margin affects product and service mixes, customer selection, product quality, and expense budgets throughout the business.
Human Performance

In addition to the financial perspective, the performance of your team must also be measured. If you are not measuring an outcome, chances are it will not be managed. Without management and guidance, how will you know that your team’s performance is on par with your vision and strategy?

Tip

A job description describes the essential functions and the tasks to be done while the performance standard defines how well each function or task must be performed.

Using Performance Standards

Without clear objectives and goals, organizations often discover they are inadvertently rewarding the wrong behaviors or outcomes. One form of measurement is performance standards. Often referred to as “Standards of Performance”—or SOPs—these measurements provide the business owner and management team with clear objectives and goals for a defined timeframe and are often tied to budgetary or fiscal outcomes.

Your performance standards may be developed using the SMART goals approach discussed in Module 1. SMART goals always produce measurable standards for performance.

An effective performance standard:
- Is developed in collaboration with the employees who do the tasks or functions.
- Is explained to new employees within their first month on the job.
- Provides a benchmark for evaluating work performance.

A performance standard is typically derived by:
- Identifying what will be measured.
- Assigning a numeric value or a certain level of achievement.
- Assigning a target date for achievement.
- Developing a list of criteria to evaluate how well the standard was met.

One example of these criteria might be:

<table>
<thead>
<tr>
<th>Grade</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>E = Exceptional</td>
<td>Performance well exceeds expectations and is consistently outstanding.</td>
</tr>
<tr>
<td>A = Above Expectations</td>
<td>Performance is consistently beyond expectations.</td>
</tr>
<tr>
<td>S = Solid Performance</td>
<td>Performance consistently meets expectations and at times exceeds them.</td>
</tr>
<tr>
<td>I = Improvement Needed</td>
<td>Performance does not consistently meet expectations.</td>
</tr>
<tr>
<td>U = Unsatisfactory</td>
<td>Performance is consistently below expectations. Deficiencies should be addressed as noted in the performance appraisal.</td>
</tr>
</tbody>
</table>

Examples of Performance Standards

Entrepreneurs use financial and non-financial indicators to measure the success of their operating and growth plans. The following examples are typical performance standards that many entrepreneurs rely on. Use My Performance Indicators to identify the performance standards you will use to measure your success.

Sales is a common function for performance standards. Budgets can be easily broken down and assigned to sales personnel in the form of quotas and goals. A performance standard identifies what will be sold, in what timeframe, and at what level of value. Sometimes bonuses are indicated as well so that the sales associate has clear incentives for going above and beyond the quota. Example: Sell $4,000,000 in product and services with a minimum of 5 percent net profit within fiscal the year.

Product development is often linked to a performance standard. In this case, the measurement is based on either hitting or exceeding the target timeframe for launching a new product. It might be tied to the impact of the dollars being spent and the company's
ability to generate revenue. Example: Develop and finalize new product within a budget of $1.5 million within the fiscal year.

Often such a standard will need to be broken down further, providing specific milestones such as: First quarter—develop product specifications; second quarter—initiate and finalize design; third quarter—complete safety and performance testing; and fourth quarter—develop schematics and instruction manuals.

**Tip**

When identifying and assigning value to a performance standard, be clear about what needs to be accomplished.

**Professional development** may be a less obvious standard of performance, but it is no less important. For managers this standard is critical as they strive to be better managers and supervisors. Example: Develop an individualized professional development plan that includes specific seminars or workshops that will help meet employee’s goals. The standard would include attending specified training programs within the calendar year.

Use *My Performance Indicators* to identify performance standards that you will measure.

<table>
<thead>
<tr>
<th>My Performance Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Place a check beside the performance indicators that you need to know or explore in greater detail.</td>
</tr>
<tr>
<td>Sales per employee</td>
</tr>
<tr>
<td>Average annual sales growth</td>
</tr>
<tr>
<td>Gross margin</td>
</tr>
<tr>
<td>Number of transactions per unit or time</td>
</tr>
<tr>
<td>Average sales dollars per transaction</td>
</tr>
<tr>
<td>Average cost per unit</td>
</tr>
<tr>
<td>Number of units produced</td>
</tr>
<tr>
<td>Number of units sold</td>
</tr>
<tr>
<td>Professional development achieved</td>
</tr>
<tr>
<td>New products or services to market</td>
</tr>
</tbody>
</table>

Don’t be afraid to look for outside assistance in the process of measuring performance. Just as you go to a lawyer for legal advice and an accountant for financial advice, look to a business or management consultant to assist you in developing metrics for measuring performance. Sometimes an outside eye can identify barriers to success or unrealized potential.

Use Activity 8b My Success Measurements and Goals to assign your expectation of the level of achievement for one of the indicators you chose. This measure might be a numeric value or a qualitative statement indicating what would be considered successful.

The final step in the measurement process is to determine, through the use of performance criteria, whether the employee was successful in achieving the goal. Use Activity 8c Create My Performance Standards to create criteria and to write three performance standards for your job description.
you are what you measure

Mary Naylor is the CEO and founder of Capitol Concierge, a service business for office buildings, and VIPdesk, a premium concierge service for national brand leaders in the financial services, auto, and travel industries. The businesses collectively bring in approximately $15 million in annual revenue.

Capitol Concierge gives office-building owners the ability to offer a concierge service from the lobby of their commercial properties. They hire and train the individuals, and the property manager pays them an annual fee to staff the building and provide services—flowers, gifts, tickets, information—to the people who work there. In seven years, Naylor grew that business from one location to 80 buildings.

Naylor explains, “I’m a big believer that you are what you measure. Every company should have a critical number that you look at as a driver of your business, whether it’s cost per order or cost per request—whatever drives home the underpinnings of your business model. In addition, we have about five key indicators that I use in both companies which the entire team will track week to week. Our critical three are recognized revenue, annual contract value, and cost per request. Other indicators are total requests, total product sales, number of clients, population base, and burn rate.”

The company keeps their three critical numbers and key indicators on a giant board, and everyone in the company knows what they are and how individual numbers impact revenue and profitability. Because they’re tied to the same goals, the employees are consistently on the same page.

They regularly ask themselves: Is every position still critical? Are we getting maximum productivity out of each department and division? Can we re-bid and do things cheaper?

Naylor is adamant that you have to take care of your team. “We have a stock option plan for all employees, so everyone has a stake in the company. Plus, everyone’s bonus is based on the same two numbers measuring revenue and profitability. We pay out the bonuses if we hit the numbers—or some portion thereof on a sliding scale—and if we don’t, we don’t. It’s tied to company performance, so we win or lose together. The people are the business. If you forget that, you won’t have a company that lasts.”

The Operations Plan

Now it’s time to turn to the development of the Operations Plan. The role of an Operations Plan, when documented, is to unify a company in order to accomplish all the necessary tasks that must be done in the necessary order to achieve success. It is based on realistic, tangible, and achievable goals that must be reached if the company is to achieve its sales and profit objectives.

The Operations Plan—a section of the overall Business Plan—is primarily an action document. The chief executive officer (entrepreneur) uses the Operations Plan to coordinate the efforts of all phases of the enterprise toward achieving the goals of the business. As your company grows you will likely hire a manager of operations who will be responsible for providing daily oversight of the Operations Plan in action.

Each month, the Operations Plan is used to compare the monthly performance against the agreed-upon targets in order to answer the following questions:

• How are we doing?
• Who is meeting their projections?
• Who is not?
• Where are we having trouble? How bad is it?
• Are we on target or exceeding expectations?

The plan should leave no room for doubt in the minds of the entrepreneur and the management team about what must be done each month of the year.
At the end of the fiscal period, the entrepreneur and management team’s performance can be evaluated fairly and accurately against benchmarks that measure their performance. The Operations Plan provides that benchmark.

One word of caution: be sure that you build a plan that enhances rather than hampers performance at your company. As important as operations documentation can be to reaching your vision for growth, it is possible to slow growth with an Operations Plan that forces team members to spend too much time documenting and not enough time getting the work done. Find a balance in your Operations Plan. Be sure your systems and processes are clearly defined but leave room for the spontaneous and creative. Who knows? A new approach may find its way into next year’s Operations Plan as a new “best practice.”

K-Technologies founder Jeff Kryszak developed a user-friendly tool to measure progress—a type of scorecard that's both easy to produce and digest. “When we wrote our first plan we had thirty different performance measures, but that was too much to manage and didn’t provide useful information to respond to,” Kryszak explains. The new scorecard is simpler with about ten indicators, each color-coded for faster comprehension. Green indicates whether the category is on track, yellow means something is out of balance, and red signifies the area needs immediate attention.

As you think about the Operations Plan, your overall goals should be set first. Individual departments can then set their budgets based on those goals. Bringing the team together to establish these overall goals is a savvy leadership strategy. Team members need to feel a part of the process. After all, they are the ones who will make it happen. Start your Operations Plan with My Operations Plan Checklist before moving on to the activities and action steps in this module.

My Operations Plan Checklist

Before you begin writing your Operations Plan, make sure that you have carefully considered each of the following elements:

- The operational systems needed to support the business growth strategy have been identified.
- Policies, processes, and procedures related to those systems are created and documented.
- Management teams have participated in identifying the total goals.
- Job descriptions are written for each member of the team.
- Performance standards criteria are written to evaluate success.
- Timelines are applied to performance standards to ensure completion.
- Evaluation of the costs associated with the growth strategy is complete.

List actions you will take:
Fast growth has sparked a systems mindset for Chuck Hall. “It seemed as though we were reinventing the wheel each time we started a project,” says Hall, founder of Charles Hall Construction in Clarendon Hills, Illinois.

Yet Hall was cautious: “I've worked for other companies where systems were too rote, too documented—there was no room for innovation.”

To balance consistency with creativity, Hall introduced a quality-control system patterned after the U.S. Army’s After-Action Review. “Each project is seen as a single event in the eyes of the company,” Hall explains.

During a project, which can take eight to 12 months to complete, Hall selects key events or milestones to gauge progress. When milestones are reached, the project team discusses both successes and mistakes and looks ahead. The meetings are chaired by a “client committee”—a team of key executives and personnel that focuses on issues from the client's perspective. Meeting client expectations is crucial because Hall relies on repeat business and referrals rather than maintaining a sales team.

By providing a forum to discuss what has gone well and what hasn't, the milestone meetings have an important byproduct: they shed light on best practices.

“There's been an improvement in documents that the entire team uses, which gives us better coordination up front. Our next big step is capturing the information in a database so people can reference it later and learn,” says Hall.

Summary

In this module you have looked at the benefits of documenting operations and the policies, processes, and procedures that keep your business’s systems moving. You also read about the performance indicators you can use to measure success and performance criteria that will be necessary to determine success. Take the time to create the operations that will support your business now and as it grows. Efficient operations that make the most of your resources can be a competitive advantage that trumps the competition.

Key Things to Remember

- Each operational system includes policies, processes, and procedures that work together to support the workflow.
- Processes are “what we do.” Procedures are “how we do it.” Policies are “why or when we do it.”
- Performance standards help you and your team know how you are doing and how to improve.
- Make the most of the knowledge assets of your business: identify, capture, and share them with your team.
- A carefully defined operations plan allows you to spend less time focused on how to get things accomplished and more time guiding your business toward your vision and goals.
Activity 8a: Using Procedures and Policies to Succeed

Discuss the impact of operating a business without establishing procedures and policies.

Directions
What makes processes, procedures, and policies so important? Why is there so much emphasis on their value as a business asset, especially with regard to growth? Perhaps it’s easier to answer these questions when we see what can happen without them.

A. Read the following scenario. Spectrum Training Associates opened its doors in 2009 to offer leadership and management training. Its principals were good at leadership training and had a passion for working with people to create productive work environments. Because it was just the two of them, the company really didn’t have documented processes or procedures. They felt it wasn’t necessary as they each had their own responsibilities and took care of business. Client payments were collected after the program was completed, but no formal billing system was in place. Generally the principals worked with each client to collect the money at the most appropriate time.

For the first couple of years business was steady and they were able to cover the bills, but cash was not flowing as they had hoped. By early 2012, the principals decided they needed a plan for growth. They were convinced that more business would add cash flow and give more exposure to the organization. Their plan was to find a third person to focus on additional training opportunities for existing clients and a broader range of training opportunities for new clients. One of their new company goals was to broaden their training focus to include functional areas such as financial and computer training.

After a broad search they discovered a financial expert who was interested in a sub-contracting position with the company. Her curriculum design work was impeccable and her training style was engaging. The two principals of the company set out to sell additional programs while at the same time delivering programs they had already contracted.

After just one week, the principals had booked their financial expert for two programs and had many more opportunities on the way. By all accounts, it appeared they had struck gold. Their market research was correct, and they had identified a perfect target market.

Because they had made the sales so quickly, there was no time to put all the contracts and paperwork in place before the expert went out into the field. They all agreed that this was a detail that could wait until later.

The first program went smoothly, and once complete, the sub-contractor went to the principals of Spectrum Training and asked for payment. The principals suggested that they had not had time to bill the client, but as soon as they received payment from the client, they would be able to pay the sub-contractor for her work. The sub-contractor was not happy but believed she would eventually receive her money, so she went on to the next assignment.

Within the next two weeks, the second program was complete. The sub-contractor, having delivered marvelous training, went to the principals to collect her payment. This time the principals had been out selling more programs and once again had not invoiced the clients — neither the first or the second. Because cash was still short, they again suggested they would bill the clients and payments would be made after the money was collected.

The sub-contractor was furious. Not only was she unwilling to wait for payment, she was no longer interested in doing more work. The new programs that had been sold could not be fulfilled. As quickly as the principals had started down the road of growth, they watched their mission come to an abrupt end.

Where did they go wrong?
Activity 8a: Using Procedures and Policies to Succeed  continued

B. **Discuss the following question.** In your small group, discuss how policies, processes, and procedures could have created a different outcome for Spectrum Training Associates. Be specific by addressing each issue you can find in the story.

C. **Create a workflow.** Identify the steps necessary to eliminate the billing and collection problems. Create a workflow that will prevent these problems.

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### Activity 8b: My Success Measurements and Goals

Establish success measurements and goals to be used in your Operations Plan.

**Directions**

Use the chart below to set some success measurements and goals for your business. For each indicator that you want to monitor, establish a value or level of achievement in the middle column. Then set a due date or timeframe for that achievement.

**EXAMPLE**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Measurement tool: Value or level of achievement</th>
<th>Due by:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales per Employee</td>
<td>Each sales associate must achieve 25 sales, with a minimum sale of $1,000.</td>
<td>Quarterly goal due on the last business day of the month ending the quarter.</td>
</tr>
<tr>
<td></td>
<td><strong>Note:</strong> Derive this number by determining the overall sales goals of the company and then dividing it accordingly.</td>
<td></td>
</tr>
</tbody>
</table>

**My Success Measurements and Goals**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Measurement tool: Value or level of achievement</th>
<th>Due by:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales per employee</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average annual sales growth</td>
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<td></td>
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<td></td>
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<tr>
<td>Gross margin</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Number of transactions per unit or time</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average sales dollars per transaction</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average cost per unit</td>
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<td></td>
</tr>
</tbody>
</table>
### Activity 8b: My Success Measurements and Goals continued

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Measurement tool: Value or level of achievement</th>
<th>Due by:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of units produced</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of units sold</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Professional development achieved</td>
<td></td>
<td></td>
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<tr>
<td>New products or services to market</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of customers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of new customers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ratio of new to existing customers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average sales per customer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee retention</td>
<td></td>
<td></td>
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<tr>
<td>Other</td>
<td></td>
<td></td>
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<tr>
<td>Other</td>
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</tr>
</tbody>
</table>
### Activity 8c: Create My Performance Standards

Establish criteria and performance standards for one job description.

**Directions**

In Action Step 7.1 Create Job Descriptions, you developed your job description. You will now use that job description to develop the criteria and performance standards for the job.

**Step 1 Determine criteria.** Think about the criteria you want to use for your performance standards. One example of these criteria might be:

<table>
<thead>
<tr>
<th>Code</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>E</strong></td>
<td>Exceptional Performance well exceeds expectations and is consistently outstanding.</td>
</tr>
<tr>
<td><strong>A</strong></td>
<td>Above Expectations Performance is consistently beyond expectations.</td>
</tr>
<tr>
<td><strong>S</strong></td>
<td>Solid Performance Performance consistently meets expectations and at times exceeds them.</td>
</tr>
<tr>
<td><strong>I</strong></td>
<td>Improvement Needed Performance does not consistently meet expectations.</td>
</tr>
<tr>
<td><strong>U</strong></td>
<td>Unsatisfactory Performance is consistently below expectations. Deficiencies should be addressed as noted in the performance appraisal.</td>
</tr>
</tbody>
</table>

Write the criteria for your performance standards here:

<table>
<thead>
<tr>
<th>Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tbody>
</table>

**Step 2 Set performance standards.** List three specific performance standards that could be realistically used for your job description. See pp. 316–318 for examples of performance standards. Try to assign a measurable value to each and a timeframe for achieving those goals. Remember to determine if these standards are to be included as part of the job or if you have additional incentives you will attach for meeting or exceeding expectations.

<table>
<thead>
<tr>
<th>Performance Standard</th>
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<tbody>
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<td></td>
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<td></td>
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</tbody>
</table>
Action Step 8.1: Design the Workflow

Develop one complete workflow for a single operational system.

Directions

Using the list of operational systems you created, try moving through the following templates to create one complete process structure with a policy.

Step 1 Enter the operational systems for your business.

Operational Systems

Step 2 Choose one system and enter a series of processes connected with that system.

Step 3 Choose one process and enter the procedures associated with that process.
Action Step 8.1: Design the Workflow continued

Step 4 Choose one procedure and create a workflow. Use the Procedure Level example on p. 311 as a guide. Draw boxes on the page and connect with arrows to illustrate the workflow.

Step 5 Write at least one policy that correlates to this documented process.
Action Step 8.2: Prepare My Operations Plan

Establish that my business has efficient and effective operations and has planned for growth.

Directions
Complete the Operations Plan for your business and include any changes you plan to implement in your operations. Be sure to highlight the performance measures you use for your business. Refer to the job descriptions, performance standards, and workflows that you have created in modules 7 and 8 as you work on your Operations Plan.

A. Use the business planning template. For this action step, you will use the Business Plan Template document you have been using throughout this program. Go to the Operations Plan in the template to insert your information.

Each section of the template contains headings with questions in hidden text which will not be printed. These questions will prompt you to consider the type of information to include under each heading. The questions are also listed below for easy reference. You should incorporate answers to all of the questions that apply.

B. Respond to the questions and statements below. Turn your responses into complete sentences and paragraphs to complete the first draft of your Operations Plan. If you cannot answer a question completely, answer as well as you can and make a note to do further research and determine the answer later in the program.

Operations Plan Questions

Operational Systems
What are the operational systems that are needed for your business to function smoothly? Include the Operational Systems you defined in My Operational Systems on p. 308 in this section of the plan. Consider the systems needed for a large operation while the business is still small—think big and the business will grow big. Include routine business systems as well as controls in place to protect your business from such things as criminal actions or natural disasters. Refer to procedures and employee manuals.

Operations System Workflow
Include your workflow from Action Step 8.1 here.

Operational Improvements
What major changes are necessary within each system to support your plan for growth? It may be helpful to document the systems that are in place today to more easily identify what else is needed to move forward with your growth strategy.
Action Step 8.3: Finalize My Operations Financial Projections

Finalize the financial projections associated with your company’s growth plan.

Directions
Action Steps 4.2, 5.3, 6.7, and 7.4 have helped you create your budget. This action step will help you review the budget information you have entered to this point to prepare you for the analysis that will take place in Module 9.

A. Review your initial budget. From the Worksheet tabs or the Print Options tab, print the following worksheets to review your latest figures:
   - Sales Worksheet
   - Inventory Worksheet (for companies that sell products)
   - Operating Expenses Worksheet
   - Capital Budget Worksheet

B. Analyze the figures based on your most recent planning decisions. Each projection should reflect facts collected either from the company’s own historical financial statements or from outside sources. Have you included each cost item that applies? Are the projected costs supported by adequate research from trusted sources?

Remember:
The Financial Template contains all projected costs for your business entered into three main worksheets—Inventory, Operating Expenses, and Capital Budget. Categories on each worksheet may contain figures associated with operations as well as other costs of doing business such as marketing. For example, Telephone Expenses may include the basic costs of the office telephone system as well as the costs of the toll-free sales and marketing line.

If you have production costs, direct costs associated with production are entered on the Inventory Worksheet including the production manager’s salary. Be careful to only include this salary expense in the Inventory Worksheet, avoiding a duplicate entry on the Operating Expenses Worksheet.

C. Make appropriate changes. Based on the new information available, enter changes into the Sales, Inventory, Operating Expenses, or Capital Budget Worksheets to more accurately represent projected costs for your plan in the Financial Template.
Throughout the planning process, you have used the Financial Template to build your financial projections. You've reviewed and refined your budget to reflect your current plans. Now it's time to finalize your budget and analyze it for profitability, financial performance, and cash flow based on industry financial standards.

This module is designed to help you make specific changes to improve profitability based on your Three-Year Projected Income Statement, strengthen financial performance based on the Three-Year Projected Balance Sheet, and increase the business's overall wealth based on the company's financial ratios. Once you have determined how much money it will take to grow your business according to the plan, if you are like most entrepreneurs, you will be eager to learn how to maximize the internal sources of cash as well as how to investigate and approach external sources of cash.

**Key Questions**

- How can I improve my business’s profitability and financial performance?
- How can I know the short-term and long-term cash flow needs that my business has?
- What are the external sources of cash available to support the operations and growth of my business and how should I approach them?

**Action Steps**

<table>
<thead>
<tr>
<th>Action Step</th>
<th>Due Date</th>
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</thead>
<tbody>
<tr>
<td>9.1 Complete My Financial Projections</td>
<td></td>
</tr>
<tr>
<td>9.2 Finalize My Financial Plan</td>
<td></td>
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<tr>
<td>Read Module 10 Making It Happen</td>
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Mining for Profits

Unlike the 156-pound gold nugget, said to have been exposed by a wagon wheel in 1869, few gold nuggets are found accidentally. In 1980, Kevin Hillier used a great deal of patience, hard work, and a metal detector to discover the 62-pound Hand of Faith nugget. Just as a miner searches for gold using his experience, advice from others, and special tools, entrepreneurs seek ways to profit through their business's activities.

Today’s gold miners use electronics and computers to search for large gold nuggets, which bring the greatest return on the miner’s efforts. You, too, should invest time and resources mining your own rare gold nuggets—the key financial performance strategies that will bring you the greatest return on your entrepreneurial efforts. When these financial strategies are identified and mastered, you can begin to mine the smaller gold nuggets, which are still important but don’t do as much to improve financial performance as a few of the larger nuggets.

### Mining Tools

The entrepreneur’s mining tools are the financial statements and ratios that measure financial performance in the following areas:

- **Cash flow**—The flow of cash coming into and going out of your business including loans, revenue, debt payments, payroll, and expenses
- **Profit**—The amount of revenue that remains after all expenses have been covered
- **Business wealth**—The business’s increase in value each year, above and beyond the entrepreneur’s personal salary and profit distributions

If you get frustrated over financials at times, you are not alone. “I’ve been in business for twenty years, but for the first nineteen, I was winging it,” admits one FastTrac® graduate. “I thought it was good if there was a plus at the end of your P&L statement,” he says. “But that doesn’t necessarily mean you’re making money.”

