PLANNING THE ENTREPRENEURIAL VENTURE

KAUFFMAN FASTTRAC.
Startup your idea.
# Planning the Entrepreneurial Venture

**STUDENT**

## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Overview</td>
<td>1</td>
</tr>
<tr>
<td>1</td>
<td>Becoming an Entrepreneur</td>
<td>7</td>
</tr>
<tr>
<td>2</td>
<td>Recognizing Opportunities</td>
<td>41</td>
</tr>
<tr>
<td>3</td>
<td>Defining a Business Concept</td>
<td>67</td>
</tr>
<tr>
<td>4</td>
<td>Model Feasibility Checklist</td>
<td>101</td>
</tr>
<tr>
<td>5</td>
<td>Product/Service Planning</td>
<td>135</td>
</tr>
<tr>
<td>6</td>
<td>Management &amp; Organization Planning</td>
<td>177</td>
</tr>
<tr>
<td>7</td>
<td>Market Planning: Industry &amp; Competition</td>
<td>225</td>
</tr>
<tr>
<td>8</td>
<td>Market Planning: Market Analysis</td>
<td>257</td>
</tr>
<tr>
<td>9</td>
<td>Market Planning: Penetration</td>
<td>277</td>
</tr>
<tr>
<td>10</td>
<td>Market Planning: Pricing</td>
<td>323</td>
</tr>
<tr>
<td>11</td>
<td>Financial Planning: Financial Terms &amp; Start-Up Costs</td>
<td>349</td>
</tr>
<tr>
<td>12</td>
<td>Financial Planning: Operating Expenses, Sales &amp; Inventory</td>
<td>379</td>
</tr>
<tr>
<td>13</td>
<td>Financial Planning: Cash Outlays &amp; Sources</td>
<td>413</td>
</tr>
<tr>
<td>14</td>
<td>Financial Planning: Financial Statements</td>
<td>443</td>
</tr>
<tr>
<td>15</td>
<td>Finalizing the Business Plan</td>
<td>477</td>
</tr>
</tbody>
</table>
Overview

This overview will provide critical information to help you successfully complete this course. After reading this overview, you will be able to answer the following questions:

- What's in it for me?
- What knowledge and skills will I acquire by taking this course?
- What am I in for?
- What tasks and assignments will I complete as a part of this course?

Objectives

In this chapter, you will learn to:

- Identify the assignments necessary to complete this course.
- Recognize the multiple resources available to assist in the completion of the course assignments.
- Be familiar with Ewing Marion Kauffman, entrepreneur, philanthropist, and founder of the organization that developed this course.
0.1 Course Overview

0.1.1 Introduction

This blended learning course is a dynamic, interactive learning experience that combines the success of face-to-face instruction with the ease and flexibility of Internet-based e-learning. The varied learning opportunities provided during this course will lead you through the steps of successful entrepreneurship.

There are many advantages to taking a blended-learning course. Internet-based e-learning provides an excellent opportunity to explore entrepreneurship. This course includes concise content and entrepreneurial stories to read, Internet resources to explore, online activities to play, self-assessments to take, videos to watch, and more. This variety allows you to tailor your learning to meet your needs. You can start at the beginning of the online content and explore everything or you can maneuver through the online portion to get the specific information needed.

The face-to-face instruction provides another invaluable learning experience. The instructor can select from numerous learning tools to introduce entrepreneurship topics. Assignments, exercises, scenarios, and case studies provide a valuable foundation for groups and individuals to practice the topics learned.

0.1.2 Learning Tools

Successful entrepreneurship is achieved when people have passion for an idea, carefully plan a strategy, and pursue the business, whether they are born with entrepreneurial qualities or not.

The goal of this course is to help you experience the key elements of successful entrepreneurship. To aid in this process, the instructor will select appropriate learning tools from the following:

- **Exercises**—Group or individual activities designed to practice an entrepreneurial concept either for your own business concept or a case study.

- **Scenarios**—Group activities that provide experience in applying entrepreneurial concepts to a scenario business. This same business is followed throughout the course.

- **Assessments**—Multiple-choice questions that allow you to self-assess your knowledge of entrepreneurial concepts previously introduced.

- **Assignments**—Individual, practical application of entrepreneurial concepts to build a business plan for your own business concept.

Assignments are a required element of the course. By completing them, you will have the tools you need to navigate this entrepreneurial journey.

The assignments for Planning the Entrepreneurial Venture include the following:

- Personal Vision
- Model Business Feasibility Check
- Business Concept
- Business Plan
0.1.3 Personal Vision

The first step in the entrepreneurial journey is to discover your own personal vision. The personal vision is a statement about your own life goals. The personal vision includes goal setting in the areas of lifestyle, professional, and financial. This assignment is critical in assessing and finding a business that is right for you. The personal vision includes:

- **Lifestyle criteria**—The type of lifestyle that you desire, including how much time you have for the business, where you want to work, and how your family will be involved.

- **Professional criteria**—The professional aspirations you have, including the type of work you enjoy, future professional goals, and role you wish to play.

- **Financial criteria**—The financial targets you have set, including the level of income you want now and in the future, and the source of start-up money.

<table>
<thead>
<tr>
<th>Personal</th>
<th>Professional</th>
<th>Financial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time for business</td>
<td>Work preferences</td>
<td>Financial goals</td>
</tr>
<tr>
<td>Location</td>
<td>Future goals</td>
<td>Personal income</td>
</tr>
<tr>
<td>Family involvement</td>
<td>Entrepreneurial role</td>
<td>Sources of money</td>
</tr>
</tbody>
</table>

0.1.4 Business Concept Statement

A business concept statement is written to communicate the specifics of a proposed venture. It includes a set of cohesive ideas about how you plan to create and deliver value to a market. The business concept answers many questions about the business idea including what the product/services does, who will buy it, and how it will be promoted.

Writing a business concept statement is an important assignment to complete before the planning process begins. Having a clear business concept statement up front will help you communicate the idea to others, understand the key components that need research, and test the idea for feasibility.

**Reality**

A business concept statement should change throughout the process of testing feasibility and business planning. The changes reflect how the entrepreneur’s original business idea is improved based on information uncovered from the industry and market.
0.1.5 Model Business Feasibility Checklist

Throughout the business planning process you will be asked to test your business concept against The Model Business Feasibility Checklist. This self-assessment provides an opportunity for you to rate how well your business concept compares to the perfect, or model, business.

The Model Business Feasibility Checklist tests for feasibility in three areas: the product/service, the market, and financial. A business that achieves a perfect score—on a scale of 1 to 5—in each criterion would be a model business. No real model business exists, but the concept is a helpful tool for evaluating the feasibility of a business idea.

Several times throughout the course, you will evaluate your business concept against the model business criterion. You can use this information to improve the feasibility of your business concept and to compare one idea against another.

You will use the Model Business Feasibility Checklist throughout the course to evaluate the feasibility of your business concept.

0.1.6 Business Plan

The primary assignment in this course is to research, develop, and write a business plan for your business concept. Writing a business plan is the final feasibility test. Through this process, you will determine whether the business has a market, can make a profit, and can provide the money you need. Writing a business plan also provides you with a plan to successfully take a business through the start-up phase. This plan will help you reduce the normal risks of start-up by replacing guesses with facts.

Your completed business plan will contain several sections including management and organization, the product/service, marketing, and financial. These sections are presented in manageable assignments in Chapters 5 through 15. After collecting and analyzing information about your business concept, you will answer the questions in each assignment to complete that section of the plan. The financial plan is created with an easy-to-use Excel-based template.

When you finish this course, you will have a completed business plan for a start-up business. You can use this plan personally, internally within the business, or externally for communicating with people about your business.

Personal Reasons for Writing a Business Plan

• Analyze the business concept
• Broaden personal understanding of the business
• Convince yourself and others that you know what you are doing

Internal Reasons for Writing a Business Plan

• Address specific concept challenges
• Ensure alignment of all aspects of the business
• Clarify goals of the business
• Develop an effective marketing strategy
• Identify back-up suppliers
• Forecast profits accurately
• Determine money needed to start the business
• Guide decision making
• Communicate with the management team

External Reasons for Writing a Business Plan

• Communicate goals to external parties
• Negotiate deals with suppliers
• Recruit employees
• Raise funds necessary to start the business
• Solicit suggestions from mentors and advisors

Tip

Developing a business plan is a function of thinking, researching, evaluating and planning. Don’t get hung up on writing the plan. The writing will be easy once the planning process is complete.
0.2 Resources Available

0.2.1 Course Content

The content for Planning the Entrepreneurial Venture was written by entrepreneurs for aspiring entrepreneurs. It was designed specifically for the college student assessing entrepreneurship as a career choice. The real-life examples and essential business theories come together to form a non-traditional, experiential learning environment that makes entrepreneurship come alive for college students. In addition, the e-learning text is abbreviated to allow for brief review of each topic. Full-length, printable text is available for times when you want to read more on a certain topic.

Navigating through the content will become easy with a little practice. For help on technical aspects such as printing, accessing your files, or using other tools included in the Internet-based content, access the technical help area by clicking the Help button on the lower right hand side of the course window.

0.2.2 Real Entrepreneurs

Most successful entrepreneurs will eagerly attest to a group of supporters that helped them throughout the business planning and growth stages. Few entrepreneurs achieve this successful status alone. Therefore, it is imperative to begin building this support network. Many opportunities will be provided during this course to meet and talk with real entrepreneurs from your community. This course also provides valuable real entrepreneur stories of success and sometimes failure. Their stories can help you build strengths into your business and avoid failures they have experienced.

Throughout the course five real entrepreneurs and their businesses are featured in audio and video. These entrepreneurs give valuable insights, tips and mentorship for aspiring entrepreneurs. Their pearls of wisdom are based in the hard knocks they have overcome to bring their personal visions to reality. These lessons learned will help you achieve success as you embark on your own entrepreneurial journey.

0.2.3 Links to More Information

One source will not answer all the questions you have about planning your business. Many times throughout the business planning process, additional information is needed to make critical decisions. This information may come in the form of industry research, marketing ideas, tax answers, and more. When appropriate, links to more information have been added to the content to provide you with additional opportunities to gather information beyond the Planning the Entrepreneurial Venture content. This includes links to video clips, audio clips, websites, research periodicals, online articles, entrepreneurial books, and other resources. Look for the “More Info” items at the end of each text area to find links to more topics to help you achieve success. An example link is provided below.