Now, it’s a different story. “FastTrac® gave me a complete understanding of financials—from forecasting to analysis,” he reports. Concentrating on a few key areas of business, he is making significant strides in improving his company’s profit picture. He’s reduced his overhead and his net profit margins are increasing.

Like this entrepreneur, who improved his company’s financial performance by concentrating on a few key strategies, you too will find your own gold nuggets: the financial strategies to improve profits and cash flow and create growing wealth in your business. These strategies are discussed throughout this module along with information on how to calculate ratios and assess your own financial information. You may not immediately implement every strategy presented in this module, but you will want to choose a few key strategies that you decide will have the greatest effect on your business and begin implementing those now.

In order to implement any of these financial strategies successfully, you will need to be comfortable with the basic financial concepts associated with your business. To increase your knowledge of financial concepts and financial statements, read A Closer Look @ Financial Statements, p. 144–152.

### Read Your Financial Story

Gold has value because of its beauty and rarity. Your own business has value because of its profitability, cash flow, and potential for future wealth. The value of a company is communicated through its financial statements. Reading financial statements can be very frustrating until you learn the secret. Financial statements are not meant to be read word-for-word, or even from beginning to end.
The financial story can be read many ways. By comparing the balances of a few key financial statement accounts, you will learn a great deal about your business. To learn more of the story, you need to look closer at how account balances have changed over time. Financial ratios are a valuable tool many entrepreneurs use to get a closer look at a business’s financial performance.

The three main financial statements, Income Statement, Balance Sheet, and Cash Flow Report, which were introduced in Module 4, will be reviewed in this module. No one statement is more valuable than the others. Together they tell the story of your business. Your job as the entrepreneur is to gain a better understanding of how to read your business’s financial story.

### Financial Statements for Entrepreneurs

**Income Statement**—Shows the net income or loss that the business has experienced over a period of time—in other words, a company’s financial score card

**Balance Sheet**—Reports what the company owns, what it owes, and the net worth that remains for the owners of the business

**Cash Flow Report**—Reports the cash that flows into and out of a business on a monthly basis

As you are reading your own financial statements, you will be reviewing financial numbers and using ratios to analyze the information. Ratios are mathematical comparisons of one number to another. After the analysis, you will identify key financial strategies that will improve your business’s financial success story.

### Using Financial Ratios

Using ratios helps put actual numbers into a context that provides an apples-to-apples comparison. With ratios such as the sample percentages in the following Income Statement, you can easily evaluate trends in your business over a period of time and compare your business to other companies of varying sizes and industries.

An entrepreneur reading the financial story for his yo-yo plant may be concerned to discover that the company’s Net Margin, or bottom line profitability, has decreased in the current year from 10 percent to 8 percent. A downward trend in Net Margin does not imply a healthy financial story. Comparing this percentage to the industry average Net Margin of 6 percent, however, shows that the company is still more profitable than the average yo-yo plant.

### Comparing Financial Numbers

After using financial ratios to review your financial statements, you can look at the actual numbers to further explore your financial story. The numbers on the reports can help you understand the specific changes in different financial accounts. You can also use these numbers to compare to other companies of similar size and operation.
After reviewing the numbers to learn more, the entrepreneur of the yo-yo plant finds an increase in Sales. This is a good start to the story, but the Cost of Goods Sold and Interest Expense also increased. The increases in these two accounts appear to be the main reason for the reduction in profit this year. A loan for new production equipment explains the increase in Interest Expense. But it takes a bit of investigation to learn the rest of the story about the increase in Cost of Goods Sold. Apparently, there have been a large number of defective units that have been reworked or scrapped since the new equipment has been in use. Now the storyline gets more interesting. The entrepreneur learns that the production staff is confused about how to use the new equipment. Mystery solved!

**Identifying Financial Strategies**

After reading and understanding your financial story, you are prepared to develop strategies to improve your company’s overall profitability, cash flow, and future business wealth.

After discussing the use of the new production equipment with the distributor, the entrepreneur of the yo-yo business establishes a training program for the production staff. With a small investment of time and money, this training should provide the staff with the information they need to produce more, higher-quality yo-yos than with the old equipment. The staff sets goals that include plans to return to the company’s 10 percent Net Margin ratio.

**Get Started**

As you are reading to understand your own financial statements, you will want to have the right information easily accessible. First, you will need your own financial information. You will also want financial information from other companies in your industry and may want to have a financial glossary, such as the Glossary at fasttrac.org/resources, and a financial statement guide handy to help explain concepts that are unfamiliar.

**Gathering Company Information**

Since the budgeting process you began in Module 4 is now complete, print the following financial statements to use throughout this module in analyzing your financial performance. This budget, with your three-year projections, will reveal your future financial plans.

- Income Statement
- Balance Sheet
- Monthly Cash Flow Report
- Ratio Analysis

In addition to these projected financial statements, your historical financial statements will identify trends based on your past financial strategy.

**Collecting Industry Information**

Financial research provides the information you need to compare your financial information with other companies. Most industry figures are broken down into categories based on the size of the company. This breakdown will help you identify ratios and financial numbers that are the most realistic for your business. For example, you may be able to identify that rent expense should be about six percent of your sales by reviewing industry information.

Much financial information can be found online or at your local library. By using the NAICS or SIC classification codes, you can find information about business profits, expenses, or other financial data. Look for the following:

**Tip**

Financial information should be timely. Old numbers don’t mean as much.
• Trade associations often provide industry and competitor information concerning financial trends, industry sales, and expenses.
• Magazine and periodical databases, available at most libraries, provide additional industry information.
• Financial statement studies, available at most libraries, provide valuable financial data about companies arranged by industry and size.
• The Internet makes a multitude of information available for publicly traded companies, including those regulated by the Securities and Exchange Commission (SEC). Numerous sources provide private company information, industry information, and financial ratio analysis, sometimes for a fee.

Just as no two businesses are exactly alike, you will likely notice a discrepancy between the information you find and the information you need. For example, some information will have one or two of the ratios that you are looking for. Other information will have a few financial numbers but no ratios. With a little effort, you will be able to compile the needed information by combining resources.

Try the following searches to identify information for your industry. Add your own industry classification, NAICS or SIC code, to the search for added specificity. Or combine the following search titles to reduce the number of hits:

• Industry analysis
• Industry reports
• Financial ratios
• Industry + financial ratios
• Ratio analysis
• Industry briefs
• Industry guides
• Business profiles

**Analyze Profits on the Income Statement**

Your own story of future profitability is written into your Three-Year Projected Income Statement. It shows the amount of products or services you intend to sell, along with the costs associated with conducting business. At the bottom of the report, you can read the amount of profit you expect to achieve each of the three years.

Is your profit adequate? Could you make your story even more successful? Analyzing the Income Statement will help answer these questions. The main purpose of the Income Statement is to report profit, or Net Income—the amount of sales left over after all expenses are paid. Rather than reading this statement from beginning to end, many entrepreneurs zero in on several key aspects of profitability—Sales, Gross Margin, and Net Margin.

By reviewing the Net Margin and Gross Margin ratios together, you can learn a lot about a company. For example, at one point Wal-Mart® and Amazon.com® had nearly identical Gross Margins of 22 percent, which meant their costs of merchandise was similar as well as their pricing strategies. But even though their Gross Margins were similar the Net Margin, or bottom line, was not. Amazon’s high marketing expenses plummeted their Net Margin to a negative 54 percent whereas Wal-Mart reported a positive Net Margin of 3 percent. But that’s not the end of the story. Amazon’s investment in marketing paid off because within three years the company started posting a profit. In 2004, Amazon’s Net Margin of positive 8.5 percent surpassed Wal-Mart’s 3.5 percent.
The primary financial goal in your business should be to maximize profits. Only through continued profits will you have enough cash to pay yourself, pay others, and reinvest in the business to create more value. The Net Margin ratio helps you determine how well you are doing this. The higher the Net Margin, the more profits are generated by each sale. Some businesses, such as service companies, will inherently be able to generate higher Net Margins than others, such as manufacturers because service companies have low or no direct costs.

Your Net Margin ratio should be stable or increasing from year to year, which shows a continuous business strategy. A falling Net Margin signals problems in controlling costs or setting prices. To set a goal for an improved Net Margin, look at leaders in the industry. Following are some additional strategies to improve Net Margin.

### Recognizing the Components of Profitability

The only way to increase profitability, and therefore Net Margin, is to make a change within one of the components of Net Income, as shown on the Net Income equation on p. 333.

For example, lowering expenses will typically increase Net Income. Increasing Sales may also increase Net Income, but solutions are not always this simple. You might improve profitability in the short term by providing the same amount of services using fewer employees. Later on, however, lost sales caused by a lower quality service might have the reverse effect and might actually reduce future profit.

Each of the components of profitability—Sales, Cost of Goods, and Expenses—should be carefully researched, assessed, and projected. Pay particular attention to Sales and Costs of Goods Sold. These two components of Net Income play a very large role in the pursuit of profit.

### Sales

The best place to improve overall profitability is to increase Sales. Starbucks Coffee® has some pretty aggressive long-term sales growth goals that include a distribution system of 20,000 stores worldwide. To achieve this goal successfully, Starbucks plans to expand through market penetration (selling more current products to existing customers) and line expansion (introducing new products—ice cream and non-coffee products—to existing customers). They also plan market expansion (selling existing products to new markets) and new business development (selling new products to new markets) to meet these grand goals. Review your own growth strategy that you developed in Action Step 3.2 Determine My Business Strategy.

Adjusting prices is another strategy to increase total sales, but it can be hard to implement successfully. For a refresher on pricing strategies, review Module 5. Most products and services have an optimal price level at which sales is maximized. For some customers, a high price, accompanied with appropriate marketing strategies, implies high quality and encourages sales. For others, a low price is the only way to compete. As this optimal price is sought, it is sometimes necessary to raise prices, which has its own set of complicating factors.
After her parents’ retirement, Vivian Bowers quit her successful job with Kaiser Permanente® and became the new president of Bowers & Sons, a forty-four-year-old family dry cleaning business. Bowers explains, “People depended on us to be a stronghold in the community. Bowers & Sons was a real legacy.” During the past decade, Bowers has nearly tripled her company’s annual revenues—no small feat in a highly competitive industry with small dollar transactions. In addition to improving services to increase sales, she has raised prices too. Bowers increases prices about 5 percent annually. “Every year I get moans and groans, but very seldom do I lose customers,” she says. “And even if I do lose a few, most of them are back the next week after they try another dry cleaner and are dissatisfied.”

Cost of Goods Sold
Sales are distributed to fund the costs of operating the business—Cost of Goods Sold and Expenses. The slice of the Sales pie that is left after these expense slices have been cut is called Net Income. The primary cost associated with a business’s activity is usually the cost of providing products or services, called Cost of Goods Sold. In product-based companies, Cost of Goods Sold reflects the total cost of the inventory items that have been sold. For service-based companies it is called Cost of Sales, and it reflects the direct costs associated with providing the service. Cost of Goods Sold is usually easier to track in product-based companies. Still, every business invests money into the products or services it sells. Since the overall goal is profitability, even if you do not sell products you should evaluate the amount of time and resources you use to provide your services.

The primary way to measure Cost of Goods Sold is to look at the Gross Margin ratio. The Gross Margin ratio is determined by comparing Gross Margin to Sales.

Gross Margins can be very different from one industry to another. Because software is fairly inexpensive to create, Microsoft’s® Gross Margin ratio consistently tops 80 percent. Even within the same industry, there can be considerable differences. Coke®, which focuses on producing syrup instead of bottling or potato chips, has a Gross Margin just under 70 percent compared to Pepsi’s® under 60 percent.

Components of Cost of Goods Sold
Your business should strive to have the largest Gross Margin possible. That means you must control the costs directly associated with providing your products or services. The Sample Income Statement on p. 337 shows a Gross Margin percentage of 30 percent ($60,000 / $200,000). The Cost of Goods Sold is calculated on this sample statement by adding raw materials or merchandise purchases of $90,000 and direct labor of $60,000 to the beginning inventory of $10,000. From this total, the ending inventory balance of $20,000 is subtracted. You can then calculate that the goods sold in 2005 had an associated cost of $140,000.
As a component of profitability, Cost of Goods Sold plays a huge role in determining Gross Margin and Net Income. The higher the Gross Margin ratio, the more money you have to support the operating activities of your business.

To increase your Gross Margin ratio, you should look at each product/service separately to evaluate the individual product/service Gross Margins. McDonald’s®, for example, prices food as low as possible to get customers in the door. Beverages, however, at about a 90 percent Gross Margin, bring in the most profit.

### Sample Cost of Goods

<table>
<thead>
<tr>
<th>Cost of Goods Sold</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Inventory Jan 1</td>
<td>$10,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>+90,000</td>
</tr>
<tr>
<td>Direct Labor</td>
<td>+60,000</td>
</tr>
<tr>
<td>Total</td>
<td>160,000</td>
</tr>
<tr>
<td>Less: Inventory Dec 31</td>
<td>-20,000</td>
</tr>
<tr>
<td>Net Cost of Goods Sold</td>
<td>$140,000</td>
</tr>
</tbody>
</table>

### Sample Income Statement

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Sales</td>
<td>$200,000</td>
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<tr>
<td>- Cost of Goods Sold</td>
<td>-140,000</td>
</tr>
<tr>
<td>= Gross Margin</td>
<td></td>
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<tr>
<td>- Expenses</td>
<td>-40,000</td>
</tr>
<tr>
<td>= Net Income</td>
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<tr>
<td></td>
<td>$ 20,000</td>
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### Gross Margin

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<tr>
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<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
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<tbody>
<tr>
<td>My Company’s Gross Margin ratio</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Industry Gross Margin ratio</td>
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</tbody>
</table>

### Framing Profits

Randy Reed, co-owner of Reed’s Custom Framing, a family-owned picture framing business in Madison, Tennessee, needed a fresh perspective on his business. Through the business and financial planning process, Reed discovered several ways to strengthen profits. By comparing the Gross Margin among their products and services, Reed decided to phase out art prints and ready-made frames. “We don’t make much money on those items. Our core business is custom picture frames,” he explains. “And rather than trying to be all things to all people, it’s better to focus on what you do best—even if you have to send customers somewhere else at times.”

### Tip

Finding ways to save money and time will decrease your Cost of Sales and increase your profits.

If you have a service business, your statements may not show a Cost of Sales. Even so, you still have costs associated with your service. Whether you specifically track these costs or not, providing services to customers is a significant cost of doing business. One accountant helps his service-based clients calculate a more realistic Gross Margin by adding payroll to their Cost of Sales. In addition to payroll, costs that could be considered a direct cost of providing a sale include travel, research time, and telephone.

For additional improvements, you need to look at each component of Cost of Goods Sold—Inventory, Purchases, and Direct Labor—for opportunities to lower costs or manage your business more effectively. Inventory will be considered in greater detail with the Balance Sheet discussion later in this module.
Operating and Non-Operating Expenses

Another way to make improvements to financial performance and increase profitability is to reduce operating expenses. To know which expenses may be inflated, compare your current expenses with historical statements to identify negative trends. Then, compare your expenses to the expenses of other businesses in your industry as a percentage of Sales. For example, if eating establishments report industry average costs for payroll and benefits of 30 percent of Sales, a restaurateur should take a very close look at her own payroll costs if they are over this average.

**question expenses**

A rocky economy is hitting the industrial packaging industry hard. To weather the tough times, Neil Parham is cutting expenses at Eagle Packaging, Inc.

Every quarter, Parham meets with his team to review the numbers. They pay special attention to expense control. In a recent meeting, an employee noticed the company’s growing expenses for phone use and sought more information. “Everyone’s questioning expenses now,” Parham says. “They understand the role expenses play in affecting profits, and they want us to spend our money wisely.”

He is also cutting the cost of employees by allowing attrition to reduce his head count. Rather than refill open positions, Parham has asked his remaining fifteen employees to absorb the extra work. He realizes that’s a tall order so he helps staffers understand the financial pressures of the company by sharing financial information with them.

Evaluate Financial Performance on the Balance Sheet

Financial statements and reports must be read together to learn the whole financial story. For example, an Income Statement may report a large sale to a new customer, while the Balance Sheet shows the sale as an Accounts Receivable. Reading an aging receivables report may reveal that the account has been unpaid for quite some time. Reading all of a company’s statements and reports deepens your understanding of this financial story.

**The Balance Sheet Tells the Rest of the Story**—The Balance Sheet will help you understand your financial story’s setting and characters and how they work together to achieve the story’s end—profitability. The Balance Sheet identifies the means available to make those profits repeat and grow in future years. Using this year’s Balance Sheet, you will have a better idea of how to plot next year’s profitability story and what your future business wealth will be. To use this tool effectively and improve your financial performance, you need to evaluate the major Balance Sheet components—Assets, Liabilities, and Equity. Read A Closer Look @ Financial Statements, pp. 144–152, for more information on the Balance Sheet.

**Assets**

Assets, such as cash, equipment, and property, are owned by the company for one reason—to increase the business’s profitability and future wealth. One way to look at the effectiveness of assets is to evaluate how well they are generating profits by focusing on the Return on Assets (ROA). Look at your own business’s ROA trends over time and compare them to industry averages. Since assets are an investment in future profits, ROA should be higher than the rate paid by other conservative investments. It should also be higher than the rate paid for funds borrowed by the business.
Return on Assets compares Net Income and Total Assets to show how much income has been generated from each dollar’s worth of the company’s assets. Most manufacturing companies are very asset-intensive. They require large, expensive machinery to produce their products. For example, Yamaha has shown a Return on Asset ratio ranging between 2 and 5 percent for the last few years. Comparing that with Harley-Davidson’s impressive ROA of around 18 percent, it is easy to see that companies in the same industry can operate very differently.

Since service companies are usually very asset-light, they can have difficulty using the Return on Assets ratio to effectively evaluate financial performance. Other ratios such as Net Margin and Return on Equity may be more useful indicators for service-based companies. Net Margin is discussed on pp. 335-336 and Return on Equity on p. 345.

The total assets owned by a company will typically remain fairly stable, so an increasing ROA indicates greater profitability while a decreasing ROA indicates less profitability. You have two primary ways to improve the return on your assets—increase Net Income without acquiring new assets or improve the effectiveness of existing assets. Depending on the type of business you have, you’ll want to pay particular attention to Accounts Receivable, Inventory, and Fixed Assets when evaluating your ROA.

To improve the effectiveness of your assets, evaluate each asset category to identify room for improvement. For example, one way for companies to improve ROA is to sub-contract out some of the process rather than invest in expensive equipment to do the same work. Another way to improve your return on assets is to manage your inventory and collect accounts receivable better and faster.

### Managing Inventory

The way your business manages inventory has an impact on both profits and cash flow. When purchased, inventory is an asset recorded on the Balance Sheet. At any given time, assuming a customer wants it, you can sell inventory to regain cash. Once sold, the cost of the inventory items sold is transferred from the Balance Sheet (Inventory account) to the Income Statement (Cost of Goods Sold account). When inventory cannot be sold, it becomes worthless to the business and you should write it off and discard it.

One way to evaluate how well inventory is being managed is to look at the Inventory Turnover ratio. This ratio tells how many times the average level of inventory is sold, or turns over, during the year. The ratio should be used to compare your company’s own trends and to compare to the industry’s averages. High turnover is generally good. Depending on what you sell, a high turnover rate may be three times a year or 300 times. High turnover, however, may also indicate that there is not enough merchandise, and sales are being lost.

---

**Tip**

Investors and potential investors use the Return on Assets ratio to evaluate a company’s leadership because it shows how well management is making decisions.

**Return on Assets**

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>My Company’s Return on Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Industry Return on Assets</strong></td>
<td><strong>Return on Assets Equation:</strong> Net Income Total Assets*</td>
<td></td>
</tr>
</tbody>
</table>

* If your business experiences large variances in assets during the year, calculate ROA using an average of the assets over the period being evaluated.

**Balance Sheet Components**

- Assets
  - Inventory
  - Accounts Receivable
- Liabilities
- Equity

---

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To manage inventory effectively, you should pay close attention to the value of your inventory and the systems you need to control actual inventory.

**Inventory value**—Of course the Inventory Turnover ratio only identifies the number of times the entire inventory is sold during the year. It does not evaluate each element of inventory as it moves through the production cycles. Inventory could include raw materials ready to be produced, goods in production but not yet completed, and completed goods ready to be sold. To effectively manage inventory and the associated costs, you must correctly value the inventory as it progresses through the production cycle. For example, the retail value of a finished wooden garden shed far surpasses the original value of the raw materials used to create the shed. Your CPA, trade association, or business consultant can be of assistance in selecting and designing the appropriate systems to help you value your inventory at various stages in production.

**Inventory systems and control**—Have you ever used the computer to verify the stock available for a large sale and then run out to the warehouse to check the shelf just to be sure? Any business that sells merchandise must be aware of the actual inventory on hand in order to have just the right amount to sell to customers. Consider this: inventory lost through shrinkage—theft, breakage, and loss—must be covered by profits. In other words, if this sample company’s Net Margin is 3 percent, it takes $5,000 in new sales to make up for a $150 inventory loss!

Even with computer inventory records, your inventory control systems need a physical inventory to verify the computer’s totals. Differences may occur because of problems in the inventory control system. Use the following Inventory Management checklist to review several strategies to improve your system of inventory management.

### Inventory Management

<table>
<thead>
<tr>
<th>Tip</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knowing how much a product costs to produce helps you set prices that ensure an adequate return on your investment of materials, time, and resources.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>A $5,000 sale provides enough cash to replace $150 of lost inventory.</td>
</tr>
<tr>
<td>Sales</td>
</tr>
<tr>
<td>Expenses</td>
</tr>
<tr>
<td>Net Income</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Inventory Turnover</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>My Company’s Inventory Turnover</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry Inventory Turnover</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* If your business experiences large variances in inventory during the year, calculate Inventory Turnover using an average of the inventory over the period being evaluated.
Collecting Accounts Receivable

*Accounts Receivable* describes money due from customers for products or services already sold. In essence, when you extend credit to customers it is like giving them an interest free loan. You should have an effective collection policy to ensure that invoices are sent and cash is collected on these credit sales as quickly as possible.

One way to measure the effectiveness of your collection process is to review the Accounts Receivable Turnover ratio, which measures how many times the average receivable balance turns into cash. A high ratio indicates an efficient collection process. A low or declining ratio reveals a problem within some portion of the credit and collection process. For example, if a business has Accounts Receivable of $145,000 at the end of the year and credit sales of $1.2 million for that same year, the Accounts Receivable turnover ratio is 8.3 times, which means that the average total due in invoices was collected over eight times during the year ($1.2 million / $145,000 = 8.28). If the business allows credit terms of Net/30, they would expect their ratio to be closer to twelve times, which would indicate that invoices are collected every thirty days (365 days in the year divided by 12 months). This business looks like it needs to tighten up their collections process.

<table>
<thead>
<tr>
<th>Accounts Receivable Turnover</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>My Company’s A/R Turnover</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry A/R Turnover</td>
<td></td>
<td>Accounts Receivable Turnover ratio:</td>
<td>Annual Credit Sales</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Accounts Receivable*</td>
<td></td>
</tr>
</tbody>
</table>

* If your business experiences large variances in Accounts Receivable during the year, calculate this ratio using an average of the Accounts Receivable over the period being evaluated.

revamp collections

Over the past 20 years, Maria Rossini has built Rossini Architecture Inc. into a thriving Atlanta business with a long list of high-profile corporate clients. As the company grew, she changed her role and began concentrating on financial performance in order to develop a future direction for her company. A major task was to collect $80,000 of outstanding Accounts Receivable.