More Info
Entrepreneurship.org—designed by the Kauffman Foundation and the U.S. Commerce Department’s International Trade Administration to share best practices in entrepreneurial leadership.
0.3  Ewing Marion Kauffman

0.3.1  The Kauffman Story

Mr. Kauffman’s entrepreneurial philosophies were the secret to his success and they are still the guiding principles at the foundation he established. The Kauffman Center for Entrepreneurial Leadership at the Ewing Marion Kauffman Foundation is the nation’s largest organization focused solely on entrepreneurial success at all levels—from elementary school students to high-growth entrepreneurs.

Born in 1916, Ewing Marion Kauffman was an entrepreneur, Major League Baseball team owner, and philanthropist. He believed this success was a direct result of a fundamental philosophy—treat others as you would like to be treated. “It is the happiest principle by which to live and the most intelligent principle by which to do business and make money,” he said.

In 1950, following his service in the Navy during World War II and several years as a pharmaceutical salesman, Ewing Kauffman founded Marion Laboratories Inc., operating out of the basement of his modest Kansas City residence. He used his middle name rather than his last name so that customers would not perceive him as a one-man operation. By 1989, when Marion Laboratories was sold to Merrell Dow, it had become a global diversified pharmaceutical giant with annual sales of nearly one billion dollars. Mr. Kauffman followed his philosophy of “treating others with dignity and respect” in his leadership, hiring, and communication practices, which had an enormous impact upon the success of the company. He proved that treating others well increases their commitment to the company.

Another guiding philosophy of Mr. Kauffman’s was that those who produce should share in the rewards. This philosophy also proved highly motivating. Mr. Kauffman’s adherence to this principle can be seen in the 300 or so millionaires who were created when Marion Laboratories merged with Merrell Dow. It pleased Mr. Kauffman that along with senior managers, many plant and clerical workers who had been with the company for many years were able to realize significant wealth from their stock.

The third guiding philosophy of Mr. Kauffman’s was to give back to the community. Ewing Kauffman’s entrepreneurial success enabled him to help others. He provided jobs and economic self-sufficiency to thousands of associates at the pharmaceutical firm he created. He brought Major League Baseball back to Kansas City, Missouri by purchasing an expansion team, the Kansas City Royals in 1968. This boosted the economic base, community profile, and civic pride of the city. His most enduring gift was to establish the Ewing Marion Kauffman Foundation that helps create self-sufficient people in healthy communities. For more information, go to emkf.org.

More Info

Kauffman.org—Comprehensive website describing programs, partnerships, and initiatives in the areas of entrepreneurship and education in which the foundation is involved.
Becoming an Entrepreneur

Overview
Successful entrepreneurs develop businesses that meet a market need and help them reach their personal vision and goals. In this course, you will examine your willingness, desire, and courage to be a successful entrepreneur. To start this process, you will define your personal vision. Then you will gather information, write a business concept, and test it for feasibility against the model business and your personal vision. Finally, you will analyze information, solve emerging problems, and write a business plan. Armed with your plan, you will be ready to start this business or evaluate another business idea.

This first chapter discusses the basic role of the entrepreneur, so you can learn what is involved in entrepreneurship. Entrepreneurs often have common characteristics and competencies. You will determine which characteristics and competencies you possess. In addition, you will determine your personal vision.

Finally, this chapter outlines the process of planning and its influence on an entrepreneur’s chances of business success. You will learn what is involved in the planning process and what must be considered in writing the start-up business plan. The business plan addresses the major aspects of the business and assists the entrepreneur in developing solutions to problems as they are identified in the planning process.

Objectives
In this chapter, you will learn to:

- Define entrepreneurship.
- Identify characteristics of a successful entrepreneur.
- Recognize entrepreneurial competencies within yourself.
- Prepare a personal vision.
- Explain the importance of the planning process.
1.1 Understanding Entrepreneurship

1.1.1 Who are Entrepreneurs?

Entrepreneurs are people who interpret problems as opportunities, take action in response to needs, and accept calculated risk in the hope of creating value. Entrepreneurs find it more rewarding to solve problems in their own business than to do so for another person’s business.

Successful entrepreneurs do the following:

• Recognize an opportunity by identifying an unmet need or want, and then develop a product or service that meets it.
• Verify that others are willing to pay for the product or service.
• Manage risk by educating themselves about potential risks and problems, and then take action to minimize or eliminate such risks and problems.
• Determine the resources they will need and where to find them.
• Build a network or team of advisors, employees, consultants, and mentors who have the information and skills to help the business succeed.

1.1.2 What is Entrepreneurship?

Entrepreneurship is a process through which people and teams pursue an opportunity, use resources, and initiate change to create value. Entrepreneurs are driven by a need to control their own destinies and bring their dreams to the marketplace.

Starting a business takes time. It requires balancing commitments, it costs money, and it involves taking risks. Before starting a business, one needs to learn the basics of entrepreneurship.

Reality

According to The Wall Street Journal, less than 1 percent of inventors ever make money from their inventions.

• Successful entrepreneurs develop feasible ideas into profitable businesses. An entrepreneur does not need a novel or unique idea on which to base an enterprise. Most entrepreneurs start companies based on existing products and services whose market is well established. In reality, few new enterprises are based solely on new discoveries or inventions.
• The wise entrepreneur selects people who possess the abilities needed to help the business succeed. Many failing businesses have been taken over by new, more skilled management who turn around the fortunes of the company.
Tip
Aspiring entrepreneurs can gain valuable knowledge and experience from mentors, reading, research, experience, college coursework, and seminars.

- Experience within the industry or business is very important to business success. In some cases, however, the lack of experience can be addressed through a concerted effort on the part of the entrepreneur to learn the new field and its practices. These entrepreneurs may seek opportunities to work in the new field prior to business start-up and hire employees with the experience they need.
- Entrepreneurs find creative ways to afford the financial commitments of owning a business. They may choose low-investment businesses, such as services or Internet businesses, where they do all the work themselves.
- Smart entrepreneurs take time to develop a product, test it, market it, and develop and grow the market. A business often takes several years to break even. Some dot.com company founders became millionaires or even billionaires in a few years, as was the case with Facebook founder Mark Zuckerberg, but such instant success is rare.
- Successful entrepreneurs find ways to minimize and avoid risks, when possible. Simulations in which entrepreneurs were asked to make a choice between risks and payoffs showed that most entrepreneurs are moderate risk takers.

More Info
Creating the Uncommon Company—From Conversations with Mr. K and the Ewing Marion Kauffman Foundation. View this movie using the More Info link in the online course.

The E-Myth Revisited: Why Most Small Businesses Don’t Work and What To Do About It, Michael E. Gerber (Book)—The myths of entrepreneurship as well as why many businesses fail.

from real entrepreneurs
When he was a 23-year-old student at the University of Southern California, Jim Breen started a business that sold ice cream from a vending cart. He obtained permission to sell the ice cream at special events, giving a percentage of the revenue to the sponsor of the event. He enjoyed this business because it provided enough money to cover his living expenses and gave him time to pursue his hobby of surfing. Later he had the opportunity to supply all the concession stands for air shows sponsored by the U.S. Air Force. As a result of his experience and lessons learned in the ice cream distribution business, Breen changed his company’s focus and renamed it Umbrella Entertainment Group, which he runs as president and CEO to this day, 27+ years later.
1.1.3 The Issue of Taking Risks

Entrepreneurial success is far from guaranteed. Aspiring entrepreneurs should consider all the risks associated with starting a new business. Financial risks, such as losing savings, income and even home equity are possible. Astute entrepreneurs take calculated risks and reduce the risk factor by researching and planning their business concepts.

**Reality**

New business failure rates are high, often quoted as 70% or more within the first two to five years of operation. Yet failure rates vary significantly by industry and sector.

Potential risks, money requirements, and the amount of time required can seem overwhelming in the idea stage. This course provides the tools you need to analyze these issues and plan for success. People with motivation, desire, and the right business plan are the most likely to find themselves successful in entrepreneurship.

People with the right drive, leadership ability, and desire find themselves drawn to entrepreneurship. Combine these qualities with a good business plan to create a successful business.

One way to reduce risk is to start small, experiment with the marketplace on a small scale, and obtain customer feedback. This approach doesn’t mean that a business must stay small. The entrepreneur may have dreams of building an international million-dollar business. Testing the business concept on a limited basis at the beginning makes good sense.
from real entrepreneurs

With a lot of sweat equity and a computer, James Sheehan launched schoolfinances.com Inc., a management reports and planning system now being used by over 150 of the 340 school districts in the state of Minnesota. Sheehan recognized that considerable information was being collected by schools regarding school district operations but not in a format that could easily be used by school administrators — DRIP as he called it, Data Right and Information Poor. His experience in the computer and education fields enabled him to develop a model of all the variables that would be valuable to school administrators. Sheehan recommends that others looking to start a business do something about which they are passionate as you often end up working 14-16 hours a day, at least initially. Sheehan estimates he spent over 3,000 hours developing the Minnesota school district Financial Planning Model, sometimes referenced as the “Sheehan Model.”

Another way to minimize risk is to carefully evaluate the feasibility of a business by writing a detailed business plan. A business plan helps entrepreneurs determine whether or not a business has a market and can make a profit. With proper planning, entrepreneurs reduce the risk of starting a business by replacing guesses and suppositions with facts and research.

Reality

No universal law dictates that one’s rewards in this life are proportional to the risks assumed. Lottery players can attest to the fact that long-shot odds seldom reap rewards.

Tip

A good way to begin minimizing risks is to research the industry, test the markets and write a business plan. The chances of successfully starting and operating a business will be significantly increased by doing so.

from real entrepreneurs

In just two years, Pete Estler turned a simple idea into an e-mail marketing firm MatchLogic. He sold it for $90 million to Excite@Home. Before that, Estler turned another basement computer project, dbIntellect, into $50 million in just three years. He sold that database company to Electronic Data Corp. for stock. Estler knew that he wanted to create dramatic businesses quickly and then exit.

Estler has started a new company iBelay.com, which will be a $100 million venture capital fund, a data center, and an incubator for dot.com start-up businesses. In two months after start-up, he made investments in six dot.com new ventures and received another 200 e-mails from entrepreneurs who wanted to meet him.

Estler says, “The biggest thrill is taking two people and an idea and making them worth $100 million.”