Using her newly developed collection process, Rossini assembled written evidence of all the work completed for a client, along with well-organized details of the services provided. This process removed any ambiguity about the exact amount she was owed.

Rossini understands the legal options she can tap into for those clients who still refuse to pay, along with savvy ways to enlist third parties to strengthen her case (such as the city of Atlanta in its capacity as contractor for a project). As a result, Rossini’s Accounts Receivable plummeted from $80,000 to just $650.
Liabilities
When reading the Balance Sheet as a financial story, you will quickly identify Cash as the hero of the tale. With enough cash, a happy ending seems inevitable. Some entrepreneurs see Liabilities as the villain who is typically at odds with the hero and working behind the scenes to sabotage the business. In your real-life financial story, nothing could be further from the truth. Although not the hero, Liabilities have an important supporting role that is vital to the creation of a healthy cash flow.

The more cash you have and the longer you can hold on to it, the better. One way to secure more cash and other assets is through the proper use of Liabilities. Liabilities are categorized as either short-term or long-term debts, called Current or Long-Term Liabilities.

Current Liabilities
Current Liabilities are bills or loan payments due within the next business cycle, usually a year. The primary Current Liabilities are Accounts Payable, Accrued Expenses, and Short-Term Notes Payable. Accounts Payable are amounts owed to vendors and suppliers who have allowed your business to purchase materials, merchandise, and supplies on credit. Accrued Expenses are normally estimates of future expected payments such as wages, interest, and taxes that have not yet come due. Short-Term Notes Payable are usually interest-bearing debts that have been secured for the purposes of purchasing assets or otherwise supplying cash to operate the business.

Evaluating Your Use of Current Liabilities
Several ratios, called Liquidity ratios, are used to measure a company’s ability to pay its short-term bills, also called its liquidity. The two most commonly used ratios are the Current Ratio and the Quick Ratio. The Current Ratio is based on all of the Current Assets and Current Liabilities, and a 2:1 ratio is usually considered ideal. In other words, a business has twice as many Current Assets as it has Current Liabilities. You should compare your own Current Ratio to other companies in your industry to determine your Current Ratio goal. The Apollo Group®, provider of higher education programs for working adults, might have been concerned about their Current Ratio of 1.59 compared to the ideal of 2. Compared to Franklin Covey® at 1.64, however, their ratio looks to be in line with the industry.

The Quick Ratio, also called the acid test, determines if you have sufficient cash, receivables, and marketable securities available immediately to pay off current debts. This ratio excludes inventory because it is often difficult to liquidate inventory quickly. Just as gold is tested with nitric acid to determine its quality, potential creditors may use this acid test to judge the quality of your business as a potential payer. A 1.0 ratio is usually preferred. If this number is going down, sales are not strong enough to meet daily cash obligations.

<table>
<thead>
<tr>
<th>Liquidity Ratios</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>My Company’s</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>□ Current Ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>□ Quick Ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>□ Current Ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>□ Quick Ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Current Ratio:         | Total Current Assets* | Total Current Liabilities |
|                        | (Current Assets – Inventory)* | Total Current Liabilities |

* If your business experiences large variances in assets, liabilities, and inventory during the year, calculate these ratios using averages for the period being evaluated.
If your liquidity ratios are lower than ideal, assess why your cash supply is weakening and work on appropriate strategies to increase cash flow. This approach will improve your ability to pay your bills in the long-term. During this time, maybe you can refinance and get longer-term loans, or investors could contribute additional cash that could be used to pay off debts. Doing so will ease the current stress on cash.

**Long-Term Liabilities**

Long-Term Liabilities are debts that will not be repaid until after the current business cycle, which is typically one year. It is healthy for a company to have some long-term debt, especially if the business needs considerable assets to operate. The Debt to Asset ratio measures the extent to which a company is financed with debt. It is important to keep the ratio of debt to asset at a healthy level. Generally, a Debt to Asset Ratio of no more than 50 percent is considered sensible. Having a Debt to Asset ratio of more than 1 is like being upside down in your car loan—you owe more money than the car, or in this case the business, is worth.

Potential lenders and investors may use the Debt to Equity ratio, which compares the relationship between what is owed (Liabilities) with what is owned (Equity), to learn to what extent the assets are funded with debt rather than equity. If the ratio is high compared to the industry, the company may be labeled as not being able to repay its debts. Although recommended Debt to Equity ratios vary among industries, bankers usually consider this ratio acceptable when it is between 1:1 and 3:1. Where the Current and Quick Ratios measure the company’s ability to survive a short-term financial crisis, a Debt to Equity ratio measures the company’s ability to survive over the long-term.

<table>
<thead>
<tr>
<th>Debt Ratios</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>My Company's</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>经销到资产比率</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>经销到资产比率</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt to Asset Ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* If your business experiences large variances in assets, liabilities, and equity during the year, calculate these ratios using averages for the period being evaluated.

The more a company’s debt exceeds its net worth, the less likely it is to obtain financing. As these ratios increase, the company’s ability to obtain financing decreases. Additionally, as more debt is acquired, the owner’s position is weakened and those that own the debt (banks, large suppliers) can establish control of the company. Since a high Debt to Asset Ratio may signal to potential funders your inability to meet debt payments, it may be important for you to improve this ratio. In general, the only ways to do so are to increase the value of your assets or pay off debt. A CPA or business consultant can help you evaluate whether inventory or other assets could be assessed at a higher value. Paying off debt will also improve the Debt to Equity Ratio. Another way to improve the Debt to Equity Ratio is to increase equity through retained earnings by increasing profits or additional owner contributions.
Equity
Sense your business may be the biggest investment you will ever make, the Return on Equity (ROE) ratio is an important ratio to calculate. By comparing Net Income to Equity, this ratio reveals the rate of return a company has earned on its equity investment. If Return on Equity is 30 percent, for example, then thirty cents of Net Income is created for each dollar that has been invested. The higher the number, the greater the return the company is earning for its owners.

Bankers often refer to Return on Equity as ROI or Return on Investment. Thinking of it this way, your business's Return on Equity should be at least as much as you could have earned by placing money in conservative investments such as CDs or bonds. What could you have earned on the stock market? In a bank account? This information will help you develop Return on Equity goals that will be sure to help you build future wealth in your business.

Tip
Equity includes amounts invested into the business by its owners as well as the accumulated Net Income the company has generated throughout its business life, called Retained Earnings.

Return on Equity
<table>
<thead>
<tr>
<th>My Company's Return on Equity</th>
<th>Industry Return on Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>Return on Equity Equation: Net Income / Total Equity*</td>
</tr>
<tr>
<td>Year 2</td>
<td></td>
</tr>
<tr>
<td>Year 3</td>
<td></td>
</tr>
</tbody>
</table>

* If your business experienced a major change in equity during the year, calculate ROE using an average of the equity over the period being evaluated.

The reason that Return on Equity is such a helpful ratio is that it compares the relationship between three very important financial strategies—profitability, asset management, and financial leverage. Increasing profitability, improving asset efficiency, and proper financial leveraging will all have a positive effect on your Return on Equity.

Some time ago, Dell® computer decided to improve shareholder return by revamping its asset management policies. Better management of the computer components inventory became the focus of their efforts. Inventory and Accounts Receivable are Dell's two most significant assets. By controlling these two accounts, Dell would show increased sales for each dollar of total assets used and increase the basic Return on Equity of the business. Dell increased Inventory Turnover, which means that more cash was available to generate additional sales instead of being invested in assets. Dell's results show how improved asset management can increase Return on Equity because better asset management eventually shows up in the form of increased profit margins.

Select Your Key Financial Indicators
The secret to striking it rich in your business is to find your own gold nuggets, the financial strategies that have the most impact on financial performance. Pursue the strategies you select by using your profit mining tools—the financial statements and ratios. The key to effective financial decisions is knowing which ratios to track. Complete Gold Nuggets on p. 346 to choose the ratios you will most likely use immediately to monitor your business's financial performance. You will use these ratios again in Action Step 9.1 Complete Financial Projections when you will evaluate the decisions you have made during this program and the resulting impact on profitability and cash flow.
Gold Nuggets

Place a check in the box next to the ratios that you will begin using immediately to maximize your company’s financial performance—profitability, cash flow, and future value.

<table>
<thead>
<tr>
<th>✓</th>
<th>Ratio Name</th>
<th>Equation*</th>
<th>What It Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Net Margin p. 336</td>
<td>( \frac{Net \ Income}{Net \ Sales} )</td>
<td>Profitability</td>
</tr>
<tr>
<td>2.</td>
<td>Gross Margin p. 338</td>
<td>( \frac{Gross \ Margin}{Net \ Sales} )</td>
<td>The profit a company enjoys on the goods it sells after direct costs are subtracted</td>
</tr>
<tr>
<td>3.</td>
<td>Return on Assets (ROA) p. 340</td>
<td>( \frac{Net \ Income}{Total \ Assets} )</td>
<td>Profits generated with existing assets</td>
</tr>
<tr>
<td>4.</td>
<td>Return on Equity (ROE) p. 345</td>
<td>( \frac{Net \ Income}{Total \ Equity} )</td>
<td>Whether or not the company is a good investment</td>
</tr>
<tr>
<td>5.</td>
<td>Inventory Turnover p. 341</td>
<td>( \frac{Cost \ of \ Goods \ Sold}{Inventory} )</td>
<td>How popular the merchandise is</td>
</tr>
<tr>
<td>6.</td>
<td>Accounts Receivable Turnover p. 342</td>
<td>( \frac{Yearly \ Credit \ Sales}{Accounts \ Receivable} )</td>
<td>The number of times that accounts receivable amount is collected throughout the year</td>
</tr>
<tr>
<td>7.</td>
<td>Current Ratio p. 343</td>
<td>( \frac{Total \ Current \ Assets}{Total \ Current \ Liabilities} )</td>
<td>Whether the company has enough liquidity to pay its short-term obligations</td>
</tr>
<tr>
<td>8.</td>
<td>Quick Ratio p. 343</td>
<td>( \frac{(Current \ Assets – Inventory)}{Current \ Liabilities} )</td>
<td>Whether the company’s assets minus inventory will provide enough liquidity to cover its short-term obligations</td>
</tr>
<tr>
<td>9.</td>
<td>Debt to Asset p. 344</td>
<td>( \frac{Total \ Liabilities}{Total \ Assets} )</td>
<td>The proportion of assets that are financed by creditors’ funds (debt)</td>
</tr>
<tr>
<td>10.</td>
<td>Debt to Equity p. 344</td>
<td>( \frac{Total \ Liabilities}{Total \ Equity} )</td>
<td>How much the company relies on debt versus equity financing</td>
</tr>
</tbody>
</table>

* If your business experiences large variances in assets, liabilities, or equity during the year, calculate the ratios using averages for the period being evaluated.
Consider Cash Flow Needs on the Cash Flow Report

In your own financial story, the hero—Cash—plays a key role defeating its archrival—Insolvency—which uses up every financial resource. If Insolvency wins, your business heads towards bankruptcy. Luckily, in any financial story Cash will always defeat Insolvency if Cash is available. You need to know the exact role of Cash in your financial story, where it comes from and when it will be needed to make sure it will always be available.

The Leading Role of Cash
Cash’s leading role in the financial story is to fund the business’s pursuit of profits. Profits in turn generate more cash. A thorough discussion of the relationship between profits and cash may begin to sound like an answer to the age-old question, *Which came first, the chicken or the egg?* Simply put, profits can only be put in your pocket or deposited in the bank when you receive the cash from sales. Still, if your business is profitable, you are producing cash. Ask yourself: *When will you receive the cash? When will you have enough of it to meet your profit goals?*

To answer these questions, you must have persistence when it comes to managing cash flow. Consider the following steps:

1. **Project your cash needs.** You need to know how much you need, when you will need it, and what it will be used for.
2. **Maximize internal cash flow.** A primary source of cash should come from your own business activities. Find ways to maximize cash flow.
3. **Find external cash sources.** To fund your growth, you will likely need cash from external sources as well. Find sources that offer terms that match your own goals for those funds.

Projecting Your Cash Needs
One of the most valuable tools for measuring, analyzing, and planning monthly cash flow is to use a Monthly Cash Flow Report. A Cash Flow Report will identify the cash expected each month from sales and non-revenue sources, such as bank loans or equity contributions. It will also report the monthly expenses and non-expense payments, such as loan payments or equipment purchases. In this way, the worksheet reports back to you all of the cash that is expected to flow into and out of your business during each month.

When you use the Financial Template, a Three-Year Monthly Cash Flow Report will be automatically generated. The value of this monthly projection is to show forecasted cash flow monthly, seasonally, and annually. In this way, you can plan for cash shortfalls, forecast additional cash needs, and plan to invest idle cash.

The sample on pp. 348–349 shows the first of a three-year projected Cash Flow Report for Clean Corp, a twelve-year-old company supplying premium quality textiles for rent. You first encountered Clean Corp in Activity 4a, pp. 127–130. This worksheet shows the management’s first budgeting attempt. They will review this Cash Flow Report to identify changes that need to be made to improve cash flow.
# Charting Financial Performance

## CLEAN CORP

### Cash Flow Statement (Projected)

<table>
<thead>
<tr>
<th>Year</th>
<th>Pre Start-up</th>
<th>JAN</th>
<th>FEB</th>
<th>MAR</th>
<th>APR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash In</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collections from Accounts Receivables</td>
<td>184,530</td>
<td>193,757</td>
<td>110,718</td>
<td>119,945</td>
<td></td>
</tr>
<tr>
<td>Equity Received</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Loans Received</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other Cash In (receipts from other assets)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other Cash In (interest, royalties etc)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Cash In</strong></td>
<td>-</td>
<td>184,530</td>
<td>193,757</td>
<td>110,718</td>
<td>119,945</td>
</tr>
<tr>
<td><strong>Total Cash Available</strong></td>
<td>80,000</td>
<td>264,530</td>
<td>241,014</td>
<td>140,593</td>
<td>140,304</td>
</tr>
<tr>
<td><strong>Cash Out</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory Expenditures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory/Raw Material (Cash)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Inventory/Raw Material (Paid on Account)</td>
<td>-</td>
<td>132,862</td>
<td>139,505</td>
<td>79,717</td>
<td>86,360</td>
</tr>
<tr>
<td>Production Expenses</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Insurance</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Licenses &amp; Fees</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Marketing &amp; Promotion</td>
<td>4,842</td>
<td>4,842</td>
<td>4,842</td>
<td>4,842</td>
<td>4,842</td>
</tr>
<tr>
<td>Meals &amp; Entertainment</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Miscellaneous</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Office Expense</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Office Supplies</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Outside Services</td>
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<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Payroll Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; Wages</td>
<td>-</td>
<td>21,083</td>
<td>21,083</td>
<td>21,083</td>
<td>21,083</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>-</td>
<td>2,741</td>
<td>2,741</td>
<td>2,741</td>
<td>2,741</td>
</tr>
<tr>
<td>Benefits</td>
<td>-</td>
<td>2,741</td>
<td>2,741</td>
<td>2,741</td>
<td>2,741</td>
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<tr>
<td>Professional Fees</td>
<td>1,937</td>
<td>-</td>
<td>-</td>
<td>1,937</td>
<td>-</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Rent</td>
<td>2,388</td>
<td>2,388</td>
<td>2,388</td>
<td>2,388</td>
<td>2,388</td>
</tr>
<tr>
<td>Repairs &amp; Maintenance</td>
<td>4,842</td>
<td>-</td>
<td>-</td>
<td>4,842</td>
<td>-</td>
</tr>
<tr>
<td>Shipping &amp; Delivery</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Telephone</td>
<td>323</td>
<td>323</td>
<td>323</td>
<td>323</td>
<td>323</td>
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<tr>
<td>Training &amp; Development</td>
<td>-</td>
<td>-</td>
<td>3,873</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Travel</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Utilities</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Vehicle</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Paid on Account</td>
<td>-</td>
<td>35,000</td>
<td>35,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Non-Operating Costs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Purchases</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Estimated Income Tax Payments</td>
<td>-</td>
<td>6,006</td>
<td>-</td>
<td>6,006</td>
<td>-</td>
</tr>
<tr>
<td>Interest Payments</td>
<td>-</td>
<td>459</td>
<td>459</td>
<td>459</td>
<td>459</td>
</tr>
<tr>
<td>Loan Principal Payments</td>
<td>-</td>
<td>2,049</td>
<td>2,058</td>
<td>2,067</td>
<td>2,075</td>
</tr>
<tr>
<td>Owner's Draw</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other Cash Out</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Cash Out</strong></td>
<td>-</td>
<td>217,272</td>
<td>211,139</td>
<td>120,234</td>
<td>135,797</td>
</tr>
<tr>
<td><strong>Monthly Cash Flow (cash in - cash out)</strong></td>
<td>-</td>
<td>(32,742)</td>
<td>(17,383)</td>
<td>(9,516)</td>
<td>(15,852)</td>
</tr>
<tr>
<td><strong>Beginning Cash Balance</strong></td>
<td>80,000</td>
<td>80,000</td>
<td>47,258</td>
<td>29,875</td>
<td>20,359</td>
</tr>
<tr>
<td><strong>Ending Cash Balance</strong></td>
<td>80,000</td>
<td>47,258</td>
<td>29,875</td>
<td>20,359</td>
<td>4,507</td>
</tr>
</tbody>
</table>

---

The worksheet has two main sections—Cash In and Cash Out. These items use up cash, and except for interest and taxes, will not be expensed on the Income Statement. The last line of the worksheet is the most important. Any negative number shows insolvency—an inability to pay bills.
### CLEAN CORP

**Cash Flow Statement (Projected)**

<table>
<thead>
<tr>
<th>MAY</th>
<th>JUN</th>
<th>JUL</th>
<th>AUG</th>
<th>SEP</th>
<th>OCT</th>
<th>NOV</th>
<th>DEC</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>129,171</td>
<td>175,304</td>
<td>202,983</td>
<td>202,983</td>
<td>129,171</td>
<td>110,718</td>
<td>119,945</td>
<td>166,076</td>
<td>1,845,300</td>
</tr>
<tr>
<td>129,171</td>
<td>175,304</td>
<td>202,983</td>
<td>202,983</td>
<td>129,171</td>
<td>110,718</td>
<td>119,945</td>
<td>166,076</td>
<td>1,845,300</td>
</tr>
<tr>
<td>133,678</td>
<td>179,317</td>
<td>219,412</td>
<td>226,785</td>
<td>169,247</td>
<td>85,266</td>
<td>76,004</td>
<td>119,907</td>
<td>1,925,300</td>
</tr>
<tr>
<td>93,003</td>
<td>126,219</td>
<td>146,148</td>
<td>146,148</td>
<td>93,003</td>
<td>79,717</td>
<td>86,360</td>
<td>119,575</td>
<td>1,328,616</td>
</tr>
<tr>
<td>129,664</td>
<td>162,888</td>
<td>195,611</td>
<td>186,709</td>
<td>194,699</td>
<td>129,207</td>
<td>123,073</td>
<td>156,296</td>
<td>1,962,589</td>
</tr>
</tbody>
</table>

**Charting Financial Performance**

Clean Corp’s monthly sales fluctuate as their restaurant rentals peak during the winter holidays and the wedding season.

Some payments, such as maintenance and professional services, are paid on a quarterly contract.

Paying off the LOC in August has revealed the need to once again draw on that same line of credit.

High Ending Cash Balances may indicate an opportunity to use cash to invest, pay dividends, or repay loans.

Some payments, such as maintenance and professional services, are paid on a quarterly contract.

Paying off the LOC in August has revealed the need to once again draw on that same line of credit.
Maximizing Your Internal Cash Flow

Funding sources will be either internal or external to the business. Internal sources include not only cash flow generated from the profits of the business, but also funds provided by the entrepreneur and other owners. One way to ensure the best use of your cash is to maximize your internal source of cash flow. Companies with strong profits and cash flow are able to fund a considerable portion of their own growth rather than to rely on external sources of debt or equity.

Harley-Davidson, the nation’s #1 seller of heavyweight motorcycles, has achieved success beyond producing V-Twin cruising motorcycles that customers wait in line to purchase. Harley-Davidson has strengthened what is already one of the most recognizable symbols in America today, the Harley logo, by selling Harley clothing and accessories. They have also opened Harley-Davidson Cafes in New York City and Las Vegas that combine Harley souvenir merchandise and rare biker memorabilia with food, such as the Harley Hog Sandwich. With an ownership/rider membership of over 500,000 nationwide, other motorcycle manufacturers have found it difficult to match Harley-Davidson in terms of customer loyalty and sales. As the saying goes, “It’s one thing to have people buy your products. It’s another for them to tattoo your name on their bodies.” This combination of customer loyalty, quality merchandise, and market differentiation has fueled a growth rate of 17 percent. Harley has funded its growth over the last 10 years almost entirely through cash generated from operations rather than through constantly issuing new equity.

The Cash Cycle

The cash cycle can be used to monitor and improve internal cash flow. The cash cycle tells the number of days it takes for your business’s cash to be invested into your products or services and received back again from sales to customers.

Consider a business with a very short cash cycle—a restaurant. In the restaurant business, inventory (food) is sold quickly and customers generally pay their bills immediately. This setup creates a very healthy, and short, cash cycle. The restaurateur also gets to hold onto cash before paying employees and many vendors. Compare this arrangement to the long cash cycle of a pharmaceutical company, which must have significant funds available just to research and develop new products to be created, tested, approved, and then sold. The longer the cash is out-of-pocket, the harder it is to pay your bills and show a profit.

The cash cycle is measured by comparing four primary components: Accounts Receivable, Inventory, Accounts Payable, and Payroll. The first two components tend to lengthen the cash cycle because your cash is out-of-pocket, invested in inventory and sales. The second two components often shorten the cash cycle as cash sits in your pocket while you take some time to pay your bills and employees. In order to measure the components of the cash cycle, you will calculate four ratios: Days Receivable, Days Inventory, Days Payable, and Days Payroll Accrual. These ratios make up the Cash Cycle equation:

### Cash Management

1. Project your cash needs.
2. Maximize internal cash flow.
3. Find external cash sources.

### Cash Cycle

- **Inventory**
- **Accounts Receivable**
- **Payroll**
- **Accounts Payable**

The shorter the cash cycle, the quicker cash is generated and brought back into the business.
Cash Cycle Equation

\[
\text{Days Receivable} + \text{Days Inventory} - \text{Days Payable} - \text{Days Payroll Accrual}
\]

Components that Lengthen the Cash Cycle

- **Accounts Receivable**—Accounts Receivable is measured by calculating Days Receivable, which is the time it takes customers to pay for products or services. An acceptable Days Receivable ratio depends upon your credit policy. For example, if you allow your customers 30 days to pay their bills and your Days Receivable is 32 days, you are doing an acceptable job of collecting cash from your customers. For the Days Receivable calculation, see the table on p. 352.

- **Inventory**—Inventory is measured by calculating Days Inventory, which is the time it takes for inventory to be produced and sold. Your Days Inventory ratio will vary depending upon the type of business and industry you are in. Since the fewer days you hold inventory the better, a low Days Inventory will benefit the cash cycle the greatest. For service companies without inventory, parts, or other merchandise, Days Inventory will be zero. For the Days Inventory calculation, see the table on p. 352.

Components that Shorten the Cash Cycle

- **Accounts Payable**—Accounts Payable is measured by calculating Days Payable, which is the time it takes for you to pay your bills to suppliers who have allowed you credit terms. Your Accounts Payable balance should represent payments that are still due to vendors who have allowed you credit terms. These vendors are likely supplying materials or services that you use in offering your products or services (Cost of Goods Sold or Cost of Sales). Therefore, Cost of Goods Sold is part of the Days equation. An acceptable Days Payable ratio will reflect your payment policy. For example, if your vendors allow you 30 days to pay your invoices and your Days Payable is 28 days, you are doing an acceptable job of paying your bills. For service companies that do not have Cost of Sales, an Accounts Payable Aging Report can help you to estimate the number of days it is taking for you to pay your bills. For the Days Payable calculation, see the table on p. 352.

- **Payroll**—Payroll is measured by calculating Days Payroll Accrual, which is the time it takes for you to pay your employees. This ratio assumes that your primary costs for payroll relate to offering your product or service (Cost of Goods Sold). Your Days Payroll Accrual should reflect your payroll cycle. For example, a bi-weekly payroll should yield a Days Payroll Accrual of around 14 days, and a monthly payroll should be around 30 days. For service companies that do not have payroll that relates to Cost of Goods Sold or Cost of Sales, look at your payroll cycle in days. This estimate should give you a fairly accurate number to work with. For the Days Payroll Accrual calculation, see the table on p. 352.

Calculating the Cash Cycle

Although these ratios seem to be designed for product-based businesses, the theory behind each ratio is also valid for service-based businesses. Difficulty in calculating these ratios could arise if your service-based company’s financial statements do not include the numbers needed to calculate some of these ratios, such as Cost of Sales. With the help of an accountant, your accounting system can be designed to yield the figures you need to calculate your cash cycle. It will be worth the effort, as these controls will help you tighten your cash cycle. Use the following table to help you calculate and analyze your own cash cycle in Cash Cycle on p. 353.
### Ratio Formula

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Formula</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Days Receivable</td>
<td>(rac{\text{Average Accounts Receivable}}{\text{Sales per year}}) x 365 days</td>
<td>(\frac{236,000}{1,760,780}) x 365 = 49 days&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Days Inventory</td>
<td>(rac{\text{Average Inventory}}{\text{Annual COGS or Cost of Sales}}) x 365 days</td>
<td>(\frac{145,000}{1,285,369}) x 365 = 41 days&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Days Payable</td>
<td>(rac{\text{Average Accounts Payable}}{\text{Annual COGS or Cost of Sales}}) x 365 days</td>
<td>(\frac{70,000}{1,285,369}) x 365 = 20 days&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Cash Cycle</td>
<td>(\text{Days Receivable} + \text{Days Inventory} - \text{Days Payable})</td>
<td>+ 49 + 41 - 20 = 70 days</td>
</tr>
</tbody>
</table>

<sup>a</sup> These calculations use average monthly balances for Accounts Receivable, Inventory, Accounts Payable, and Payroll to eliminate any fluctuation based on seasonal activity.

<sup>b</sup> Many business activities, such as bank deposits, check writing, and payroll processing, happen no more than once each day. Therefore, all cash cycle ratios are rounded up to the next day.
## Cash Cycle

First, calculate your cash cycle. Then identify ways to improve your internal source of cash.

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Formula</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ Days Receivable</td>
<td>( \left( \frac{\text{Average Accounts Receivable}}{\text{Sales per year}} \right) \times 365 ) days</td>
<td></td>
</tr>
<tr>
<td>+ Days Inventory</td>
<td>( \left( \frac{\text{Average Inventory}}{\text{Annual COGS or Cost of Sales}} \right) \times 365 ) days</td>
<td></td>
</tr>
<tr>
<td>- Days Payable</td>
<td>( \left( \frac{\text{Average Accounts Payable}}{\text{Annual COGS or Cost of Sales}} \right) \times 365 ) days</td>
<td></td>
</tr>
<tr>
<td>- Days Payroll Accrual</td>
<td>( \left( \frac{\text{Average Payroll Accrual}}{\text{Annual COGS or Cost of Sales}} \right) \times 365 ) days</td>
<td></td>
</tr>
</tbody>
</table>

Cash Cycle

\[ + \text{Days Receivable} + \text{Days Inventory} - \text{Days Payable} - \text{Days Payroll Accrual} \]

I will implement the following ideas to shorten my cash cycle and improve internal cash flow:

**Accounts Receivable** – My goal is to receive payments as soon as possible.
- Use an aging report to identify late payers.
- Aggressively pursue overdue accounts.
- Offer incentives for prompt payment.
- Put unreliable payers on shorter payment terms or COD (Cash on Delivery).
- Bill on a timely basis.
- Offer convenient payment options, such as cash, credit cards, or checks.

**Inventory** – My goal is to keep inventory moving as fast as possible.
- Make wise inventory purchases.
- Increase sales, marketing, or other promotional efforts to sell inventory.
- Liquidate slow-moving or obsolete inventory.
- Seek extended payment terms for my purchases of raw materials and inventory.

**Accounts Payable** – My goal is to hold payments as long as possible without incurring penalties (such as past-due charges) by taking longer than is allowed by the vendors.
- Buy from firms offering longer payment terms.
- Don’t pre-pay without receiving adequate benefit.
- Negotiate payment terms that allow me to pay in strategic intervals based on when the services are delivered.

**Payroll Accrual** – My goal is to keep payroll cash as long as possible without improving my own cash position on the backs of my employees.
- Make sure my paydays are similar to others in my industry, being careful about changing the paydays just to improve the company’s cash position.
Finding External Cash Sources

When seeking external cash to support growth, remember that just like you, funders have specific goals they intend to accomplish with the relationship. Some funding sources seek an ongoing relationship while others work towards promoting small businesses and still others attempt to earn as high a return as possible on their investment.

Funding Stages

In each business stage, you will have different opportunities for funding because you will have different resources available to meet the funding goals of potential funders. Even though exceptions can always be found, the following table illustrates the common preferences of many types of funders.

<table>
<thead>
<tr>
<th>Type of Funding</th>
<th>Start-Up Funding</th>
<th>Operational Funding</th>
<th>Growth Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Savings and Home Equity Loans</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Friends and Family</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Credit Cards</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Current Earnings</td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Customers</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Professional Advisers or Business Acquaintances</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Leasing Companies</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Bank Loans</td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Angel Investors</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Venture Capital Investors</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Private Placements</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Initial Public Offering</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>New Owner/Partner</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Factoring</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Joint Ventures / Strategic Alliances</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Sale of Distribution Rights</td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

For more information on these funding sources, read A Closer Look @ Internal and External Cash Flow Sources on pp. 375–380.

Conception and Start-Up Stages

Most entrepreneurs must rely on their own money sources when first starting a business. Because of the high risk, banks tend to lend money to start-ups only if the borrower has a good credit history, can provide solid collateral to secure the loan, and will personally guarantee the loan.

Although angel investors require a significant return on their investment, high-growth ventures may obtain seed funding in the conception and start-up stages from angels to fund concept development, initial product creation, and the first marketing efforts.

Early Operating Stage

Many entrepreneurs seek lines of credit to give them the flexibility of having cash available when it is needed. Banks are much more interested in lending to businesses with an
operational track record, so obtaining loans for purchases of large items such as equipment, as well as general operational cash needs, is generally easier.

For those businesses with high-growth opportunities, angel investors might also be interested in getting involved by providing both funding and expertise. Alternative sources also become more available to you as your expertise grows. You may become aware of customers, suppliers, or even competitors who could become a source of cash flow through joint-venture or some other type of arrangement.

**Growth and Rapid-Growth Stages**

Growth generally takes a lot of cash flow to cover increasing levels of payroll and inventory or to buy new equipment. Funding sources for this phase will include banks, angels, venture capital investors, private placements, and even initial public offerings. You will want to find high-quality business advisers to help you through the maze of funding in your growth stage.

**banking strategy**

“You always hear that you should develop a relationship with a bank before you need a loan,” says Dixie Junk. “Yet when so many other issues are demanding your attention, it’s hard to take that advice—especially if you’re not having a cash flow problem.”

Dixie and her husband, Robert launched Junk Architects, PC while living in New York. Within a few months, the company’s revenue was running three times its overhead, a pleasant situation that continued for many years, so the Junks saw no need to spend time with bankers. “In fact, for the first ten years of business, we did everything possible to avoid talking to the bank,” Dixie admits.

Only later did the couple realize their mistake when they sought an expansion loan. Fortunately, the Junks were strong on strategy. Before they approached any banks, the architects assembled a comprehensive package that included cash flow projections, aging schedules for accounts receivable and payables, equipment and furniture assets, corporate and personal tax returns, and a statement of net worth. The package also contained some of the firm’s marketing materials, resumes, references, and articles from newspapers and magazines that mentioned Jünk Architects.

With the help of advisers from the Helzberg Entrepreneurial Mentoring Program, the Junks picked seven or eight banks to approach, ranking the institutions in reverse order of the likelihood they would offer the company a loan. “That gave us a chance to practice our presentation,” Dixie says. “We tweaked it a little each time, and by the time we got to the banks on our short list, we were much more confident.”

The Junks secured both a loan and a line of credit, and since then, the architects have worked hard to maintain close ties with their bank.

**Maturing Stage**

The funding during this stage is very similar to the early operating stage. These businesses have already established relationships with lending institutions, so lines of credit or short- and long-term notes will typically already be in place. However, lenders will also recognize that the business is moving towards a need to innovate lest a decline in future sales occur, so they will be keeping a close watch on the business.
Funding Goals

Hundreds of funding options exist out there, but don’t get confused by the number of options. Take time to identify your own goals for funding so that you can match them with sources that will be more likely to have a desire to help you. Four major goals to consider are the amount of money needed, the use of the funds, the costs, and the consequences associated with the funding.

Amount

The amount of money you need to finance the company has a bearing on available sources. When you need a small amount, it might be fairly easy for you to obtain funds by pledging personal assets, such as a mortgage loan. Banks will typically only provide commercial loans within a minimum and maximum range. Many angel and venture capital investors are only interested in amounts beyond the bank’s maximum range. In each case, the amount you can acquire through financing depends on your business’s ability to repay the money through loan payments or distributions.

Tip

You can find out fairly easily what the funder wants. The key question is whether you can go along with it.

Use of Funds

Will the money be used to buy fixed assets and inventory, to fund accounts receivable, or for research and development? Each of these options requires different kinds of money. For example, a coffee shop owner seeking funds to purchase an espresso machine that will be useful for four to six years in producing revenue would likely seek a loan with a payback schedule of a similar time frame. In this way, the debt repayment is due in the same years that income will be generated with the machine.

Cost

Money is expensive, so consider the costs. Private investors such as angels, investment bankers, and venture capitalists typically want a 25 percent to 100 percent return per year for the use of their funds. One of the reasons for the continued popularity of bank financing is that it is an affordable source of money that can reach upwards of 1–5 percentage points over the prime interest rate.

Tip

Using short-term debt to finance long-term fixed assets is a common mistake. Short-term loans usually finance business operations. Long-term loans finance equipment and other major purchases.

Consequences

When obtaining funding from debt sources, you need to consider the consequences of not being able to repay the debt. If lenders go after the collateral, the worst consequence might be that you will have to close your business. Failure to provide your investors adequate returns could also mean you lose control of your business. The consequences depend upon the funding agreement and what you have offered as collateral. Consider the impact that outside funding can have on your control of the business before you choose a funding source.

Based on your current stage of business, complete Potential Funding Sources to identify funding sources whose funding goals are a match with your own.
### Potential Funding Sources

You should consider all the options of internal, external, and alternative funding sources. Look at the speed and cost of each as you identify potential sources.

I will seek funds from the following sources:

<table>
<thead>
<tr>
<th>Internal Sources</th>
<th>Alternative Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal savings and home equity loans</td>
<td>New owner/partner</td>
</tr>
<tr>
<td>Friends and family</td>
<td>Customers</td>
</tr>
<tr>
<td>Credit cards</td>
<td>Professional advisers, business acquaintances</td>
</tr>
<tr>
<td>Current earnings (profits)</td>
<td>Leasing companies</td>
</tr>
<tr>
<td></td>
<td>Factoring</td>
</tr>
<tr>
<td></td>
<td>Joint ventures / Strategic alliances</td>
</tr>
<tr>
<td></td>
<td>Sale of distribution rights</td>
</tr>
</tbody>
</table>

### External Sources

- Lines of credit
- Short-term notes payable
- Long-term notes payable
- SBA-backed loans
- Angel investors
- Venture capital investors
- Private placements
- Initial public offerings

### Preparing for Potential Funders

As you prepare to approach potential funders, look for people who want what you can offer. Issues to consider when approaching the bank, potential investors, and other stakeholders are discussed next.

#### Approaching the Bank

Successful banking relationships are built on the personal relationship you develop with your banker. Don’t rely on the phone book when choosing a potential loan officer. You should interview and evaluate his or her ability to help you at the same time he or she is sizing you up. Consider the following tips to help find the right bank and loan officer:

- Search for banks that target businesses like yours.
- Obtain referrals from entrepreneurs, accountants, lawyers, or consultants.
- Establish a business account where you do your personal banking.
- Look for full-service banks that participate in SBA lending programs.
- Find a lending officer that specializes in your type of business.
- Ask about the banking services you want for your business.

Go prepared into your interview with the banker. The loan officer will need to know certain things about you and your business to determine whether your business is a good fit with the bank’s lending policies. Be prepared to share the following with the banker:

- How much money you need and what the money will be used for
- How the money will be repaid
- When you need the money
- A written business plan with completed financial projections finalized in Action Step 9.2
- What the bank stands to gain by providing money to your business
- How the loan will be repaid if things don’t work out as planned
- Current, personal financial statements for any principals involved in the venture
- A list of collateral to be offered as security, including an estimate of the present market value of each item

### Tip

Even if you establish your company as a corporation, a bank may require you to personally guarantee the debt. If the company cannot repay the debt, you will be required to do so personally.
Approaching Investors
The two primary types of equity investors are angel investors and venture capitalists. Each individual investor has different funding goals and should be evaluated for its potential match with your business’s funding goals. Still, some generalities can help you prepare for these interviews.

Angel investors—Historically, angels have not publicized themselves as investors. Therefore, they can be difficult to find. They frequently attend events where entrepreneurs gather to informally nose around to see what might be of interest to them. You may also be able to find angels by contacting attorneys, accountants, entrepreneurship centers, and local economic development governmental agencies. In the past decade, however, investors have formed and joined over 200 new angel organizations in the United States. Angels join these organizations to find investing opportunities and to take advantage of efficient deal processing that organizations have adopted.

Venture capital investors—The best way to get your business plan noticed by a venture capitalist is through a referral from an attorney, board member, angel investor, entrepreneurship center, trade organizations, or other personal contact. The story of Scott Cook’s search for venture capital for Intuit® (the maker of QuickBooks®) is fairly typical. He contacted twenty venture capitalists and was turned down by all of them. Only after raising money from friends and family, writing his own ads, and receiving orders was he able to obtain funding.

Another opportunity for you to find interested venture capitalists is through venture capital events and competitions sponsored by your local entrepreneurial organizations. At these events, you can receive mentoring and pitch your company to hundreds of potential investors. For example, InvestMidwest is a program designed to annually showcase the best technology and high growth companies from throughout the Midwest. Companies that have presented at InvestMidwest over the last six years have successfully raised over $200 million dollars in equity investment. Springboard Venture Capital Forums provide women-led high growth enterprises with access to investment capital and a six-month training and coaching program involving investors, accountants, lawyers and business development professionals.

Finding Other Stakeholders
If you find the traditional funding sources of banks and investors do not meet your needs, look elsewhere. To find other creative sources of financing, look for people who could benefit from what your company offers. These stakeholders are ones most interested in seeing your company succeed. In other words, when you win, they win. Stakeholders might include suppliers, the landlord, and even customers. They may be able to help by providing favorable terms of payment; if they are in a position to provide financing, all the better.

When you get the opportunity to talk with potential investors, be straightforward about your Business Plan and financing needs. Be prepared to discuss these issues:

• Your plan to meet the growth expectations in a functional area of business that interests the potential investor.
• Your management team: key positions filled and plans for the future.
• Your role in the business, now and in the future.
• An appropriate exit strategy, with specifics of which public companies might be interested in acquiring your company in the future, and why.

Once you initiate a relationship but before you are funded, maintain open communication to keep investors updated about your progress and setbacks.
Summary
Equipped with the financial tools presented in this program, you are ready to begin mining your business for financial success. After completing this module, you will use the projected financial statements you have built throughout this program to analyze your business’s performance. With this information, you will make strategic decisions to maximize cash flow, future profitability, and the wealth of the company. After determining specific cash needs, you will investigate potential sources of cash and prepare to seek the necessary funds.

Key Things to Remember

• Reading the financial statements, evaluating key financial ratios, and making quick changes to operations can have a dramatic effect on profitability and financial performance.

• In addition to profits, a business must have a healthy cash flow to be successful.

• The majority of a business’s cash flow to support operations should come from internal sources, mainly profits.

• Future cash flow needs should be estimated to establish a plan for obtaining external cash to support operations and growth if needed.

Module 10 will help you add the final touches to your plan and prepare a venture presentation summarizing your vision and plans to achieve it. The focus is on your role as the entrepreneur in implementing your plan as you consider the specific actions to take, persons responsible, and deadlines for your key strategies.
### Activity 9a: Profitability Analysis

Practice analyzing the Income Statement and Balance Sheet for profitability and overall financial performance.

#### Directions

Use the financial information available for Clean Corp, a scenario introduced in Activity 4a, pp. 127–130, to analyze the company’s profitability, efficiency, and liquidity. Discuss the changes necessary to improve financial performance.

Based on your facilitator’s instructions, use the following financial information for your analysis:

- CLEAN CORP’s Historical Income Statement and Balance Sheet on p. 362
- CLEAN CORP’s Historical Ratios on p. 363
- Industry Ratios – NAICS 812331 and SIC 7213 Linen Supply on p. 363

**Step 1 Maximize profits.** Place a checkmark beside the profitability ratios assigned by the facilitator in the table below. Reviewing the ratio(s) assigned to you, answer the following questions:

- What does this information tell you about the profitability of Clean Corp?
- What recommendations would you make to maximize Clean Corp’s profits?

### Profitability Ratios

<table>
<thead>
<tr>
<th></th>
<th>Ratio Name</th>
<th>Equation</th>
<th>EXAMPLE</th>
<th>Clean Corp Calculation for 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Net Margin p. 336</td>
<td>( \frac{\text{Net Income}}{\text{Net Sales}} )</td>
<td>( \frac{5,526}{1,760,780} = .3% ) or in other words: $1 in sales results in $0.003 net income.</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Gross Margin p. 338</td>
<td>( \frac{\text{Gross Margin}}{\text{Net Sales}} )</td>
<td>( \frac{475,411}{1,760,780} = 27.0% ) or in other words: For every $1 in sales, plant costs, delivery and merchandise cost $.73.</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Return on Assets p. 340</td>
<td>( \frac{\text{Net Income}}{\text{Total Assets}} )</td>
<td>( \frac{5,526}{754,000} = 0.7% ) or in other words: Money invested in assets yielded a return of 0.7%.</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Return on Equity p. 345</td>
<td>( \frac{\text{Net Income}}{\text{Total Equity}} )</td>
<td>( \frac{5,526}{492,000} = 1.1% ) or in other words: Owners earned a 1.1% return on their equity investment.</td>
<td></td>
</tr>
</tbody>
</table>
Activity 9a: Profitability Analysis

Step 2 Improve efficiency. Place a checkmark beside the efficiency ratios assigned by the facilitator in the table below. Reviewing the ratio(s) assigned to you, answer the following questions:

- What does this information tell you about how efficiently Clean Corp operates?
- What recommendations would you make to improve Clean Corp’s efficiency?

<table>
<thead>
<tr>
<th>✓</th>
<th>Ratio Name</th>
<th>Equation</th>
<th>EXAMPLE</th>
<th>Clean Corp Calculation for 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.</td>
<td>Inventory turnover p. 341</td>
<td>Cost of Goods Sold / Inventory</td>
<td>1,285,369</td>
<td>= 9 times in 2009; approx. every 41 days</td>
</tr>
<tr>
<td>6.</td>
<td>Accounts Receivable Turnover p. 342</td>
<td>Yearly Credit Sales / Accounts Receivable</td>
<td>1,760,780</td>
<td>= 7 times in 2009; approx. every 52 days</td>
</tr>
</tbody>
</table>

Efficiency Ratios

Step 3 Review liquidity. Place a checkmark beside the liquidity ratios assigned by the facilitator in the table below. Reviewing the ratio(s) assigned to you, answer the following questions:

- What does this information tell you about how easily Clean Corp can pay their bills now and in the future?
- What recommendations would you make to improve Clean Corp’s ability to meet their obligations?