More Info

The Art of Calculated Risk, Richard Branson—Branson, billionaire founder of the Virgin group, shares how he evaluates business opportunities and how you can apply it to your business. entrepreneur.com/article/217479
1.2 Recognizing Entrepreneurial Competencies

1.2.1 Character Traits

To further understand the nature of entrepreneurship, it is helpful to examine the common traits of successful entrepreneurs:

- **Desire**—Unquestionably, a successful entrepreneur must fervently want to be one. Entrepreneurs’ desire to succeed pushes them to perform the tasks necessary to be successful.

from real entrepreneurs

A group of physicians, seeking to escape their problems with malpractice insurance considered a new business to manufacture medical equipment that looked quite promising, according to the business plan that had been prepared by a large accounting firm. The group assembled for a kickoff meeting. The money was in place. The management team, experienced in the industry, was in place. Still, the venture never got off the ground. Why? The doctors did not want to be in that business. After meeting for four hours, they all walked out of the room, firmly convinced they should fold the enterprise. They realized they lacked true dedication and desire needed for the venture’s success.

- **Energy**—Most entrepreneurs have high energy levels which enables them to tackle the many demands of entrepreneurship. Having energy is sometimes a matter of good health. Other times energy seems to be more a matter of temperament.

- **Thrive on uncertainty**—An entrepreneur must be able to exist and prosper in an a changing, dynamic environment. Many entrepreneurs view times of uncertainty as opportunities for business development.

- **Determination**—No matter how hopeless things appear, entrepreneurs don’t give up. They report time and again that the thing that enables them to succeed is their resolve not to fail.

- **Responsibility**—Entrepreneurs realize that they are responsible for their own success. No one else will do it for them.

- **Persuasiveness**—Entrepreneurs are able to persuade other people to help them in various ways, such as lend them money, work hard for them, buy from them, and sell to them on favorable terms.

- **Self-discipline**—In any business, there are many tasks that people do not enjoy doing. Entrepreneurs have the self-discipline to complete all the tasks necessary for success.

Reality

“Nothing in the world can take the place of persistence. Talent will not; nothing is more common than unsuccessful men with talent. Genius will not; unrewarded genius is almost a proverb. Education will not; the world is full of educated derelicts. Persistence and determination alone are omnipotent. The slogan ‘Press on’ has solved and always will solve the problems of the human race.”

— Calvin Coolidge
• **Self-confidence**—Entrepreneurs believe in themselves and have confidence in their abilities to solve problems that arise. They do not become paralyzed by the fear of failure.

• **Social responsibility**—Most successful entrepreneurs are motivated to share their wealth by giving back to their communities and society as a whole.

• **Ethics**—Ethical business owners reap the long-term benefits of building trustworthy relationships with customers, colleagues, and others.

### from real entrepreneurs

A person who sold goods to the PX’s on military bases found out that he could easily bill them for products he did not deliver. He got away with it for several years and made a lot of money doing so. Now he is spending some years as a guest of the government. He was sure to get caught sooner or later. A fear of punishment alone does not make an entrepreneur act ethically. The successful entrepreneur knows that ethical business practices are the best route to long-term success.

• **Value appropriate control systems**—Successful entrepreneurs know the importance of adequate controls for key variables within their businesses, such as costs, inventories, and cash.

### Reality

Studies of business failures clearly indicate that the lack of adequate control systems is one of the biggest causes of bankruptcy.

### 1.2.2 Skills, Knowledge, and Abilities

In addition to having similar character traits, most entrepreneurs also have similar skills, knowledge and basic abilities:

• **Problem solving**—Successful entrepreneurs are problem solvers. Business owners spend a lot of time troubleshooting, trying to identify the problems that are plaguing their business, and then doing something about them.

### from real entrepreneurs

Health issues and a disabling condition created a unique business opportunity for an entrepreneur who was frustrated at the discomfort caused by regular-fitting clothes. This person was wheelchair bound, and thus required specially designed and sewn clothes, using Velcro instead of zippers and buttons. Seeing an opportunity, she soon formed a joint venture with a major wheelchair manufacturer and founded a firm in a niche market that specializes in meeting the clothing needs of wheelchair users.

• **Market awareness**—Entrepreneurs take their directions from the market. Market observation and analysis enables entrepreneurs to identify and verify market opportunities.
1.2.3 Assessing Entrepreneurial Characteristics

Aspiring entrepreneurs benefit from studying the traits of successful entrepreneurs for two reasons.

- First, after seeing what it takes to be successful in the entrepreneurial world, individuals may evaluate whether or not they have the traits necessary to be an entrepreneur.
- Second, they can focus on developing these traits. Aspiring entrepreneurs should evaluate the strength of their entrepreneurial characteristics and identify the competencies that they want to improve.

When you evaluate yourself against entrepreneurial characteristics, you have to be honest with yourself. Do you have these characteristics? If not, what must you do to obtain them?
Exercise 1.2.3
Assess Entrepreneurial Characteristics

Learning Objective
• Assess your entrepreneurial characteristics and prepare an action plan to strengthen specific characteristics in need of development.

Overview
Although no exact set of characteristics is possessed by all entrepreneurs, many entrepreneurs share a number of common traits and skills. In this exercise, you will evaluate to what degree you possess common entrepreneurial characteristics and prepare an action plan to strengthen those characteristics you wish to develop further.

Step 1
Review common entrepreneurial characteristics. Review the character traits, skills, knowledge, and abilities in the Entrepreneurial Characteristics Self Evaluation.

Step 2
Conduct a personal self assessment. Evaluate the strength of your entrepreneurial characteristics by circling the number that best represents how well each of the characteristics below applies to you. Use a scale from 1 to 10, in which 1 indicates your competency is weak and 10 indicates your competency is strong.