<table>
<thead>
<tr>
<th>✓</th>
<th>Ratio Name</th>
<th>Equation</th>
<th>EXAMPLE</th>
<th>Clean Corp Calculation for 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.</td>
<td>Current Ratio p. 343</td>
<td>Total Current Assets / Total Current Liabilities</td>
<td>488,500 / 135,000</td>
<td>= 3.6 or in other words, $3.60 is owned in current assets for every $1 owed in current debts.</td>
</tr>
<tr>
<td>8.</td>
<td>Quick Ratio p. 343</td>
<td>(Total Current Assets – Inventory) / Current Liabilities</td>
<td>343,500 / 135,000</td>
<td>= 2.5 or in other words, $2.50 is owned in cashable assets for every $1 owed in current debts.</td>
</tr>
<tr>
<td>9.</td>
<td>Debt to Asset p. 344</td>
<td>Total Liabilities / Total Assets</td>
<td>262,000 / 754,000</td>
<td>= 34.7% or in other words, For every $1 in assets, the company owes $0.35 in debts.</td>
</tr>
<tr>
<td>10.</td>
<td>Debt to Equity p. 344</td>
<td>Total Liabilities / Total Equity</td>
<td>262,000 / 492,000</td>
<td>= 53.3% or in other words, For every $1 of equity the owners have invested, the company owes $0.53 in debt.</td>
</tr>
</tbody>
</table>
### Activity 9a: Profitability Analysis

#### CLEAN CORP 2011 Year-End Historical Income Statement

<table>
<thead>
<tr>
<th>Description</th>
<th>2011</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales (Less Returns &amp; Allowances)</td>
<td>$1,760,780</td>
<td>100.0%</td>
</tr>
<tr>
<td>Cost of Goods Sold - Linen Disposal</td>
<td>1,285,369</td>
<td>73.0%</td>
</tr>
</tbody>
</table>

**Gross Margin** $475,411 27.0%

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bad Debt Expense</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>8,000</td>
<td>0.45%</td>
</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Insurance</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Licenses &amp; Fees</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Marketing &amp; Promotion</td>
<td>52,823</td>
<td>3.00%</td>
</tr>
<tr>
<td>Meals &amp; Entertainment</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Office Expense</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>1,761</td>
<td>0.10%</td>
</tr>
<tr>
<td>Outside Services</td>
<td>2,289</td>
<td>0.13%</td>
</tr>
</tbody>
</table>

**Payroll Expenses**

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries &amp; Wages</td>
<td>268,408</td>
<td>15.24%</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>34,893</td>
<td>1.98%</td>
</tr>
<tr>
<td>Benefits</td>
<td>34,893</td>
<td>1.98%</td>
</tr>
<tr>
<td>Professional Fees</td>
<td>7,043</td>
<td>0.40%</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Rent</td>
<td>26,000</td>
<td>1.48%</td>
</tr>
<tr>
<td>Repairs &amp; Maintenance</td>
<td>17,608</td>
<td>1.00%</td>
</tr>
<tr>
<td>Shipping &amp; Delivery</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Telephone</td>
<td>3,522</td>
<td>0.20%</td>
</tr>
<tr>
<td>Training &amp; Development</td>
<td>7,043</td>
<td>0.40%</td>
</tr>
<tr>
<td>Travel</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Utilities</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Vehicle</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**Total Operating Expenses** $464,282 26.37%

**Operating Income** $11,128 0.63%

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Expense</td>
<td>3,234</td>
<td>0.18%</td>
</tr>
<tr>
<td>Other Income (Interest, Royalties, etc.)</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**Income Before Taxes** $7,894 0.45%

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Taxes (If C corporation)</td>
<td>2,368</td>
<td>0.13%</td>
</tr>
</tbody>
</table>

**Net Income** $5,526 0.31%

---

#### CLEAN CORP 2011 Year-End Historical Balance Sheet

<table>
<thead>
<tr>
<th>Description</th>
<th>2011</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash &amp; Equivalents</td>
<td>$80,000</td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>236,000</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>145,000</td>
<td></td>
</tr>
<tr>
<td>Security Deposits</td>
<td>4,500</td>
<td></td>
</tr>
<tr>
<td>Other Current Assets</td>
<td>23,000</td>
<td></td>
</tr>
</tbody>
</table>

**Total Current Assets** 488,500

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant &amp; Equipment</td>
<td>1,109,000</td>
<td></td>
</tr>
<tr>
<td>Computer Equipment</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Equipment/Machinery</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Furniture &amp; Fixtures</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Vehicles</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Leasehold Improvements</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Building</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Less: Accumulated Depreciation</td>
<td>(843,500)</td>
<td></td>
</tr>
<tr>
<td>Other Non-Current Assets</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

**Total Non-Current Assets** 265,500

**Total Assets** $754,000

<table>
<thead>
<tr>
<th>Description</th>
<th>2011</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$70,000</td>
<td></td>
</tr>
<tr>
<td>Line of Credit</td>
<td>65,000</td>
<td></td>
</tr>
<tr>
<td>Other Current Liabilities</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

**Total Current Liabilities** 135,000

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Long-term Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td>127,000</td>
<td></td>
</tr>
<tr>
<td>Real Estate Loans</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Other Non-Current Liabilities</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

**Total Long-term Liabilities** 127,000

**Total Liabilities** 262,000

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owners Equity</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>482,000</td>
<td></td>
</tr>
<tr>
<td>Less: Owner’s &amp; Investor’s Draws</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

**Total Equity** 492,000

**Total Liabilities and Equity** $754,000
### Activity 9a: Profitability Analysis continued

#### CLEAN CORP

**Historical Ratios**

<table>
<thead>
<tr>
<th>Ratio Name</th>
<th>Industry Ratios</th>
<th>2011</th>
<th>2011</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Margin:</td>
<td>Net Income &amp; Net Sales</td>
<td>5,526</td>
<td>0.3%</td>
<td></td>
</tr>
<tr>
<td>Gross Margin:</td>
<td>Gross Margin &amp; Net Sales</td>
<td>475,411</td>
<td>27.0%</td>
<td></td>
</tr>
<tr>
<td>Return on Assets:</td>
<td>Net Income &amp; Total Assets</td>
<td>5,526</td>
<td>0.7%</td>
<td></td>
</tr>
<tr>
<td>Return on Equity:</td>
<td>Net Income &amp; Total Equity</td>
<td>5,526</td>
<td>1.1%</td>
<td></td>
</tr>
<tr>
<td>Inventory Turnover:</td>
<td>Cost of Goods Sold &amp; Inventory</td>
<td>1,285,369</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Accts. Rec. Turnover:</td>
<td>Credit Sales &amp; Accounts Receivable</td>
<td>1,760,780</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>Current Ratio:</td>
<td>Total Current Assets &amp; Total Current Liabilities</td>
<td>488,500</td>
<td>3.6</td>
<td></td>
</tr>
<tr>
<td>Quick Ratio:</td>
<td>Total Current Assets – Inventory &amp; Total Current Liabilities</td>
<td>343,500</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>Debt to Assets:</td>
<td>Total Liabilities &amp; Total Assets</td>
<td>262,000</td>
<td>34.7%</td>
<td></td>
</tr>
<tr>
<td>Debt to Equity:</td>
<td>Total Liabilities &amp; Total Equity</td>
<td>262,000</td>
<td>53.3%</td>
<td></td>
</tr>
</tbody>
</table>

#### Industry Ratios – NAICS 812331 and SIC 7213 Linen Supply

<table>
<thead>
<tr>
<th>Ratio Name</th>
<th>Industry Ratios</th>
<th>2011</th>
<th>2011</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Net Margin</td>
<td>1.4 – 2.7 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Gross Margin</td>
<td>38.4 – 47.4 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Return on assets (ROA)</td>
<td>1.7 – 3.3 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Return on Equity (ROE)</td>
<td>3.9 – 4.7 %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Inventory turnover</td>
<td>14 – 22 times</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Accounts Receivable Turnover</td>
<td>9 – 11 times</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Current Ratio</td>
<td>2.1 – 3.0</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

You will not always find the exact ratios you need from one industry report, as you see here. It may take a combination of sources. You may also need to calculate the ratios from average numbers found in some sources.
Activity 9b: Cash Flow Analysis

Practice analyzing the monthly Cash Flow Report, Income Statement, and Balance Sheet for cash flow needs, and discuss potential sources of cash.

Directions

Use the financial information available for Clean Corp, a scenario introduced in Activity 4a, pp. 127–130, to analyze the company’s cash flow needs. Discuss the changes necessary to improve cash flow and to provide the necessary cash from external sources.

Based on your facilitator’s instructions, use the following financial information for your analysis:

- CLEAN CORP’s Historical Income Statement and Balance Sheet on p. 362
- CLEAN CORP’s Historical Ratios on p. 363
- Industry Ratios – NAICS 812331 and SIC 7213 Linen Supply on p. 363

Step 1 Project cash needs. The following cash balances were budgeted by Clean Corp’s management in their first draft Cash Flow Report. Review the report and discuss answers to the following questions:

- In which month is cash first needed?
- How much cash is needed to support Clean Corp’s operations?

<table>
<thead>
<tr>
<th>CLEAN CORP</th>
<th>Projected Ending Cash Balance*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>JAN</td>
<td>$47,258</td>
</tr>
<tr>
<td>FEB</td>
<td>29,875</td>
</tr>
<tr>
<td>MAR</td>
<td>20,359</td>
</tr>
<tr>
<td>APR</td>
<td>4,507</td>
</tr>
<tr>
<td>MAY</td>
<td>4,014</td>
</tr>
<tr>
<td>JUN</td>
<td>16,429</td>
</tr>
<tr>
<td>JUL</td>
<td>23,802</td>
</tr>
<tr>
<td>AUG</td>
<td>40,076</td>
</tr>
<tr>
<td>SEP</td>
<td>(25,452)</td>
</tr>
<tr>
<td>OCT</td>
<td>(43,941)</td>
</tr>
<tr>
<td>NOV</td>
<td>(47,069)</td>
</tr>
<tr>
<td>DEC</td>
<td>(37,289)</td>
</tr>
</tbody>
</table>

Activity 9b: Cash Flow Analysis continued

Step 2 Maximize internal cash flow. Some of Clean Corp’s cash shortages could be reduced by maximizing the cash flow that is generated internally from the business’s operations. Review Clean Corp’s cash cycle report and discuss answers to the following questions:

• What does this information tell you about Clean Corp’s cash flow?

• What recommendations would you make to maximize Clean Corp’s internal cash flow?

<table>
<thead>
<tr>
<th>CLEAN CORP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Cycle Report</td>
</tr>
<tr>
<td>Ratio</td>
</tr>
<tr>
<td>+ Days Receivable</td>
</tr>
<tr>
<td>+ Days Inventory</td>
</tr>
<tr>
<td>− Days Payable</td>
</tr>
<tr>
<td>= Cash Cycle</td>
</tr>
</tbody>
</table>

Step 3 Find external cash sources. Based on the needs for cash identified in Step 1, discuss the potential sources of cash available to Clean Corp. Comparing advantages and disadvantages within the aspects of amount, use of funds, cost, and consequences, select potential sources of cash from the following list:

Internal Sources
- Personal savings and home equity loans
- Friends and family
- Credit cards
- Current earnings (profits)

External Sources
- Lines of credit
- Short-term notes payable
- Long-term notes payable
- SBA-backed loans
- Angel investors
- Venture capital investors
- Private placements
- Initial public offerings

Alternative Sources
- New owner/partner
- Customers
- Professional advisers, business acquaintances
- Leasing companies
- Factoring
- Joint ventures / Strategic alliances
- Sale of distribution rights

If you are not completely familiar with these funding sources, review Take A Closer Look @ Internal and External Cash Flow Sources on pp. 375–380.
Activity 9c: Funding Goals

Identify your business’s potential funding sources and develop a plan to request funding.

**Step 1 Funding Requirements.** Some entrepreneurs raise capital through investors who take an equity position in their businesses. Others borrow from a lender. Some do both.

**Identify specific funding need:**
Amount – What amount of money is required?

Use of funds – How will the funds be used?

Costs – What interest rate or return on investment is your business willing and able to pay?

Consequences – Which risks are you willing to assume—those associated with debt financing (loss of the business through liquidation) or those associated with equity financing (loss of control)?

**Step 2 Match with Funding Sources.** Based on your needs and preferences, as identified above, and your knowledge of the requirements and preferences of debt and equity funders, place a check mark in the appropriate column to indicate if your funding needs would most likely fall in the debt category, equity category, or could be both.

<table>
<thead>
<tr>
<th>Match of Business’s Funding Needs with Funding Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Criteria</strong></td>
</tr>
<tr>
<td>Amount – Funding sources have minimum and maximum amounts they wish to invest or loan to any one business. Banks may offer loans in lesser amounts while investors may be looking for larger amounts.</td>
</tr>
<tr>
<td>Use of funds – Different uses of funds require different kinds of money. For example, funds to purchase fixed assets typically come from debt sources. Funds for research typically come from equity sources.</td>
</tr>
<tr>
<td>Costs: Interest (debt) or Dividends (equity) – Bank interest rates range from 1–5 percentage points over prime. Equity investors look for much higher returns, possibly 25 to 100 percent per year for the use of their funds.</td>
</tr>
<tr>
<td>Consequences – Failure to repay the debt may result in the borrower losing the business. Failure to provide investors adequate returns may result in loss of control of the business.</td>
</tr>
</tbody>
</table>

**Step 3 Potential Type of Funding.** Based on responses to Steps 1 and 2, what category of financing is most likely to meet your needs?

Check one:  [ ] Debt  [ ] Equity
Activity 9c: Funding Goals continued

**Step 4 Potential Funding Contacts.** From the list below, checkmark the funding sources you plan to use. Then select two check marked categories from the list above and record specific names of institutions, individuals, or contacts within that category below.

<table>
<thead>
<tr>
<th>Internal and Personal Sources</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Debt</strong></td>
<td><strong>Equity</strong></td>
</tr>
<tr>
<td>❑ Friends and family</td>
<td>❑ Personal savings</td>
</tr>
<tr>
<td>❑ Credit cards</td>
<td>❑ Friends and family</td>
</tr>
<tr>
<td></td>
<td>❑ Current earnings (profits)</td>
</tr>
<tr>
<td></td>
<td>❑ Home equity loans</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>External Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Debt</strong></td>
</tr>
<tr>
<td>❑ Lines of credit</td>
</tr>
<tr>
<td>❑ Short-term notes payable</td>
</tr>
<tr>
<td>❑ Long-term notes payable</td>
</tr>
<tr>
<td>❑ SBA-backed loans</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other Sources: Debt and Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>❑ New owner/partner, customers, professional advisers, business acquaintances, leasing companies, factoring, joint ventures / strategic alliances, sale of distribution rights</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>List of Potential Funders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Record specific names of institutions, individuals, and contacts.</td>
</tr>
</tbody>
</table>

-
Activity 9c: Funding Goals continued

Step 5 Funding Plan. Develop a plan to approach the list of funders identified in Step 4. In what order will you approach funders and why?

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Action Step 9.1: Complete My Financial Projections

Evaluate the decisions you have made during this program and the resulting impact on profitability and cash flow.

Directions
Throughout this program you have created a budget that represents the financial impact of your business strategies. This action step reviews your business’s financial performance based on these strategies. Now you will review specific financial indicators that you have chosen to evaluate additional strategies for profitability and cash flow. You will also evaluate your business’s ability to maximize internal cash flow.

A. Review your key financial indicators for financial performance. Identify the key financial indicators, your own gold nuggets, which have the most impact on financial performance. Refer to Gold Nuggets on p. 346. Choose ratios that you will begin using immediately to maximize your company’s performance. Using the Financial Template, click the Print button for Print Ratio Analysis on the Print Options worksheet. Review your ratios and the information associated with those ratios in the module to identify changes necessary to make improvements. Make these changes part of your Financial Plan.

<table>
<thead>
<tr>
<th>Ratio Name</th>
<th>What It Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Net Margin p. 336</td>
<td>Profitability</td>
</tr>
<tr>
<td>2. Gross Margin p. 338</td>
<td>The profit a company enjoys on the goods it sells after direct costs are subtracted</td>
</tr>
<tr>
<td>3. Return on Assets (ROA) p. 340</td>
<td>Profits generated with existing assets</td>
</tr>
<tr>
<td>4. Return on Equity (ROE) p. 345</td>
<td>Whether or not the company is a good investment</td>
</tr>
<tr>
<td>5. Inventory Turnover p. 341</td>
<td>How well the company is placing orders for the right merchandise in the right quantities and at the right time</td>
</tr>
<tr>
<td>6. Accounts Receivable Turnover p. 342</td>
<td>The number of times that accounts receivable amount is collected throughout the year</td>
</tr>
<tr>
<td>7. Current Ratio p. 343</td>
<td>Whether the company has enough liquidity to pay its short-term obligations</td>
</tr>
<tr>
<td>8. Quick Ratio p. 343</td>
<td>Whether the company’s assets minus inventory will provide enough liquidity to cover its short-term obligations</td>
</tr>
<tr>
<td>9. Debt to Asset p. 344</td>
<td>The proportion of assets financed by creditors’ funds (debt)</td>
</tr>
<tr>
<td>10. Debt to Equity p. 344</td>
<td>How much the company relies on debt versus equity financing</td>
</tr>
</tbody>
</table>

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Action Step 9.1: Complete My Financial Projections

B. Consider cash flow needs. When you know how much cash you need and when you will need it, you are ready to evaluate potential internal and external sources of cash. Using the Financial Template, click the Print buttons for Year 1-3 Cash Flow Reports on the Print Options worksheet. Review your monthly ending cash balances to identify needed funds. To find your most likely sources of funding, review the list of potential funders on p. 357.

Complete the Capital Budget Worksheet to help you determine the exact amount of money needed and the Equity & Debt Worksheet to record the sources of money anticipated. Specific guidance concerning these worksheets is available in A Closer Look © Using the Financial Template on pp. 138–143.

- **Capital Budget Worksheet** provides different sections to guide you through the process of recording the cash you expect to spend for non-expense cash expenditures.

- **Equity & Debt Worksheet** records the cash you receive for items other than revenue, including equity or debt you will likely seek. Consider this your last review of the monthly cash flow to validate that you have sufficiently covered all cash needs. The template offers several options to consider if you still find yourself needing additional cash to support business operations.

C. Print your financial statements. Print the following financial statements to give them a final review. When using the Financial Template, use the Print Options Worksheet and click the Print button for Print Financial Projections.

- Cash Flow Report (for three years)
- Year-End Income Statement
- Year-End Balance Sheet
- Ratio Analysis
Action Step 9.2 Finalize My Financial Plan

Develop the Financial Plan section of your Business Plan.

Directions
This action step takes you through the process of formalizing your Financial Plan into a written document with accompanying projected financial statements.

A. Print out the financial statements. Use the Print Options Worksheet to print the following Financial Statements to include in your Business Plan:

- Monthly Income Statement
- Monthly Cash Flow Report
- Year-End Income Statement
- Year-End Balance Sheet
- Financial Analysis/Ratios

The worksheets you used to project the information are also a useful resource for your Business Plan. Use the Print Options Worksheet to print the following worksheets that apply. These worksheets should be included in the Appendix of your Business Plan.

- Historical Balance Sheet, if applicable
- Operating Expenses Worksheet
- Start-Up Funding & Expenditures from the Start-Up Company Set-Up Worksheet, if applicable
- Capital Budget Worksheet
- Equity & Debt Worksheet
- Sales Worksheet
- Amortization Schedule, if applicable

B. Complete the written portion of the Financial Plan. A narrative summary of your Financial Plan will appear in front of the financial statements. For this action step, describe your start-up costs (if applicable), sales and income projections, cash requirements, sources of financing, and exit strategy. The Business Plan Template asks these questions to help you focus on the highlights of your Financial Plan:

Business Plan Questions

Start-Up Costs (if applicable)
What are your estimated costs to start this business? Are these one-time costs (expenditures) or ongoing costs (expenses)?

Sales Projections
What are your sales projections for the next three years? Where did you get the information to project financials? Are the projections reasonable?

Income Projections
What are your net income projections for the next three years? What are your strategies to continually improve profitability?

Cash Requirements
How much cash will be required to cover start-up costs (if applicable), operations, and/or growth?

Sources of Financing
Based on cash requirements to start, maintain operations, and grow, will you seek debt or equity financing? How much is the cost of obtaining these funds?

Exit Strategy
What is your overall plan for growth? How will this plan enable you to obtain a wealthy harvest upon exit? What are your specific plans for going public, selling the business, merging the business, or other exit strategies?
A Closer Look @ Profits vs. Cash

If you’re producing a profit and showing a positive Net Income, are you also producing a positive cash flow? Not necessarily. In its most literal term, profits refer to the sum of revenues minus expenses. This amount cannot be put in your pocket, like cash, or deposited in the bank. Only cash has tangible value.

Reporting Profits vs. Cash—Although the Income Statement does report the profitability of the business, Net Income doesn’t always indicate positive cash flows. These discrepancies between what is shown on the Income Statement and what is actually flowing into and out of your business make it critical for you to understand all three financial statements—Income Statement, Balance Sheet, and the Cash Flow Report. See A Closer Look @ Financial Statements, pp. 144–152, for a discussion of these statements.

Keep in mind two primary questions when analyzing profits and cash flow:

1. What financial transactions are included in the Net Income Equation that do not affect cash flow?
2. What financial transactions are excluded from the Net Income Equation that do affect cash flow?

Let’s look at these two types of transactions.

Non-Cash Transactions That Affect Net Income

Two expense accounts in particular can reduce your Net Income during a reporting period but will not affect the cash balance of your business. These non-cash accounts are Depreciation and Amortization.

Depreciation—When an asset is purchased, the purchase price is recorded on the Balance Sheet. Throughout the useful life of the asset, a portion of the purchase price is reported on the Income Statement. This depreciation did not have any impact on the cash balance of the business after the original purchase, but it does affect the profits of your business.

One reason for depreciating assets is to more properly record the decreasing value of an asset over its useful life. When Betty Cannon of Betty’s Trucking, Inc., in DeSoto, Kansas, purchases a new tractor and trailer for her over-the-road hauling company, she records the purchase cost of these assets on her Balance Sheet. As time passes and she uses these assets, the cost of using the tractor and trailer is reported during their useful life. Each year they lose value as an asset, so their value decreases on the Balance Sheet. The amount of value lost on the Balance Sheet each year appears on the Income Statement as an expense. Then, when the assets’ useful life is over, they will be fully depreciated and have a remaining value of $0.

Another important reason for reporting depreciation is called the matching principle. The matching principle says that the expenses involved in generating revenue must match (or be recorded in) the same time period in which that revenue is realized.

Several different depreciation methods can be used to record the costs of fixed assets, but for planning purposes, straight-line depreciation is most common. This method is easy to calculate, and the value of the asset is evenly distributed over its useful life. In straight-line depreciation, you estimate the useful life for each asset.
A Closer Look @ Profits vs. Cash  continued

The Financial Template uses the following life expectancies:

<table>
<thead>
<tr>
<th>Equipment Types</th>
<th>Estimated Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer Equipment</td>
<td>3</td>
</tr>
<tr>
<td>Equipment/Machinery</td>
<td>7</td>
</tr>
<tr>
<td>Furniture &amp; Fixtures</td>
<td>7</td>
</tr>
<tr>
<td>Building</td>
<td>20</td>
</tr>
<tr>
<td>Vehicles</td>
<td>5</td>
</tr>
<tr>
<td>Leasehold Improvements</td>
<td>5</td>
</tr>
</tbody>
</table>

Amortization—Amortization is similar to depreciation, except that it records the expense of intangible assets. These assets generally have no physical existence, but can have significant value to their owners. Examples of intangible assets are goodwill, patents, trademarks, and copyrights. Amortization is treated like depreciation. It is a non-cash expense to the business.

Cash Transactions That Do Not Affect Net Income
The Income Statement excludes several transactions that may affect your cash flow but do not affect profits. These transactions include cash received from lenders or investors and cash paid out for principal payments of debt, purchases of equipment, and payments to owners. All of these transactions can have a significant effect on the cash flow of your business and will be included in the Cash Flow Report but not on the Income Statement.

Comparison of Income Statement to Cash Flow Report
It is important to understand how profits as reported on the Income Statement compare with cash as reported on the Cash Flow Report.

Consider the differences reported on the first month's Income Statement and Cash Flow Report on p. 374 for a consulting firm with three employees and five clients. This business writes checks to purchase office supplies and pay payroll every two weeks.

On January 31, the consulting firm will prepare and mail invoices to its clients for $39,000 total revenue. This amount is posted on the Income Statement because the money is expected to be received. The $39,000 has not been collected yet, and will not show up on the Cash Flow Report until it is.

Because of this delay in collecting the fees, the owners contributed $36,000, which provided enough cash to get them through the first month. They will still need money to get them through the second month as Net/30 terms were given to clients, which means that their customers do not have to pay for the services for thirty days. As a result, the payment for these invoices may not be received until early March.