Entrepreneurial Characteristics Self Evaluation
Character Traits Weak Strong
a. Desire 1 2 3 4 5 6 7 8 9 10
b. Energy 1 2 3 4 5 6 7 8 9 10
c. Thrive on uncertainty 1 2 3 4 5 6 7 8 9 10
d. Determination 1 2 3 4 5 6 7 8 9 10
e. Responsibility 1 2 3 4 5 6 7 8 9 10
f. Persuasiveness 1 2 3 4 5 6 7 8 9 10
g. Self-discipline 1 2 3 4 5 6 7 8 9 10
h. Self-confidence 1 2 3 4 5 6 7 8 9 10
i. Social Responsibility 1 2 3 4 5 6 7 8 9 10
j. Ethics 1 2 3 4 5 6 7 8 9 10
k. Value appropriate control systems 1 2 3 4 5 6 7 8 9 10
l. Problem solving 1 2 3 4 5 6 7 8 9 10
m. Market awareness 1 2 3 4 5 6 7 8 9 10
n. Low support needs 1 2 3 4 5 6 7 8 9 10
o. Business knowledge 1 2 3 4 5 6 7 8 9 10
p. Good people judgment 1 2 3 4 5 6 7 8 9 10
**Step 3**

**Prepare Action Plan.** Select three competencies in which improvement would be most beneficial to your future business. Beside each competency, identify two steps you will take to improve or strengthen it.

<table>
<thead>
<tr>
<th>Competency</th>
<th>Action Plan</th>
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<tbody>
<tr>
<td><strong>EXAMPLE</strong></td>
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<tr>
<td>1. Value appropriate control systems</td>
<td>1. I need to take a class to understand accounting and budgeting processes better.</td>
</tr>
<tr>
<td></td>
<td>2. I need to find an accountant who could help me set up and understand a budget.</td>
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1.3 Establishing a Personal Vision

1.3.1 Introduction

Starting a business involves a series of important decisions. In many ways, it is like planning a trip. In order to travel successfully and meet the journey’s objectives, travelers complete many of the steps below. In a similar manner, a potential business owner should complete the corresponding steps which follow in parenthesis.

- Consider what they want out of their journey – challenge, adventure, intellectual stimulation. (Prepare a personal vision.)
- Outline the activities they would like to do and identify their destination. (Write a business concept.)
- Decide who will go with them and make the necessary contacts. (Build a network.)
- Consider the services (fuel, food and lodging) needed along the way. (Identify resources.)
- Make a list of things needed to pack for the trip and prepare an itinerary. (Write the business plan.)
- Identify the amount of money needed for the trip, where it will come from, and how it will be spent. (Identify sources and uses of funds.)
- Decide how long they want the trip to last. (Plan the exit strategy.)

Travelers take into consideration personal goals, special opportunities, financial considerations and time limitations when planning ahead. Planning well in advance will likely make the journey a success. The same applies to an entrepreneur embarking on a business venture.

1.3.2 Personal Vision

Planning for a successful business start-up is similar to planning for a successful journey. Some may be thinking, “I don’t like to do much planning before I travel. I just like to head out the on the open road and see where it takes me.” Many ex-entrepreneurs have had this same attitude about their business.

If a course for the business is not set, how will the entrepreneur ever know if the venture is successful? Entrepreneurs need to analyze their own personal objectives before they can plan for business success. The first step is to analyze their personal vision for their future. The personal vision helps aspiring entrepreneurs select a business that is right for them. Through the personal vision, entrepreneurs establish lifestyle, professional, and financial objectives with which to evaluate business ideas.

Tip

You should understand your own personal objectives before you plan your business. This includes planning for your desired lifestyle, professional growth, and financial objective.
1.3.3 Lifestyle Criteria

The first consideration when defining a personal vision is lifestyle criteria. Entrepreneurs determine what type of lifestyle they want and then pursue a business that can support it. An entrepreneur should consider several lifestyle criteria when planning a new business.

- **Work hours**—Entrepreneurs should think about the days of the week and times of day that they want to work. Also, how many weeks per year and at what time of year do they want to work? They will want to understand the needs of the customer and how those needs will affect the business.

*from real entrepreneurs*

One aspiring entrepreneur wanted to start a business to spend more time with her young children. Her first business idea was a retail store. She quickly determined that working weekends and evenings was a necessity in retail. Starting this business would have been a big mistake for her!

- **Flexibility**—Entrepreneurs need to consider how much flexibility they want in their schedule to allow for responsibilities involving family members and friends.

- **Desired location**—Entrepreneurs should consider where they want to live and work when selecting a location for a business. Sometimes entrepreneurs select a location before choosing a business. Then business concepts can be evaluated based on their compatibility with the location.

- **Travel**—Is the entrepreneur looking for travel opportunities or trying to avoid them? Entrepreneurs should decide how much they would like to travel before selecting a business concept.

- **Morals, beliefs, and standards**—Entrepreneurs should seek a business that supports and cultivates their morals, beliefs, and standards.

- **Physical requirements**—Age and health must be considered. Entrepreneurs must weigh the mental and physical requirements of the potential business against their current physical condition and health.

- **Family involvement**—Entrepreneurs must evaluate how the business will impact their families, and discuss important issues with family members.

*from real entrepreneurs*

A doctor who decided to open her own eye clinic did not have a specific location in mind. She made a list of what she wanted a town to have: climate, population, outdoor recreational activities, and educational facilities. She then took a trip across the United States looking for the location that fit these lifestyle criteria. Reno, Nevada, had all the qualities she wanted, so she relocated there and started her clinic.
1.3.4 Professional Criteria

Entrepreneurship can bring limitless professional growth opportunities. Entrepreneurs need to define what is important to them professionally.

from real entrepreneurs

Entrepreneurs that place a high value on power usually have some strategic game plan for obtaining it. The legendary Howard Hughes, an aviator, innovator, entrepreneur, and billionaire, would buy businesses just to obtain a powerful position in the industry. Ted Turner tried to obtain power in the television industry through the acquisition of Columbia Broadcasting System (CBS), but his efforts were rebuffed. Turner later became a media mogul by pioneering the concept of TV superstation broadcasting to cable systems nationwide by satellite. The merger of his Turner Broadcasting Station with Time Warner created the largest entertainment company in the world.

- **Power or status**—Some people have a strong need to be in charge rather than take directions from others.
- **Involvement in daily operations**—Some entrepreneurs want to be engaged in the day-to-day operations and decision making of the business.
- **Expertise, skills, and preferences**—Many entrepreneurs will identify the strengths they bring to their business and hire or contract with others to overcome their weaknesses.

Reality

Beware that the quest for power is often driven by ego, which many entrepreneurs say is their most negative trait. Ego can drive entrepreneurs to stop listening to advisors and employees and start thinking that they are always right.

from real entrepreneurs

A businesswoman decided to leave the world of medical administration and do what she’d dreamed of for 20-plus years—be a children’s clothing designer and manufacturer. She started with the old sewing machine she had but soon acquired enough clients to afford the purchase of a cutting and sewing system. Her business success was accomplished with determination and hard work and she’s doing what she enjoys and gets paid for it as well.

- **Job security**—Examples abound of owners whose basic goal for being in business is to make a stable income. To ensure this, some entrepreneurs avoid risks.
- **Future professional goals**—Successful entrepreneurs take time to visualize where they would like to be five or ten years in the future. They ask themselves:
  - What do I see myself doing professionally?
  - Am I in the same business or am I doing something completely different?
  - What business has the best potential of getting me where I want to be professionally?
- Starting a business now that takes away from where the entrepreneur wants to be five or ten years down the road is like taking a long, unnecessary detour.
- **Growth business or lifestyle business**—A growth business is one in which fast growth is the goal. A lifestyle business is designed to meet the personal objectives of the entrepreneur. Entrepreneurs must decide if their goal for the business is to grow quickly or to provide a certain lifestyle and personal income.
from real entrepreneurs

Lifestyle business—The fraternity and sorority yearbook was successful at USC and earned about $20,000 in profit for the founders. When the two students expanded to other campuses, problems began to surface. Their sales representatives would not meet deadlines. They would quit in the middle of the school year. They would not be truthful about actual sales. The two owners were miserable with growing the business and dealing with many unanticipated problems from a distance. Finally, one of them decided that they should just publish the yearbook at USC and turn it into a lifestyle business.

Growth business—LaserCycle remanufactures toner cartridges for laser printers, laser fax machines, and copy machines. Rick Krska, its founder, was constantly trying new business ideas, but he never hit it big until LaserCycle. He dipped into his personal savings account for $20,000 to start the business, and during the start-up year, he invested an additional $10,000. Within three years, sales reached $2.2 million; within ten years they approached $15 million. Of the 7,000 companies in the world that do what LaserCycle does, LaserCycle distinguished itself as one of the leading performers. Krska had a sound plan for managing growth.

1.3.5 Financial Criteria

In addition to lifestyle and professional criteria, entrepreneurs should consider several financial criteria:

- **Personal financial obligations**—The most critical financial criteria is to establish a business that supports the entrepreneur’s personal financial commitments. Each business concept should be evaluated on how well it meets these personal financial obligations.

- **Future personal income**—In addition to covering financial obligations, most aspiring entrepreneurs have personal goals for future income. Entrepreneurs should evaluate the business’s ability to meet these goals.

- **Business profit**—The business needs an income as well. This income, or profit, is used to reinvest in the business. Most businesses go through cycles of growth that require additional funds. Planning in advance for these needs can help keep the business stable and growing.

- **Personal investment**—It is often necessary to invest personal funds to get a business started. If funds are limited, the entrepreneur may need to narrow the initial scope of the business.
- **External money sources**—Additional sources of investment capital are through debt and equity. Each has its advantages and drawbacks. Debt is borrowed money that must be repaid in accordance with the terms of the loan. Equity is investment money for which the investor receives some ownership in the business. Equity can be provided by the founder and/or by outside investors. Once other people invest in a business, they typically want to have a say in how the business is managed.

### Reality

Debt, so long as it is being paid, allows the entrepreneur to retain more control than non-owner equity financing.

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### from real entrepreneurs

White Castle fast food hamburger chain, famous for its small beef patties topped with chopped onions, first opened its doors in 1921. This family owned business, still going strong over 90 years later, follows an expansion strategy of slow, measured growth primarily in the Midwest and Northeast regions. The company does not franchise and finances it expansion to new locations solely through its retained earnings. This growth strategy is very different from those used by many of the fast food hamburger chains, such as McDonalds and Burger King.