The only payment that the company has not made immediately is for outside services from their financial and computer support consultants. They were given payment terms by the vendor, so you won’t see the $1,850 for these services on the Cash Flow Report until February.
## Consulting Company Example

### Income Statement

<table>
<thead>
<tr>
<th>JAN</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Sales (less returns &amp; allowances)</strong></td>
<td>$39,000</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>-</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td><strong>39,000</strong></td>
</tr>
</tbody>
</table>

**Operating Expenses**
- Advertising: 750
- Bad Debt Expense: -
- Bank Charges: -
- Depreciation & Amortization: 1,450
- Dues & Subscriptions: -
- Insurance: 1,000
- Licenses & Fees: -
- Marketing & Promotion: 1,400
- Meals & Entertainment: -
- Miscellaneous: -
- Office Expense: -
- Office Supplies: 3,400
- Outside Services: 1,850
- Payroll Expenses
  - Salaries & Wages: 17,500
  - Payroll Taxes: 3,750
  - Benefits: 1,250
- Professional Fees: -
- Property Taxes: -
- Rent: 6,000
- Repairs & Maintenance: -
- Shipping & Delivery: -
- Telephone: 450
- Training & Development: -
- Travel: -
- Utilities: -
- Vehicle: -
- Other: -
- Other: -
- Other: -

**Total Operating Expenses**: **38,800**

**Operating Income**: **200**

**Interest Expense**: -

**Other Income (for example, interest)**: -

**Income Before Taxes**: **200**

**Income Taxes (if C Corp)**: -

**Net Income**: **$ 200**

## Consulting Company Example

### Cash Flow Report

<table>
<thead>
<tr>
<th>JAN</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash In</strong></td>
<td></td>
</tr>
<tr>
<td>Cash Sale</td>
<td>$ -</td>
</tr>
<tr>
<td>Collections from Accounts Receivable</td>
<td>-</td>
</tr>
<tr>
<td>Equity Received</td>
<td>36,000</td>
</tr>
<tr>
<td>Loans Received</td>
<td>-</td>
</tr>
<tr>
<td>Other Cash In (receipts from other assets)</td>
<td>-</td>
</tr>
<tr>
<td>Other Cash In (for example, interest, royalties)</td>
<td>-</td>
</tr>
</tbody>
</table>

**Total Cash In**: **36,000**

**Total Cash Available**: **36,000**

**Cash Out**
- Inventory Expenditures
- Inventory/Raw Material (Cash): -
- Inventory/Raw Material (Pd on Account): -
- Production Expenses
- Advertising: 750
- Bank Charges: -
- Dues & Subscriptions: -
- Insurance: 1,000
- Licenses & Fees: -
- Marketing & Promotion: 1,400
- Meals & Entertainment: -
- Miscellaneous: -
- Office Expense: -
- Office Supplies: 3,400
- Outside Services: -
- Payroll Expenses
  - Salaries & Wages: 17,500
  - Payroll Taxes: 3,750
  - Benefits: 1,250
- Professional Fees: -
- Property Taxes: -
- Rent: 6,000
- Repairs & Maintenance: -
- Shipping & Delivery: -
- Telephone: 450
- Training & Development: -
- Travel: -
- Utilities: -
- Vehicle: -
- Other: -
- Other: -
- Other: -
- Paid on Account: -
- Non-Operating Costs
- Capital Purchases: -
- Estimated Income Tax Payments: -
- Interest Payments: -
- Loan Principal Payments: -
- Owner’s Draw: -
- Other Cash Out: -

**Total Cash Out**: **35,500**

**Monthly Cash Flow (Cash In - Cash Out)**: **500**

**Beginning Cash Balance**: -

**Ending Cash Balance**: **$ 500**
A Closer Look @ Internal and External Cash Flow Sources

Internal Sources
Internal sources of funding have the advantage of being less expensive and taking less time to secure. The disadvantages of using internal sources of funding may include not having a close relationship with an outside lending source when one is needed, not accumulating a credit history, and inconsistency in the available cash because of fluctuations in the company’s cash flow situation.

Personal Savings and Home Equity Loans
Using personal savings or borrowing money from the equity you have built in your home are by far the most inexpensive ways to obtain funding for your business. By using your own funds you will also maintain total control of your business. You will want to take into consideration a few issues, however, before pulling these funds into your business. First, how will using your savings or home equity impact your personal financial security? What impact could losing this money have on your future? You will also want to consider that as you develop a relationship with a bank or lending company and repay the loan, your business is creating a much-needed credit record.

Friends and Family
Money borrowed from relatives and friends is another relatively easy source of funding. Although this source of funding may be external to the business and its owners, it is considered an internal source because it is obtained solely through close, personal relationships. Generally these sources will not require completed applications or certain credit scores. The strings attached to these loans or equity investments, however, may be rather tangled. Before receiving these funds, be sure to fully understand all requirements and expectations of the funders. Take into consideration the potential fallout (loss of friendships or uneasy family relations) if something goes wrong and you can’t pay the loan back on time or the business doesn’t make it. You should establish a clear understanding of the risk associated with the investment, as well as repayment expectations for loans that include interest rates, term life insurance to pay your debt in case something happens to you, and contingencies for not being able to repay the loan. CircleLending now Virgin Money USA, virginmoneyus.com, provides a service to formalize those handshake loans between family and friends.

Credit Cards
Many entrepreneurs use credit cards as a means to provide cash to a business. One reason is that they can get money quickly with little, if any, application process. You should only use credit card debt for a specific purpose with a plan to approach more traditional, less expensive funding options in the future.

As with any other debt, credit card debt must be repaid. This payment process can often be difficult given the combination of a business’s tight cash flow and the credit card company’s excessive interest rates. Because credit card debt is unsecured, it is a personal debt. Using credit cards can risk your personal assets.

Here are some tips to using credit card debt safely:

- Treat the debt as a regular loan with a set payback period and affordable monthly payments. In other words, never borrow more than you can pay back.
- Look for low, fixed interest rates. Moving your balance from card to card, for a time, can help you keep these low rates.
- Take advantage of the incentives of the credit card such as cash-back bonuses for purchases you might normally write a check for. To avoid taking on too much debt, never charge more than you have established in your monthly budget.
- Make sure that any cash-advance checks are made out to your company and make a copy for your records. This way you’ll have proof that the cash advances were used to expand your company and not used for personal expenditures.
A Closer Look @ Internal and External Cash Flow Sources continued

Current Earnings (Profits)
Businesses are expected to generate cash flow from current earnings. At the completion of the cash cycle, your business should have cash left over after all expenses have been paid. This internal cash flow is an integral part of every business because unless a business is profitable, it is paying out more in expenses than it is receiving in sales. Profitable businesses generate enough cash to pay back loans, finance growth, or pay dividends to the owners.

External Sources
When external sources of cash flow are from debt, the amounts received must be repaid according to a specific set of terms and conditions. The money to pay back these loans generally comes from sales. So, in effect, you are taking an advance against future earnings to grow the business. Other cash flow sources, such as equity investments, may not have a specific payback schedule, but these will typically cost you quite a bit more in the long run.

Traditional Funding Sources
Evaluate traditional funding sources as they may provide you with the best option to cover your cash flow needs. These include bank loans, angel investors, venture capital investors, private placements, and initial public offerings.

Bank Loans
Banks are a traditional source of funding to small business owners. Their principal role has been as a lender offering short- and long-term loans and lines of credit. The SBA-guaranteed lending program encourages banks and non-bank lenders to make long-term loans to small businesses by sharing in the lenders’ risk. This practice allows lenders to make loans that they usually wouldn’t make.

Bank financing is attractive to business owners because they maintain control at a reasonably low cost. Payback timing and other terms are usually not flexible; however, you can sometimes negotiate them. Finding a lender with expertise in your industry will help ensure that you receive the right type of financing at the right time. Banks generally offer lines of credit, short- and long-term loans, and some offer SBA-backed loans.

be loan savvy

“Make sure you get the right type of loan for your business,” says Judith Griggs of Preferred Machine Tools in Fort Worth, Texas. Although thrilled to obtain a $250,000 SBA loan, Griggs later discovered that the fixed-term, seven-year note didn’t really suit her needs. “Because my business is buying and selling equipment, I need to replenish inventory often, and I would have been better off getting a larger credit line,” she explains.

“Be careful how many banks you approach for a loan,” adds Griggs. If too many banks pull your credit records and no action is taken, it can depress your credit scores.

Lines of Credit—When a line of credit is awarded to your business, you can draw upon the funds, to a maximum level, whenever you need them. This type of funding is appropriate to cover seasonal fluctuations in sales or regular cash shortages. You determine the amount and terms of the line of credit in advance based on the needs of your business and the policies of the lending institution.

In most cases, you will pay lines of credit within a year. The bank may impose other policies such as not using the line of credit for two months after you pay the balance. The rate on a line of credit will vary based on the institution and your business. In general, the rate is often 1–2 percentage points over prime for established companies and slightly higher for new businesses.
A Closer Look @ Internal and External Cash Flow Sources continued

**Short-Term Loans**—A short-term note is your written promise to pay a stated sum on or by a specific date, usually in one year or less. Depending upon the deal you negotiate, these loans are either secured (collateralized) or unsecured (signature loan). For a secured loan, you pledge collateral to offset the loss to the lender should you default on the loan. If you fail to meet the terms of a secured note, the lender asks the court to take possession of whatever asset you pledged as collateral and sell it. The proceeds of the sale are then applied to the amount due on the note. The loss of collateral will not release you from all liability on the debt if the collateral sale proceeds are not enough to pay off the loan.

**Long-Term Loans**—Depending on the purpose of the loan, a long-term loan will have a payback period between two and fifteen years. For loans obtained to purchase equipment and vehicles, the payback period will vary between two and seven years. If the loan is used to purchase real estate, the payback will be significantly longer. Be aware of any balloon payment provisions within your loan agreement and the impact that they can have on your cash flow. If included, these provisions will stipulate that the loan be paid off prior to the end of the loan period. For example, a twenty-five year note for the purchase of a building could have balloon provision in year five. So although the amount of each monthly payment is based on a twenty-five-year amortization schedule, which keeps the payments lower, the loan must be refinanced at the end of five years. By allowing the bank the ability to re-assess the business’s financial condition and adjust the interest rate accordingly, this process reduces the amount of risk the bank incurs during the loan period.

You will find that the interest rates, loan origination fees, and terms on long-term loans vary greatly based on the lending institution’s policies and your business’s age and financial status. Although the amount or type of collateral may be negotiable, these loans are never unsecured.

**SBA-Backed Loans**—The Small Business Administration is not a lender, so it does not provide direct loans to businesses. Instead it has several programs that may help you secure loans from lenders with reasonable terms. The primary programs are the 7(A) and 504 Loan Guaranty Programs. Through these programs you can receive small business loans through participating lending institutions, which are then guaranteed by the SBA. There are exceptions to the SBA working only through lending institutions. For example the SBA offers direct loans to businesses to recover from government declared disasters such as a hurricane.

Lending institutions approved to participate in SBA loan programs can help provide information and assistance throughout the SBA loan application process. The main advantages of this program go to the bank. Think of the SBA as a sort of underwriter for the loan. They have a guarantee from the SBA that if the loan recipient is unable to repay the loan, the SBA will repay a portion of the debt to the bank. The lender incurs very little risk. The main advantage for you is that you may be able to get a loan through this program when you couldn’t get a loan traditionally.

All commercial lenders, as well as the SBA, evaluate loan applications by reviewing the following elements:

- **Cash flow of the business**—In today’s lending environment, most lenders are primarily cash flow lenders, which means that your business has to show that your business can repay the loan.

- **Character of the management team**—From a banker’s perspective, the character of the management team reflects your willingness to pay. A record of non-payment or a prior personal bankruptcy, for example, might cause a banker to view a borrower’s character as too risky.
A Closer Look  @  Internal and External Cash Flow Sources  continued

• **Collateral available**—By putting up collateral, you show that you are committed to the success of your business. Bankers really don’t want to seize your collateral because they have no desire to be secondhand equipment dealers or sell out your stocks and bonds. But they like to have some recourse just in case your business fails.

• **Owner’s equity contribution**—You have to have at least as much at risk as the bank or other investors. This doesn’t mean that your borrowing capacity is limited to what you can put in personally, but it does mean that you have to have some of your own cash in the deal (plus, in some cases, the cash investment from other investors).

• **Condition**—If your area’s economy is struggling, the risk of your deal will be magnified. Economic factors may be beyond your control but, once again, will affect your banker’s decision. A banker may be doing you a favor by not accepting your growth strategy today because of conditions in the economy. Tomorrow, when conditions have changed, a loan may be more appropriate.

• **Credit**—Your credit history is a key piece of the puzzle for your banker. How have you handled credit in the past? If you have paid your debts more or less on time, you don’t have a history of bankruptcy or creditor lawsuits, and you have proven that you can use credit effectively, your banker’s concerns will be somewhat eased.

### Tip
A good credit record seldom causes the banker to make a loan, but a bad record will cause the banker to deny credit.

**Angel Investors**
Private investors, called angels, are typically high net worth business owners and entrepreneurs who have successfully exited their businesses and seek to invest both time and money in other ventures, often in the early stages. Funding early stage companies is high risk (with 10 to 15 percent of invested companies providing most of the return on investment to angels); consequently, these investors seek high-growth opportunities to invest both their cash and their time. Typically, they seek companies with the potential to grow between 10 to 30 times their value in five years.

Angels typically invest in rounds of $250,000 to $1 million with several angels investing $25,000 to $100,000 each. Frequently angels are drawn to ventures because they have an interest in that particular industry or in the entrepreneur.

**Venture Capital Investors**
Venture capital investors seek later stage companies with phenomenal growth potential —those who need several million dollars to achieve success. Like all equity investment, venture capital money is an expensive funding option, requiring the selling of equity in the business in return for the investment of capital. For a high-technology company with a very aggressive growth strategy and an expectation of extraordinary growth, venture capital may be appropriate. Very few companies, however, (fewer than 2,000 in the United States) are successful in attracting first-time venture investment each year.

Venture capitalists are full-time, professional investors of risk capital. They invest funds solicited from state and corporate pension dollars, trusts and endowments, corporate resources, and wealthy families. A good venture capitalist becomes a part of the venture building team, with the CEO and other executives. Venture capitalists have a responsibility to their own investors to maximize the return on investment. Because of these expectations, venture capitalists will want to cash out of the business in five to seven years for a return of at least five times their investment and often much more, through the sale or merger of the company or, more rarely, through an Initial Public Offering (IPO).
A Closer Look @ Internal and External Cash Flow Sources continued

When thinking about contacting venture capital firms, entrepreneurs should consider the following characteristics:

• **Size of market**—Venture capitalists are looking for high-growth potential, which usually translates into a $1 billion market, and a new company that can capture at least $100 million in revenue over five years.

• **Types of investments**—Venture capitalists are looking for new markets, new technologies, or radically different ways to do old things. For the most part, today’s venture capital investments are predominantly in technology and life sciences.

• **Minimum investments**—The average round of venture capital investment is $7–$8 million, but a few venture capitalists will invest as little as $500,000 in highly promising companies with an overall need for $3–$5 million in financing.

• **Management team**—Venture capitalists look for a management team with experience in the market in which they operate. They also value prior experience in start-up companies. You should be able to clearly show how key positions—chief executive officer, chief operating officer, chief financial officer, vice president of sales, and chief technology officer—will be handled in your venture.

• **Venture capitalist’s participation**—Most venture capitalists play active roles in the firms in which they invest. In a very real sense, when you take equity capital, your investor becomes a partner in the operations of your business. They usually place representatives on the board of directors and will take steps to ensure the CEO has the experience necessary to grow your company as planned.

**Private Placements**
A private placement is the sale of securities not involving a public offering. This type of financing may take the form of debt, equity, or a combination of the two. Private placements are exempt from scrutiny by the Securities and Exchange Commission (SEC) so long as companies meet certain guidelines.

Preparing a private placement memorandum may cost anywhere from $3,000 to $20,000 or more, depending on the complexity of the venture. Wealthy passive investors often are attracted to fund private companies.

You can make a private placement directly, but more commonly investment bankers, broker/dealers, and financial consultants handle these matters much as they would handle other types of financing. Consult a knowledgeable investment lawyer or accountant before attempting a private placement offer.

Paying for the preparation of a private placement memorandum does not guarantee your company is fundable or that any investor may be interested in funding the company. Carefully study possible sources of capital prior to paying for the preparation of a private placement memorandum.

**Initial Public Offerings**
An initial public offering (IPO), also referred to as going public, results from a privately held company electing to sell a portion of its common shares of stock through public markets. Going public is very expensive and also involves significant regulations and restrictions. While a very unlikely option for successful start-up ventures (fewer than 200 companies go public annually in the United States), public markets are excellent sources of large amounts of money to fund an existing company’s growth. IPOs can provide an opportunity for early angels and venture capitalists to eventually liquidate their investment as their shares later become eligible for public trading. While IPOs are often described as an exit strategy, they are primarily opportunities for promising companies to raise significant amounts of capital to fuel the continued growth of the business.
A Closer Look @ Internal and External Cash Flow Sources continued

Alternative Funding Sources
Traditional internal and external funding sources may or may not provide you with the best option for cash flow. After evaluating each potential funder, you might want to consider alternative cash flow sources.

New owners/partners—One way to obtain new funding for a company is to bring in a new owner. Along with a cash contribution, this new owner may be able to provide a new skill set and fresh ideas to the business. Consider that equity owners, to some degree, will become part of your management team and will have direct input into decision-making. Be prepared to discuss your expectations before entering any agreements.

Customers—In some instances customers want products or services so badly they will either put a deposit down with their orders or supply the money an entrepreneur needs prior to getting the job done.

Professional advisers, business acquaintances—Lawyers, CPAs, other business professionals, and business acquaintances have been known to invest in an enterprise if the prospects look bright enough. Sometimes business acquaintances have other contacts who may make additional resources available that can nurture your new firm.

Leasing companies—Leasing is becoming a more popular financing strategy. Equipment/asset leasing, including the sale and subsequent lease back of an asset, can be a major source of capital.

One of the benefits you might identify in your evaluation is that leasing can free you from purchasing equipment that will be obsolete with changing technology. For example, a computer expected to have a 20 percent residual value in three years could be worthless in one year. The lessor accepts this risk. Many lessors provide takeouts, rollovers, or upgrades for technological changes so that your business can maintain state-of-the-art equipment. Generally, lease payments cost less than loan payments on equipment. However, to fully understand the long-term ramifications of a lease, be sure that a thorough evaluation of the lease arrangement is performed. Your evaluation needs to include an analysis of the tax, financial, and cash flow impact that the lease will have on your business.

Factoring—Factoring is a way to short-term finance by selling accounts receivable to a commercial financing company called a factor. Factoring applies to companies with Accounts Receivable. Therefore, it is usually an appropriate, albeit expensive, way to finance the early and mature operating stages.

Factoring does not use your Accounts Receivable as collateral. Instead, Accounts Receivable are sold directly at a discounted value to a factoring company. Factors do all of the collection work, which includes mailing the invoices and doing the bookkeeping, usually at a considerable cost.

Joint ventures / Strategic alliances—Sometimes other firms with an interest in your business will form a strategic partnership to help you accomplish tasks. For example, if you were working on a new toxic waste disposal system, you may find a waste management firm to finance your work. The strategic alliance would probably involve a specific agreement that provides benefits to everyone involved. For example, you would receive the resources of the larger firm, and it would receive exclusive licensing rights to the resulting technology. In other cases, you can use a joint-venture arrangement to help finance your operations. Two or more firms can share the same assets such as the plant, offices, and people, thus lowering their capital needs.

Sale of distribution rights—Often people will pay money for distribution rights to a product. Naturally, to get a lot of money from a distributor, you must be prepared to give a lot in return. The distributor may ask for the rights to a large area, such as everything east of the Mississippi. Before selling such rights, you should require performance guarantees.
Throughout this FastTrac® GrowthVenture™ program, you have focused on your vision and the goals necessary to achieve this vision. Your Business Plan includes strategies for each functional area of your business—management, products and services, marketing, operations, and financial. It is now time to work on the steps to make it happen.

This module helps you review the strategies you have developed for your business’s success, identifying priorities for immediate action. You will identify specific actions to take, persons responsible, and task deadlines for your key strategies. You will also focus on your ongoing role as the entrepreneur who makes it happen by considering the specific resources and support you will need. Adding the final touches to your plan and preparing a venture presentation summarizing your vision and plans to achieve it are your final preparation before getting to work on implementing the plan—the reason you began this effort in the first place. Since Making It Happen is the last module of the program, your Business Plan and venture presentation action steps should be completed prior to attending the final session.

Key Questions

- How do I get started implementing my Business Plan?
- How will I know if implementation is on track?
- What should I do first to make my plan a reality?

<table>
<thead>
<tr>
<th>Action Steps</th>
<th>Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.1 Finish and Assemble My Plan</td>
<td></td>
</tr>
<tr>
<td>10.2 Evaluate My Business Plan for Completeness</td>
<td></td>
</tr>
<tr>
<td>10.3 Prepare a Venture Presentation</td>
<td></td>
</tr>
</tbody>
</table>
Completing Your Plan

Have you ever imagined being stranded on an island? Your first thoughts would probably be of mere survival. Like the movie Cast Away’s main character, Chuck Noland, you might spend your time looking for food and securing shelter until your rescue. But did you ever think what you might do beyond the actions necessary to survive? Consider the tale of The Swiss Family Robinson. This family, also deserted on an uninhabited island, worked to build their own paradise and rejected rescue when it finally arrived. What’s the difference? Why did Noland spend years on an island merely surviving while the Robinsons were thriving?

In the same way, some entrepreneurs fail, some survive, and others thrive in business. What is the secret to thriving? How can you lead your business to success, fully achieving your vision? This module will reinforce the following factors that will help you survive and thrive.

- **Work on your business.** Many surviving entrepreneurs spend the majority of their time working in their business—meeting customers’ demands and fighting fires. To thrive, you must work on your business, assessing, planning, and aligning every aspect—every departmental goal, every job description, every daily task—with your strategies for growth.

- **Don’t do it alone.** Business owners learn sooner or later that they can’t thrive in business being a one-man band. Build and rely on your management team to help shoulder the load. You should also consider consultants, contractors, advisers, mentors, and other resources to get the additional expertise you need to thrive.

- **Make it happen now.** You’ve thought about it, planned it, and written it. Just like Nike’s® motto, it’s time to Just Do It®. It’s time to make your plan happen. General George Patton, one of the most successful U.S. field commanders of all time, declared, “A good plan vigorously executed right now is far better than a perfect plan executed next week.” For entrepreneurs, this means it’s time put your plan into practice.

You should feel a great sense of accomplishment for your achievements to this point in the program. You’re almost done, and at the same time, you’re just getting started. The first three steps included in this module will guide you through the process of completing your plan:

- Documenting Your Plan
- Presenting Your Plan
- Implementing Your Plan

You will also assess ways to thrive in your entrepreneurial role, working on your business to identify specific tasks you will take, the support and resources needed, and opportunities to give back.

Tip

If your plans sit untouched and unused, the work you have done throughout this program will do you no good.
making growth happen

To successfully implement a growth plan, everyone must work together to achieve the company vision. Appropriately, the key to ClearBlue’s growth—according to Todd P. Smith, CEO of the Detroit- and Chicago-based communications firm—“is holding steadfast to our core values of intelligence, innovation, integrity, and fun while growing the organization with the best people in the business.”

Gut Instinct: When we started, six people asked themselves: “What would it be like if we could put together only the best people in the business and set out to do business differently?” With that motivation, says Smith, “we followed our gut instinct, which told us that we could differentiate ourselves from other communications companies by building our team one great person at a time.” It worked. Five years later ClearBlue employed over 40 team members.

Doing What You Do Well: A key strength for ClearBlue is its ability to drive measurable results by capturing an audience’s imagination—for example, showing a Jeep Grand Cherokee driving up the side of a 30-story building to demonstrate its go-anywhere prowess. “It was how our audiences reacted that made it successful,” Smith says. “They became engaged and captivated by how we communicated key messages right in front of their eyes, in ways they couldn’t imagine were possible.”

Focusing on the Whole Business: The company’s moment of truth came when a large project turned out to be a losing proposition. A large project turned out to be a losing proposition. Management realized that not all facets of the business were receiving the same amount of attention. “Breakthrough creative and flawless production made us successful with our clients,” says Smith, “but we also needed to focus our efforts on the process and financial facets of the business to ensure our long-term success.” After this experience, the company raised growth capital and empowered the entire team to embrace operations and financial aspects as part of their overall success equation.

Giving Back: The story doesn’t stop there for ClearBlue. Smith says philanthropic efforts and community involvement are cornerstones of its team’s foundation. For example, two of ClearBlue’s founders have served on the board of directors of the Boys and Girls Clubs of Southeast Michigan, and its team has adopted this organization by devoting both time and energy. So what keeps Todd Smith and his team striving toward their vision? It’s passion! “Basically, we’re passionate about putting the ! in everything we do. The exclamation point is an important part of our mission; it’s a symbol that lives in our hearts and in the heart of our company name.”

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Documenting Your Plan

Like Todd Smith, you have great ideas and the passion necessary to put these ideas into practice. Your documented plan will guide you as you move forward. A plan that is only in your head can create problems. The writing process is a thinking process. If you skip this step, you will skip a thinking step that helps ensure that all the parts of your business fit together. Having a document to review will also be critical as you implement your goals and strategies.

Just like the businesses they represent, business plans come in all shapes and sizes. Each plan is written for a specific, unique reason. Therefore, no standard business plan format exists. The format of your final Business Plan will be influenced by the intended use of the plan. Throughout this program, you have been working on your Business Plan—either a formal Business Plan or an internal working business plan. At this point, it is time to finalize your plan.

Your Business Plan will include the sections listed in Business Plan Components on the next page. Finalize your plan by gathering the sections listed for the plan you will complete—Formal Plan or Internal Plan. Complete necessary sections and review the information for accuracy.

Tip

Your Business Plan is a great tool to improve your business performance. Make sure you are using your own plan to its fullest potential by reviewing the many uses of a Business Plan on p. 3 in the Introduction of this book.
Business Plan Components

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<th>Internal Plan</th>
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<th>Refer to:</th>
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The Formal Business Plan

Your formal Business Plan is a reflection of your professionalism. While readers evaluate the business and growth plan you present to them in the final document, they will also be evaluating you and your management team based on how well your plan is put together. They will assess the Business Plan on how easy it is to:

• Determine the strengths of the business model.
• Understand the business’s overall goals and objectives.
• Identify what is to be done, when it will be done, who will do it, and the financial implications.
• Read the plan and find specific information quickly.

You have probably written many drafts throughout the program. With your research complete and the main content written, you are ready to add the final touches to your plan—the Cover Page, Executive Summary, Table of Contents, and Appendix. Action Step 10.1 Finish and Assemble My Plan and Action Step 10.2 Evaluate My Plan for Completeness will lead you through the process of finalizing your Business Plan.

The Internal Working Business Plan

The business plan is a communication tool. As you grow your business, your business plan will help you and your team explain your ideas to those working with you. The format for your plan will largely depend upon the way you are going to use it. For example, one entrepreneur may be using her business plan to communicate the vision and business strategy developed throughout this program. Her business plan would include specific strategies and key measurements for each area of the business to be communicated throughout the company. Another entrepreneur may be using his plan to implement a specific growth strategy. He would use his plan to document the specific tasks, persons responsible, and deadlines necessary to achieve the specified growth. Even though each plan would have the same basic components, each would include detailed planning aspects that are most critical to their own successful implementation.

Action Step 10.1 Finish and Assemble My Plan and Action Step 10.2 Evaluate My Plan for Completeness will lead you through the process of finalizing your Business Plan.
sharing progress increases employee effort

All employees at K-Technologies know the status of the business plan. Entrepreneur Jeff Kryszak shares progress in monthly employee meetings, and department managers give updates in weekly production meetings.

“If employees know how they impact the plan, they’re going to make a greater effort, which is a win-win for us all,” Kryszak stresses.

Productivity has increased sharply for K-Technologies. “We’ve had a lot of revenue growth but haven’t added many employees,” Kryszak says. “That’s true not just on the manufacturing floor but in every aspect of our business.”

Execution is crucial, warns Kryszak. “Don’t go through all the motions of creating a plan only to let it sit on your desk.” A plan is especially important in tough times, he adds, “It helps you know where you’re going and enables you to plot growth—even in an adverse economy.”

Presenting Your Plan

According to The Book of Lists, the fear of speaking before a group is the number-one anxiety people face. The fear of dying is number six. Even experienced speakers have anxiety about speaking in front of groups.

Dr. Ray Smilor, an internationally recognized expert in entrepreneurship and president of the Beyster Institute for Entrepreneurial Employee Ownership, empathizes: “When I watch entrepreneurs give presentations to prospective investors, so many of them seem to wish they were dead, rather than have to get up and pitch their companies. Throats become parched, voices quaver, hands shake, knees knock. They’re just not very comfortable standing in front of a group. As speakers, the entrepreneurs looked incompetent, and they never managed to communicate the most important points about their enterprises. It doesn’t have to be this way.”

Presentations are an essential part of the entrepreneurial process. That’s why a presentation of your plan is recommended as a part of the FastTrac® program. How an entrepreneur communicates is just as important as what he or she communicates. Try not to think of presenting your plan as a punishment. View it instead as an exciting opportunity to talk about what you know and love best: your company. If you do, you’ll find it an enjoyable, and perhaps profitable, experience. Use the following suggestions as you complete Action Step 10.3 Prepare a Venture Presentation to present your Business Plan to your fellow participants as well as to mentors, peers, and potential funders.

Know Your Objective

When you communicate your business plan to others, have a clear objective. Are you asking listeners to take a particular action? Adopt a new perspective? Respond to facts and information? Clearly communicating your objectives will drive the audience to your end goals.

Tip

Your presentation should be the bridge between what you have and what your audience wants.

As you design your presentation, keep your overall objective in mind, as well as your audience’s needs and expectations. Knowing your objective should help dictate how to present the necessary content. Understanding the audience will help you emphasize the right information, develop the proper presentation style, and select appropriate visual aids.
Understand Your Audience

Your plan may have more than one audience and several different reasons for its presentation. For example, looking at the investment opportunity your business has to offer a potential investor will help communicate a key message important to that investor. Your needs will also be better met because the audience will gain a clearer understanding of your business and the role they could play in it. Use My Presentation Audience to clarify your audience and purpose for presenting your plan.

My Presentation Audience

Place a check mark next to the audience(s) to which you want to present and then draw a line to the purpose of the presentation for that audience. You should have no more than 2-3 purposes for each presentation. Revisit this checklist whenever you consider presenting your Business Plan. Example shown.

<table>
<thead>
<tr>
<th>Audience</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>FastTrac® facilitators and participants</td>
<td>Planning for success</td>
</tr>
<tr>
<td>Advisory board</td>
<td>Solicit feedback</td>
</tr>
<tr>
<td>Board of directors</td>
<td>Recruiting</td>
</tr>
<tr>
<td>Banker or other potential lenders</td>
<td>Orientation</td>
</tr>
<tr>
<td>Entrepreneur club</td>
<td>Communication</td>
</tr>
<tr>
<td>Family and friends</td>
<td>Strategic planning</td>
</tr>
<tr>
<td>Management team</td>
<td>Funding</td>
</tr>
<tr>
<td>Mentors</td>
<td>Professional support</td>
</tr>
<tr>
<td>Potential employees</td>
<td>Planning for growth</td>
</tr>
<tr>
<td>Potential investors</td>
<td></td>
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</tbody>
</table>

Develop a Venture Presentation for Mentors and Peers

Think about the presentation you will make in the next session to your facilitators, mentors, and fellow participants. You should take into consideration the instructions given in the previous session. How much time will you have to present? What does your audience already know about you and your business? What aspects of the business planning process will be of most interest to them? How can you highlight what this program has done to outline growth for your business?

Develop a Venture Presentation for Potential Investors

Talking to a room full of potential investors is very different from selling a product or service to customers or presenting your business concept to fellow participants. Features and benefits pitches used for customers do not necessarily excite investors. Descriptions of your planning process are irrelevant to them. The subject of your presentation to investors is not your product or service but their money: Who will use it, why it’s needed, how it will be spent, what return it will bring, and when to expect it.

Investors are interested in seeing the big picture at the beginning of the venture presentation. They want to know who you are and what your organization does. They want an engaging story about the venture’s profitability, profit margins, management team, product development, size of market, competitive climate, and market niches.

In Guy Kawasaki’s The Art of the Start he suggests that during presentations it can be helpful to imagine a “little man” sitting on your shoulder. Each time you make a statement, imagine
the little man saying, “So what?” For example, you might say something like, “We use digital signal processing in our hearing aids.” After the little man asks, “So what?” you answer, “Our product increases the clarity of sounds.” It is the “so what” part of the presentation that interests the audience.

Some entrepreneurs present their investment opportunities solo while others include their key management members. Many investors prefer to meet with and hear from the management team. Alone or in a group, you must be convincing and display leadership ability and passion. These characteristics are crucial to success in raising investor money.

When giving your presentation to investors, leave ten minutes for questions and answers—the most important part of the presentation. This time allows you the opportunity to build a rapport with potential investors and establish the credibility of the management team. Anticipate questions and prepare responses so you’ll be ready.

One entrepreneur who was extremely successful in raising money in the early stages of his business start-up, took his Business Plan presentation “off Broadway” before meeting with the big money sources. He first gave his presentation to his board of directors and then to smaller investors in outlying areas as a way to hone his presentation skills and anticipate the questions investors typically ask. He was then well prepared to give his presentation to investors he had identified as potential key players.

**Use Visual Aids**

If a picture is worth a thousand words, a picture along with the words is worth a million. Since over 80 percent of people learn best through visual stimulus, it makes sense that good visuals will improve the audience's level of understanding of your material. People will also retain more of the information when it is presented visually and orally—as much as six times more than using no visuals. As you can see, the use of visual aids is essential to reach your audience.

The benefit of using visuals is twofold. It not only benefits the audience, but it benefits the presenter as well. When using visual aids, you will tend to use more gestures and have greater movement during the presentation. This variation helps reinforce your role as the presenter and helps to keep the audience engaged.

Since visuals are so important, you will want to prepare visual aids that reinforce your major points, appeal to your audience, and work well in the physical setting of your presentation. Visual aids can involve many varieties of communication products including PowerPoint presentations, flip charts, overhead transparencies, slides, audio-slide shows, and videos. Demonstrating a process or simply passing around a sample of equipment or models can also be effective ways to clarify your message.

One caution concerning visuals: Remember to maintain eye contact with the audience—not the screen, computer, or overhead projector. The people you are presenting to should receive your consistent attention. Also, don’t repeat your visuals word-for-word since the audience is already reading the information.

These tips can help your presentation appear professional:
- Make sure visuals can be seen from the back of the room.
- Keep information on visual aids to a minimum.
- Present only one key idea per visual.
- Limit the use of colors to no more than three, not including photographs.
- Use no more than two different typefaces and a 30-point or larger font size for projected words.
Prepare for the presentation by anticipating what will happen before, during, and after the presentation. Here are some suggestions from Dr. Ray Smilor:

**Hit the key issues.** A lot of entrepreneurs never get to the two critical issues that investors want to hear about: what's the opportunity and why you can pull it off. They keep talking about how their technology works or the patents they've filed or the intricacies of how something is made. Not that these are unimportant. But in a venture presentation, the purpose is to get investors to follow up with you, at which time you can explore these details in greater depth. To get investors to want to meet with you, you have to address the two most important issues—the opportunity and your credibility.

**Be redundant.** Repetition is saying the same thing in the same way over and over. Repetition is boring. Redundancy is saying the same thing in different ways so that an audience gets multiple perspectives on an issue. Redundancy is interesting. For example, to demonstrate customer satisfaction with a product or service, you can read a testimonial, then tell a story about a visit to a customer, then give data from a survey, then provide a report from a third-party source, then describe an incident between an employee and a customer and so on, depending on the amount of time you have.

**Be persuasive.** You can enhance the persuasiveness of a presentation in a number of ways. Present new evidence, which could include new statistics, research or information with which the audience is not acquainted. Avoid the one-sided story by discussing the cons of your product before the pros. Present the nature of the problem facing the customer, then show the solution that your company can offer.

**Manage questions.** Reward a question by pointing out its importance. Repeat a question to give yourself time to think and to make sure you understand it right. If you don’t know the answer to a question, say so but indicate that you will find out.

### Implementing Your Plan

After going through this much work to prepare a business plan, it may seem crazy not to implement it. Still, entrepreneurs find many reasons to let their business plans go stale. Maybe the assumptions about the economy or market change dramatically enough that the business plan, as it is, doesn’t help. Maybe the entrepreneur starts to implement the plan and then gets off track by an opportunity that is “too good to pass up.” Maybe old work habits of putting fires out flare up, and the business plan begins to collect dust.

A business plan is not a trophy to put on the shelf; it is a dynamic plan that can set a course for continuous improvement and success—when it’s used. Make sure your business plan is an action plan that you and your team will work on together.

If you were planning a wedding, you would arrange for the invitations, decorating, catering, music, flowers, facilities, and more. You would —formally or informally—establish specific goals for each category based on your budget and the results desired. In the same way, each functional area of your business needs to have specific goals and measurement criterion such as a defined number of new customers, profitability targets, or growth in market share. This measurement will help you monitor and measure your business’s success in achieving the key strategies of the business.

The measurement you apply to monitor your business’s success needs to include a function which reports the information you will use to evaluate key measurements. For example, it is not enough to measure the success of your marketing strategies by the number of new customers your business has acquired. You must also develop a system to report the number of new customers. Although this is a fairly simple example, some measurement criterion may require a more complicated reporting process such as the kind of system you need to calculate financial ratios.
Use *Key Strategies* to review each functional area in the business plan and determine the key strategies and measurement criterion in each area. These are the strategies that are critical to achieving your overall vision and business strategy.

### Key Strategies

First, list the key strategies for each area of business. Place a ★ beside the top priority in each area. For each strategy with a ★, identify the person responsible, the key measurement criteria, and the frequency of review (whether it is weekly, monthly, or quarterly).

<table>
<thead>
<tr>
<th>★</th>
<th>Strategy</th>
<th>Person Responsible</th>
<th>Key Measurement Criteria</th>
<th>Frequency of Review</th>
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<tbody>
<tr>
<td></td>
<td>Management and Organization (Review Action Step 7.1)</td>
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<td></td>
<td>Product/Service (Review Action Step 5.1)</td>
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### Key Strategies continued

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<th>★</th>
<th>Strategy</th>
<th>Person Responsible</th>
<th>Key Measurement Criteria</th>
<th>Frequency of Review</th>
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<tbody>
<tr>
<td></td>
<td>Marketing Plan (Review Action Steps 6.1 – 6.4)</td>
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<td></td>
<td>Operations Plan (Review Action Step 8.2)</td>
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<td></td>
<td>Financial Plan (Review Action Step 9.1)</td>
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</table>
Thriving in Your Entrepreneurial Role

As an entrepreneur, you may sometimes feel like you are stranded alone on an island—unsure of where to go or what to do to survive. Don’t forget the key to both surviving and thriving is written into your business plan. This section will help you prioritize what you need to do to start implementing your plan. Read the eight tips and use the task and resource lists to develop your own “Survival Guide to Growing My Business.” Some examples of key tasks are listed to get you thinking. Be sure to include additional tasks that are a priority for your business. Check out FastTrac’s Top Resource Picks within each tip for extra insight and then add some of your own favorites—resources that can help you grow your business. The full reference and additional resources can be found on the More Info Resources lists at fasttrac.org/resources.
Begin your journey with the end in mind

Keep in mind the saying, “If you don’t know where you are going, any path will get you there.” After all your hard work in this program, you should know your destination and the plans you will carry out to reach it. Your evaluation of your growth opportunities, your plan for growth, and the exit strategy provide this plan.

Without a plan, the business runs by default—whatever happens each day becomes the plan. Businesses that don’t have a sense of direction may coast for a while, but why take the risk? Following a plan helps you make decisions, set goals, motivate you and staff members to achieve results, and find the right people to help grow the business. It also provides the basis for mid-course corrections. Not knowing what to expect from the business wastes time, money, and energy—all scarce resources for a growing venture. The point is that the plan you have just written should not sit on the shelf once you get back to the office. Business Plans are living documents that can help you plan your course and should be revisited, revised, and renewed as your business evolves.

### Tasks

Identify one to three tasks that will help you succeed in this area. Several suggestions are provided. Then, prioritize this list in the left column and assign due dates to the tasks in the right column.

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<thead>
<tr>
<th>Priority</th>
<th>Tasks</th>
<th>Date to Be Completed</th>
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<tr>
<td></td>
<td>Finish the plan.</td>
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<td></td>
<td>Have the plan reviewed by a trusted mentor.</td>
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<tr>
<td></td>
<td>Communicate the plan to my team and advisers.</td>
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<td></td>
<td>Review pp. 389–390 to develop key measurement criterion for key strategies.</td>
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<td></td>
<td>Talk with a lawyer, CPA, and trusted adviser about my exit strategy.</td>
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### Resources

Identify the support that you need to complete these tasks and resources that you can rely on for this support.

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<thead>
<tr>
<th>Support Needed</th>
<th>Potential Resources</th>
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</table>
**Keep your eyes on the prize**
Focus on your personal vision for success and you will achieve it. Remember: you define success on your own terms! Keep your personal, professional, and financial goals in mind when planning your business growth. Improving the business’s operational efficiency, increasing profitability, or growing market share are meaningless accomplishments if they don’t help you reach your individual goals. Setting your sights on what you want prior to making business decisions will ensure that your business evolves and succeeds in harmony with your own goals.

### Tasks
Identify one to three tasks that will help you succeed in this area. Several suggestions are provided. Then, prioritize this list in the left column and assign due dates to the tasks in the right column.

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<tr>
<th>Priority</th>
<th>Tasks</th>
<th>Date to Be Completed</th>
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<tbody>
<tr>
<td></td>
<td>Review my own idea of success and growth from Module 1, pp. 9–10.</td>
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<td></td>
<td>Review my Three-Year Vision from Action Step 1.2.</td>
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<td></td>
<td>Create a tangible reminder of my vision and post it where I will see it each day (examples include a vision statement or a collage using words, pictures, and symbols to motivate me).</td>
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<tr>
<td></td>
<td>Set a monthly appointment on my calendar to review the business’s progress in reaching my individual goals.</td>
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### Resources
Identify the support that you need to complete these tasks and resources that you can rely on for this support.

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<tr>
<th>Support Needed</th>
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</table>
Build your business as an asset

Your mindset and perspective of your business will have a big impact on the decisions you make and how well you achieve your growth goals. Do you consider your business as an investment in your portfolio? If so, you will strive to build your business’s value as an asset—it may be the biggest investment of money and time you will ever make. You will watch, research, and nurture it to achieve the return you expect for the risk you take. If you view your business as an immediate revenue stream, you may be driven by pressing crises or the next sale instead. You might overlook planning, delegating, and managing.

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<thead>
<tr>
<th>Priority</th>
<th>Tasks</th>
<th>Date to Be Completed</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Review valuation information at fasttrac.org/resources in the Module 2 More Info Resources list.</td>
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<td></td>
<td>Talk to my CPA or accountant about valuation strategies.</td>
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<td></td>
<td>Evaluate the Return on Equity as compared to other investments available to me and set goals for this ratio.</td>
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<td></td>
<td>Review ways to protect my product/service from competitors.</td>
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</table>

Resources

Identify the support that you need to complete these tasks and resources that you can rely on for this support.

<table>
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<tr>
<th>Support Needed</th>
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</table>
Know YOUR Customers

People talk about the global marketplace today and how technology has expanded the market of potential customers available to businesses. While true, this theory has also fueled the fire of many entrepreneurs who erroneously think that everyone is a potential customer. They neglect to define a target market.

To be successful in business you must know your customer. Knowing the customer has many advantages for you. First, knowing specific characteristics of your customer such as demographic, psychographic, and buying patterns will help you find your target market easier. This means you will have better results and save time, money, and manpower at the same time. Second, it will be easier to sell your products and services. Peter Drucker says it best, “The aim of marketing is to know and understand the customer so well the product or service fits him and sells itself.”

### Tasks

Identify one to three tasks that will help you succeed in this area. Several suggestions are provided. Then, prioritize this list in the left column and assign due dates to the tasks in the right column.

<table>
<thead>
<tr>
<th>Priority</th>
<th>Tasks</th>
<th>Date to Be Completed</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Interview 10 existing customers to better understand their needs and</td>
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<td></td>
<td>buying motives</td>
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<td></td>
<td>Plan to meet with a marketing consultant to design specific plans to</td>
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<tr>
<td></td>
<td>reach my target audience</td>
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<tr>
<td></td>
<td>Review my sales strategies to update the business’s sales goals and</td>
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<td></td>
<td>the techniques and sales skills of key team members</td>
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</table>

### Resources

Identify the support that you need to complete these tasks and resources that you can rely on for this support.

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### Tip

Be dramatically willing to focus on the customer at all costs, even at the cost of obsoleting your own stuff.

—Scott Cook, Intuit founder
Cash may be king, but profits are the keys to the castle

Keep an eye on cash flow, setting profitability goals and regularly measuring your business’s progress against them. Use key measurements to quickly reveal the financial impact of a variety of business activities. For example, you don’t have to wait for the monthly sales figures from the accounting department to know how well your sales team is doing. Monitoring the number of sales calls per day, the number of proposals each week, and the close ratios of these proposals can tell you immediately how well it is going. If a salesperson’s key measurements are faltering, you can make corrections before the impact on revenue is past recovery.

Tasks

<table>
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<tr>
<th>Priority</th>
<th>Tasks</th>
<th>Date to Be Completed</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Using my business’s key financial indicators from Action Step 9.1, set financial goals to maximize my company’s performance.</td>
<td></td>
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<tr>
<td></td>
<td>Identify key measurements and reporting systems needed to measure the company’s progress in achieving financial goals.</td>
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<td></td>
<td>Select one or more potential funders (from Activity 9c Funding Goals) and schedule an initial contact meeting.</td>
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<td></td>
<td>Review my own and competitors’ pricing and revise prices to support my business strategy and fend off competitors.</td>
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Resources

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### Do what you’re good at, not what you can do

You need to know your core competencies and build on these abilities, recognizing that your role will evolve as the business grows. Core competencies are the strengths that make you able to meet the needs of your customers. Keep in mind that your core competencies may change over time, depending on the demands of the marketplace and your business’s resources and abilities. Your core competencies should continually be developed as a competitive advantage over your competitors.

Communicate these advantages to potential customers using a solid marketing plan built on research of the industry, competition, and target market. When you know your target market—your customers—you know what they want. Your marketing strategies are then built around producing the product or providing the service that customers want at a price they are willing to pay.

### Tasks

Identify one to three tasks that will help you succeed in this area. Several suggestions are provided. Then, prioritize this list in the left column and assign due dates to the tasks in the right column.

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<tr>
<th>Priority</th>
<th>Tasks</th>
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<tbody>
<tr>
<td></td>
<td>Complete the Leadership Scorecard in Module 7 on p. 268, including feedback from my team to identify core competencies and areas I can improve to better support my business’s growth.</td>
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<tr>
<td></td>
<td>Compare the products and services I offer with my list of core competencies. Make plans to eliminate any that don’t match what I do best.</td>
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<td></td>
<td>Research my industry and its trends as well as those trends that indirectly impact my industry. Try to understand how these trends change how I do business.</td>
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### Resources

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</table>
Teams with the best players generally win

A well-run business is like a winning ball team. It makes the most of every staff member’s talents and takes advantage of every split-second opportunity to score. The entrepreneurial culture you create and the quality of your management team are critical to your success. A management team works best when it is made up of people with complementary styles and skills working toward the same business goals. A culture that embraces such a team will provide a balanced approach to business and will help nullify the friction that sometimes results when different talents and perspectives—although needed and valuable—cause team members to have different viewpoints.

Keep in mind that you may need to invest in a few superstars to keep your competitive advantage. Superstars need to be recruited, maybe even from your competition. They need to understand you and your business and the opportunity they would have by joining your team. Once they are recruited, the compensation and reward system needs to be motivating enough to keep them.

### Tasks

Identify one to three tasks that will help you succeed in this area. Several suggestions are provided. Then, prioritize this list in the left column and assign due dates to the tasks in the right column.

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<tr>
<th>Priority</th>
<th>Tasks</th>
<th>Date to Be Completed</th>
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<td></td>
<td>Develop ways to communicate your entrepreneurial culture. Consider team meetings, retreats, newsletters, celebrations, etc.</td>
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<td>Plan a method for recruiting and hiring the very best people I can find.</td>
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<td></td>
<td>Discuss my current compensation and reward system with appropriate experts to determine changes and updates needed.</td>
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<td></td>
<td>Review entity selection and laws and regulations applicable to my business with my attorney.</td>
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### Resources

Identify the support that you need to complete these tasks and resources that you can rely on for this support.

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<tr>
<th>Support Needed</th>
<th>Potential Resources</th>
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Get your ducks in a row

Take a lesson from migratory birds: learn to maintain order and increase efficiency. You may have noticed that ducks and geese appear to fly in definite patterns. Some believe the birds fly in a V formation to create an uplift for the following bird. When you establish a clear direction and define staff responsibilities—developing products, receiving orders, billing and collecting, paying vendors and suppliers, controlling inventory—you enable your staff to work together effectively and efficiently. Policies and procedures make it easier for you to keep an eye on business operations. Established now, these controls will help you keep your business running efficiently in the future and help you achieve your business’s marketing, management, and profit goals. The point is to make the business operate so smoothly that you spend very little time on daily issues and work more strategically on your business.

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<th>Date to Be Completed</th>
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<td>Make sure each job function has procedures to describe the way the tasks should be completed.</td>
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<td>Review and modify policies and procedures and modify to assure their effectiveness.</td>
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<td>Discuss potential risk and controls that can help protect my business with a CPA, financial adviser, or risk manager.</td>
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<td>Establish an employee suggestion plan to improve operations, controls, and systems.</td>
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Resources

Identify the support that you need to complete these tasks and resources that you can rely on for this support.

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In addition to the tips and related tasks included in this module, be sure to think of other ones that are important to you and your business. Don’t just think about the tasks you want to accomplish and the changes you want to make. Commit to them by writing them down, assigning the due dates, and getting to work.

Check out the Kauffman Foundation’s Entrepreneurship.org website. This premier online resource helps you get essential business information quickly and easily.
Giving Back

Most entrepreneurs are passionately motivated to share their success by giving back. If you’re like most people, you may support several charitable causes in your community. Chances are entrepreneurship is not on your list—which is surprising, if you think about it.

You don’t need a fortune to give back in meaningful ways. Today, emerging philanthropists are discovering the power they have to improve people’s lives by giving back to entrepreneurship—from mentoring, teaching, promoting innovation, and serving on boards to contributing financially through their companies. As one entrepreneur-philanthropist put it, “The joy of giving back is unbelievable. It’s like watching your children grow and be successful.”

Ewing Marion Kauffman believed that giving back was the highest form of citizenship. Kauffman said that his work in philanthropy was the most fun he had. He applied his time, energy, and resources to the things that gave his life meaning. The first lesson of Kauffman’s life is that one person can make a difference.

Helping other entrepreneurs get started is one of the most rewarding activities you can undertake. Meet three entrepreneurs who have discovered the joys of giving back. Maybe their paths will start you thinking about what you can do.

Tip
The power to make a difference comes when you look inside to find what you have to give.

Vicky Wu
At the relatively young age of 31, Vicky Wu is a good role model, even though she was in the same shoes as her mentees just a few years ago. She founded Froghop, Inc., a middleware and software company that provides a wireless infrastructure for the video game industry, enabling users to participate in games with whatever electronic device is at hand. Wu serves as a mentor in MIT’s Venture Mentoring Service program and works with both students and alumni. As one of approximately eighty-five mentors in the program, Wu attends monthly meetings where mentors discuss ventures they’re currently helping and volunteer opportunities in which they’d like to get involved. Mentors commit to working with a venture anywhere from one to dozens of times. Wu currently is mentoring three companies, helping “put their ideas in motion.”

Don Grimm
Don Grimm, former president and chairman of Hybritech® Inc., set about giving back in several arenas—from nonprofit and for-profit boards to tech transfer and angel investing. Grimm has served on the boards of several startup companies including Aegis®, Angstrom®, CellzDirect, and Invitrogen®. His reputation for wisdom and a willingness to share it yields frequent requests for other kinds of help, such as making presentations to classes and mentors. “Mentoring,” says Grimm, “is something I do all the time. I did it this morning.”

Michael Gallegos
Michael Gallegos’s mother taught him two secrets to success: always give more than expected and always give back more than you receive. Gallegos has done both, but as co-founder and president of American Property Management Corporation, giving back to entrepreneurship was not a significant element on Gallegos’s radar screen until recently. That’s when the give-back bug bit him. He now judges business plan competitions, has developed an internship program at his business, delivers guest lectures at local universities, and is creating a foundation that will provide scholarships for up-and-coming entrepreneurs. He admits that activities like judging are “a sacrifice of time, but it’s all part of giving back.” Gallegos adds, “This is just the beginning. I’m not a finished product as far as my initiatives for entrepreneurs, so check with me in five years.”
Summary

So, where will you be in one year? Three years? Five years? As Module 1 states, “It’s your decision.” You know your vision; you’ve set your goals, and you’re armed with a plan to achieve them. As you implement your plan, realize that you may need to adapt it based on changes in your business and in your market. Remember to apply the strategic thinking and decision-making skills you have developed in this program as you continue to grow your business.

Take time to reflect on where you have been and what you have accomplished in FastTrac® GrowthVenture™. Celebrate your success in this program and the successes that you and your team accomplish in the future.

Heed the advice of Carol Frank: “Play the game of business and life with authenticity, persistence, and integrity. Sometimes you will score the goal—and sometimes you will get scored upon—but at least you are not sitting on the sidelines! You are on the field, playing your heart out, gaining experience, wisdom, and success.”

Key Things to Remember

Throughout FastTrac® GrowthVenture™, you have learned to:

• Engage the planning process as a proven way to think through every aspect of the business before you commit financial resources.
• Align all aspects of your business with your personal, professional, and financial goals.
• Know your vision and goals, plan your exit, and work to build your business as an asset.
• Know what you and your business are good at—your core competencies—recognizing that your role in the business will evolve as the business grows.
• Become a leader by thinking, planning, and acting strategically.
• Ensure that your products/services have a competitive advantage valued by the market; re-evaluate and update your products/services as the needs of the market change or new opportunities arise.
• Set profitability goals and regularly measure your business’s progress against them while keeping an eye on cash flow. Cash flow is paramount.
• Involve the right people in your business—in your management team through assistance from trusted advisers, mentors, and outside professionals, and through networking and coaching.
• Establish and maintain an entrepreneurial culture for the business that supports innovation and growth.
• Communicate your business model and plans clearly and concisely to your team, customers, and funders.
• Give back by helping other entrepreneurs.
Action Step 10.1: Finish and Assemble My Plan

Put the finishing touches on your Business Plan.

Directions
Throughout this program, you have been building a formal Business Plan or an internal working plan. These two types of plans are very similar in the topics covered throughout the planning process. The main difference is the level of detail used in the final document. Whereas both are critical communication tools, the formal Business Plan may also be needed to sell your idea to potential funders, mentors, or management recruits. This means the formal plan places a stronger importance on the use of full and complete sentences, attractive layout, meaningful graphics, and final document presentation.

If you are creating a formal Business Plan, complete A and B.
If you are creating an informal working plan, complete B only.

A. Finish the remaining components of your formal Business Plan. Using the Business Plan Template and the information below, complete the Cover Page, Table of Contents, and Appendix of your Business Plan.

- **Cover Page**
  The Cover Page should create a positive first impression and include basic information the reader needs to locate or contact the company. If you are going to distribute your Business Plan to several external reviewers, assign a different number to each plan on the Cover Page. This system will allow you to track Business Plans out for review. It also may discourage recipients from copying or widely distributing the plan to others. It is advisable to include a statement such as, “The contents of this plan are proprietary and confidential. It is not to be duplicated in any way.” Remember, if you disclose information without a signed non-disclosure agreement, you may lose your ability to protect the information through trade secrets, patents, or other types of legal protection.

  Include the following information on your Cover Page:
  - Business name
  - Motto or tag line (optional)
  - Logo (optional)
  - A picture or sketch of the product/service (optional)
  - Date the plan was prepared
  - Entrepreneur’s name and title
  - Business or home address including city, state, and zip
  - Entrepreneur’s phone/fax numbers and other contact information
  - E-mail address and Web sites

- **Table of Contents**
  An organized and accurate Table of Contents—with subject headings and accompanying page numbers—will help you and the readers of your plan find information quickly. The Business Plan Template will insert page numbers on the Table of Contents automatically, but they will need to be updated as you add to your plan. When your Business Plan is complete, use your mouse to highlight the page number or select the section of the Table of Contents you want to update and then press F9 to update the numbers. Carefully proof the Table of Contents when the Business Plan is complete. Double check all page numbers. You convey a sloppy image if the page numbers are off.
Appendix

An Appendix is the appropriate place to put all supporting information for the details discussed in the Business Plan. Include documents as they are without entering them into the Business Plan template. You should prepare a Table of Contents at the beginning of your Appendix to identify the location and type of documents included. Select from the following:

- Worksheets from the Financial Template including: Sales Worksheet; Inventory Worksheet; Operating Expenses Worksheet; Capital Budget Worksheet; Equity & Debt Worksheet; and the Amortization Schedule (if applicable)
- Detailed resumes of the management team or key personnel who are or will be working in the venture
- All employee contracts, stock option plans, and retirement plans
- Personal financial statements for each of the principals
- Copies of patents, copyrights, and intellectual property registrations
- Copies of actual agreements such as legal structure, sales contract, distributor contract, non-compete/non-disclosure, and other legal document
- Samples of product/service brochures or other advertising
- Copies of logos
- Copies of reference letters, recommendations, or endorsements less than twelve-to sixteen-months-old
- Copies of related market studies or articles from trade journals or other appropriate media including the source and date
- Professional photographs of the product, facilities, or equipment
- Customer-signed orders or letters of intent
- Related information to support the industry study such as demographics or magazine articles including the source and date
- Detailed descriptions of products/services
- Map showing the location of business
- Copy of any credit reports on the business

Fonts and Format

An easy-to-read font and a simple design work best. An 11- or 12-point font in a serif style, such as Times or Times New Roman, is the easiest for most people to read. Gimmicks such as all caps and excessive use of boldface or underlining detract from the importance or significance of the text. If you have already established a brand identity, use your logo, fonts, and color scheme.

Each page should incorporate adequate white space. White space makes the text easier to read and provides a place for taking notes. Using wide margins—between 1 and 1.25 inches—and bulleted lists of information whenever possible can add white space. Titles, graphs, and other appropriate graphics increase the interest and readability of the plan. Finally, each page should be appropriately numbered.

Tip

Business Plans that include attractive design elements, simple fonts, and lots of white space are easier to read.
Action Step 10.1: Finish and Assemble My Plan continued

- **Printing and Binding**
  
  Print your Business Plan on white or light colored, standard-sized paper, 8.5 x 11 inches. Color ink can be used effectively for the headings, subheadings, and graphs. Too much color will detract from the content of the Business Plan.

  For external readers, the best type of binding secures the pages, makes it easy to flip back and forth, and lies flat on a desk. Most office supply stores and copy centers offer affordable, professional binding services. Avoid flimsy, acetate covers with detachable spines. If the Business Plan is being used internally, three-ring binders work well. This type of binding will allow you to remove or replace pages as you update them. The Business Plan can also be shared electronically by creating a .pdf file or word processing document.

B. **Assemble your Business Plan.** The next step is to assemble your Business Plan. An orderly Business Plan will make it easy for you and your readers to use.

  Each Business Plan section should begin on a new page in the following order:
  - Cover Page—for formal Business Plans (See Action Step 10.1)
  - Table of Contents—for formal Business Plans (See Action Step 10.1)
  - Executive Summary (See Action Step 3.2)
  - Management and Organization Plan (See Action Step 7.2)
  - Product/Service Plan (See Action Step 5.1)
  - Marketing Plan (See Action Step 5.2 and 6.1 – 6.4)
  - Operations Plan (See Action Step 8.2)
  - Financial Plan (See Action Step 9.2)
  - Appendix—for formal Business Plans (See Action Step 10.1)
Action Step 10.2: Evaluate My Plan for Completeness

Identify areas in my plan that need additional attention before it is complete.

Directions
Whether you are creating a formal Business Plan or an internal working plan, your plan should be complete and free from errors. Follow the instructions below to create a complete and accurate Business Plan.

A. Review your Executive Summary. The Executive Summary could very well be the most important section of the entire Business Plan because most readers will find the answers to their questions in this summary. Still, this summary of your plan should not be more than two to three pages long.

As you review the Executive Summary, keep in mind your intended reader and the purpose of presenting the plan. Every time you present your plan to a new audience, you will want to consider writing a new Executive Summary. That way you can highlight the information the new audience is most interested in. Individual attention to readers’ needs is more likely to gain their attention to your request.

Place a check beside the common mistakes below that you need to review in your own Executive Summary:
- Too much superficial data that fails to inspire the reviewer to read further
- Failure to identify unique features and benefits of the proposed product/service
- Too much technical information
- Written in first person—uses “I” instead of using your name
- Long sentences and phrases
- Too much trivial information
- Failure to specify what you hope to accomplish with the business
- Failure to identify how much money the company needs, its uses, sources, and repayment

B. Review your plan against the Business Plan Checklist. After your Business Plan is assembled, review it for completeness and accuracy. For each section, this Business Plan Checklist identifies what information should be included in your plan and tips on how it should appear. The Business Plan Checklist helps you evaluate if your plan includes key content and is well written.

Business Plan Checklist
Use the following checklist to find changes that need to be made to make your plan more readable, concise, complete, fact-based, and error free.

Overall Readability

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Overall Spelling/Grammar/Math

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### Action Step 10.2: Evaluate My Plan for Completeness

#### Overall Formatting

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- Font choice is readable.
- Spacing between lines is sufficient.
- Plan contains headings and subheadings.
- Formatting on headings and subheadings is consistent.
- Plan includes page numbers.
- Formatting on page numbers is consistent.
- Plan contains enough white space for readability.

#### Cover Page / Table of Contents—for formal Business Plan

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- Cover Page contains name of business.
- Cover Page contains chief executive’s name.
- Cover Page contains address, telephone, fax numbers, e-mail, and Web address.
- Cover Page contains company logo.
- Page numbers in Table of Contents correspond correctly.
- Appendix includes a Table of Contents.

#### Executive Summary

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- Does not exceed three pages and wholly describes the new venture.
- Describes the unique features and benefits of the product/service.
- Identifies the management team and supporting infrastructure.
- Explains the opportunities found within the industry.
- Contains plans for targeting a market segment and penetrating it.
- Specifies how much money the company needs and how funds will be obtained.

#### Management and Organization

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- Explains the legal form of business.
- Lists key management positions, including primary job responsibilities.
- Identifies the board of directors/advisory board members, including primary contributions expected.
- Documents the process of recruiting and selecting employees.
- Clarifies the compensation and employee reward systems.
- Establishes credibility of the management team.

#### Products/Services

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- Describes product/service in plain language (not too technical).
- Describes product/service in specific terms (not too broad).
- Provides evidence that the product/service is technologically feasible.
- Identifies unique features.
- Identifies special benefits.
- Wholly explains product/service limitations and potential solutions.
- Wholly explains product/service liabilities and potential solutions.
- If applicable, identifies production process and facility plans.
- Provides backup suppliers and subcontractors.
- Anticipates future related products/services and spin-offs.
- Describes how intellectual property will be created and protected.
- Lists requirements from regulatory agencies.
### Action Step 10.2: Evaluate My Plan for Completeness continued

#### Marketing Plan – Industry Profile
- **Yes**
  - Focuses on current size and growth potential of the industry.
  - Discusses industry trends and opportunities associated with each.
- **Yes**
  - Addresses geographic locations, seasonality, and industry profit characteristics.
- **Yes**
  - Identifies existing distribution networks.

#### Marketing Plan – Competitive Analysis
- **Yes**
  - Identifies direct, indirect, and future competition.
  - Contains matrix to illustrate competitive position in marketplace.
- **Yes**
  - Describes competitive advantage.

#### Marketing Plan – Marketing Analysis and Penetration
- **Yes**
  - Contains customer profile.
  - Contains target markets and size of each.
  - Fully illustrates the image of the company.
  - Describes plans to reach the market, including customer service, location, sales force, licensing and distributing.
  - Addresses plans for advertising and promotion.
  - Includes plans for marketing through technology, including the Internet.
  - Discusses other penetration strategies, including publicity, telemarketing/direct mail, website, and trade shows.
  - Describes plans for evaluating market penetration effectiveness.

#### Marketing Plan – Pricing
- **Yes**
  - Addresses pricing strategy.
  - Contains price sheet.
  - Includes volume and special pricing information.
  - Contains the company’s pricing policies.

#### Operations Plan
- **Yes**
  - Describes control systems.
  - Overviews risk management.
  - Documents work flow and related accounting processes.
  - Refers to procedures and employee manuals.
  - Describes disaster plan.

#### Financial Plan
- **Yes**
  - Sales and profit projections appear to be reasonable.
  - Assumptions and projections are wholly supported.
  - All operating expenses have been included.
  - Hidden costs have been identified.
  - Salaries and other benefits are in line with industry standards or entrepreneur’s goals.
  - Contingency plan seems reasonable if sales forecasts go unmet.
  - Figures on various documents are consistent.
  - Sources of debt or equity financing are appropriately identified.
  - Exit strategy is clearly defined.
Appendix – for formal Business Plan

<table>
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<tr>
<td>Contains resumes of the management team and key personnel.</td>
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<td>Contains all employee contracts, stock option plans, and retirement plans.</td>
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<td>Contains personal financial statements for each of the principals.</td>
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<td>Contains patent and copyright approvals.</td>
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<td>Contains such agreements as partnerships, sales, distributor contracts, non-compete/non-disclosure, corporate bylaws, and other legal documents.</td>
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<tr>
<td>Contains copies of product/service brochures or other advertising samples.</td>
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<td>Contains copies of all logos that have been developed.</td>
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<td>Contains copies of recent reference letters, recommendations, and endorsements.</td>
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<td>Contains copies of market studies or articles from trade journals or other media.</td>
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<td>Contains professional photographs of the product.</td>
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<td>Contains detailed outlines of the operating and control systems.</td>
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<td>Contains customer-signed orders or letters of intent.</td>
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<td>Contains documents that support the industry study.</td>
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<td>Contains detailed description of high-tech products.</td>
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C. Have the final draft of your Business Plan reviewed by a trusted adviser. Feedback from trusted advisers can be immensely valuable in determining the strengths and weaknesses of your plan. If possible, someone familiar with your industry should review the plan. Ask your reviewer to check for these components:

**Product/service**—Do your products and services represent the core competencies of your business? If a growth plan includes an expansion of the product or service line, does the expansion seem reasonable? Do governmental regulations exist that are not discussed in the plan?

**Market**—Does the Marketing Plan accurately describe the growth potential of the market? Is the market penetration plan reasonable and affordable?

**Financial**—Are the revenues and expenses accurately portrayed? Can the necessary growth funds be obtained? Is an exit strategy identified?
Action Step 10.3: Prepare a Venture Presentation

Practice giving a compelling venture presentation.

Directions
Making presentations about your business is part of the entrepreneurial process. Use the following suggestions to plan the presentation of your Business Plan to your fellow participants. You may choose to design a presentation for a particular purpose using your presentation during the FastTrac® program as a practice opportunity. For example, if you will be presenting your venture to potential investors, plan your FastTrac® presentation accordingly.

A. Determine your objective. You may encounter many reasons to verbally present information about your business. In most cases, you will share information and then ask listeners to take a particular action based on your information. Knowing this objective will help you select the best audience for your presentation, design the appropriate content, and develop fitting visual aids.

My objective for this presentation is to ask listeners to:

- Adopt a new perspective of
- Respond to facts and information by
- Contact me to provide more information about our products/services.
- Solicit feedback about
- Ask for more information about the business as an investment opportunity.
- Better understand
- Seek employment with our company.
- Take this action:
- Other:

B. Select an audience. Based on your objective, you will select an audience to hear your presentation. For example, if your objective is to seek funding you would make a presentation to potential investors rather than to potential employees. For your presentation to your FastTrac® peers, you may choose to ask listeners to take the role of one of the following as you present your Business Plan:

- Advisory board
- Board of directors
- Banker or other potential lenders
- Entrepreneur club
- Family and friends
- Management team
- Mentors
- Potential employees
- Potential investors
- Other:
**Action Step 10.3: Prepare a Venture Presentation** continued

C. **Develop your visual aids.** Based on your objective and your audience, you will select appropriate visual aids to help communicate your plan. List the key points of your presentation. It is best to have two or three key points.

1. 

2. 

3. 

The above key points need to be demonstrated or communicated using visual aids. Based on the various communication aids available to you, the preferences of your listeners, and your own comfort level select the type of visual aids that you will use.

- Flip charts
- Overhead transparencies
- Slides
- Audio-slide shows
- PowerPoint® presentation
- Video tapes
- DVD demonstration
- Product demonstration
- Sample product/service
- Other:
### Action Step 10.3: Prepare a Venture Presentation continued

**D. Create your outline.** Your presentation content should be organized into an outline based on the following categories, and your verbal presentation should cover the following ten basic areas in an engaging way. Jot down information in each area that may be of particular interest to your audience. Reduce the risk of simply reading your presentation by including bullet points rather than complete word-for-word text. Place a ★ beside your key issues, including the opportunity and your credibility.

**Presentation Outline**

Brief company history and explanation of future growth opportunities:

<table>
<thead>
<tr>
<th>Concise product/service description including proprietary rights:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Unique features and competitive advantage:</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Management team:</td>
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<tr>
<td></td>
</tr>
<tr>
<td>Market analysis:</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Financial summary, cash needs, and purpose of new investments, if any:</td>
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<tr>
<td></td>
</tr>
<tr>
<td>Exit strategy:</td>
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<tr>
<td></td>
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</tbody>
</table>
Action Step 10.3: Prepare a Venture Presentation continued

E. Practice, practice, practice. In addition to practicing your presentation, use the following tips from Dr. Ray Smilor to prepare for presenting your plan.

**Envision the performance**—Like actors going on stage, find out ahead of time how the stage will be set up, where you will stand, how the audience will be arranged. Then review in your mind’s eye every aspect of what you will do once you get on stage. Try to get to the site early, stand at the podium and walk across the room. By the time you give your presentation, you will have been through it already a number of times in your mind, so that once you start, the scene will be familiar to you.

**Minimize stage fright**—Every performer gets butterflies, or at least the good ones do. Butterflies in the stomach are an indication that adrenaline is flowing and that the body is ready to perform. Recognize this as a really positive sign—your senses are alert—just as good athletes do. To minimize the terror that may come once you stand on stage, take a deep breath to get oxygen into the body. Rather than look over people’s heads or avoid eye contact, find a friendly face in the audience who will smile back at you. This will help you to engage the audience, and engaging the audience will actually calm your nerves.

**Own the room**—Before you start, make sure the room or stage is designed to meet your needs and focus attention on you and your story. Check all the audiovisual equipment to make sure it works, take coins and keys out of your pockets so no one can hear them rattling and remove any distractions, like flip charts or sample products, that the presenter before you may have left on the stage.