- **Exit strategy**—Often entrepreneurs just getting started are not ready to think about how to exit the business. But, since an exit is inevitable, the question is whether or not the entrepreneur will plan their exit. The most common favorable exit strategies include selling the business, merging it with another business or selling shares in the business to the public at large. Unfavorable exits include business failure or the entrepreneur’s death. A planned exit strategy provides the vision needed to establish company goals and strategies from the start. It should drive the operating decisions from the first day the business is open.

### Tip

Reinvesting money in the business creates value, which raises the price tag when you seek to sell the business.

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### More Info

Exit Strategies for Your Business. Steve Robbins. Five exit strategies for those planning ahead to when they will no longer run their business. entrepreneur.com/management/operations/article78512.html

### Reality

All entrepreneurs will exit their businesses one day. Smart entrepreneurs plan ahead for this event.
Assignment 1: Establish a Personal Vision

Throughout this course, you will be given assignments designed to help you plan a successful business start-up. For your first assignment, you will create a personal vision. This is an opportunity to examine what is important to you and to articulate the type of life that will bring you satisfaction.

This assignment will ask you to establish goals in three areas: lifestyle, financial, and professional. Then you will use these goals to write a vision statement. This is a short statement which summarizes your lifestyle, financial, and professional goals.

By identifying your personal goals and objectives, you will be able to determine whether a business concept is a good match for you.

It is not unusual to discover that some of your goals conflict with each other. If this is the case, you can determine priorities or compromise between the conflicting goals. Ultimately, the outcome should reflect how you want to live your life.

Reality

There are no wrong answers. The only mistake you can make is to not take the time to establish what is truly important to you. If you don’t identify your goals, the rest of the business planning process will be of little value.
Assignment 1: Establish a Personal Vision

Learning Objective

• Write a personal vision statement that includes lifestyle, professional and financial goals for your business.

Overview

Establishing a personal vision will help you decide what type of business would be best for you. In this assignment, first establish a goal for each criterion listed. Then, write a vision statement using your answers.

Step 1
Establish lifestyle criteria.

How many hours do you want to work per week during the start-up phase? During the maturity phase?
(Tip: Most entrepreneurs work well over 40 hours each week. Be realistic about your number. The number of hours you want to work and the needs of the customer must mesh.)

Do you need flexible work hours? What will take precedence, family or business?
(Tip: Is flexibility a necessity for you or an added bonus? In most businesses, customers need prompt responses. How much flexibility is necessary for you and your family?)

Where is the desired location for the business?
(Tip: Are you interested in a certain business idea and want to find a location that will support it? Or, have you already selected a location and are trying to find a business that will be successful there?)
Assignment 1: Establish a Personal Vision

How much would you like to travel for your business? How often and for what duration? (Tip: Do you seek travel as part of the business or a perk of the business? Or do you wish to avoid travel altogether? Travel can add both excitement and stress to your life.)

What morals, beliefs or standards do you hold? (Tip: Do you have strong beliefs that will affect the way you do business? Identifying these now will help you build a company that can reflect these beliefs.)

What specific physical requirements or restrictions do you have? (Tip: Are you looking for physical activity in a business or are you avoiding it? Do you have specific physical or health requirements that need to be considered?)

Will your family be involved? Supportive? (Tip: Family support can make or break a new business. What support do you expect to receive from family…emotional, financial, time commitment, etc.?)
Assignment 1: Establish a Personal Vision

Step 2
Establish professional criteria.

What level of power or status is important to you?
(Tip: How important is it to you to have a sense of power and control in your business? Beware that the quest for power may be driven by ego. Many entrepreneurs say their ego has gotten in the way of listening to good ideas from advisors and employees.)

How involved do you plan to be in the daily operations of the business?
(Tip: Do you want to run everything, or do you like to delegate and manage? If you want to be a hands-on entrepreneur, you may be limiting the company’s growth potential. How will your involvement change over the course of the business’s life?)

What type of work do you enjoy? What expertise and skills do you already possess?
(Tip: Hopefully you will be working in this business for some time to come. It is critical to concentrate on a business that you enjoy and that builds on your expertise.)

How important is job security?
(Tip: No one plans to fail when starting a business. Still, you need to think about how important job security is to you. Are you looking for a steady income? Wanting steady work? Build your business with this in mind.)
Assignment 1: Establish a Personal Vision

What do you see yourself doing in 5 years? 10 years?  
(Tip: You are in control of your future. Knowing what you want in the future can help you build a business that will make those dreams come true.)

Do you plan to create a growing business or a lifestyle business?  
To what size do you want your business to grow?  
(Tip: A lifestyle business is limited in size, but can be very emotionally rewarding because it is built to achieve the personal goals of the entrepreneur. A growth business will often put more demands on the entrepreneur, but also creates greater financial rewards when the entrepreneur is ready to exit.)

Step 3  
Establish financial criteria.

What level of income do you need to cover your personal financial obligations?  
(Tip: Complete a personal budget to determine money needs and uses.)

What level of income would you like to reach in the future?  
(Tip: Be realistic with this figure. Sure, we would all like to be billionaires. Consider your dreams, but be reasonable as well.)
Assignment 1: Establish a Personal Vision

How much profit would you like the business to produce?
(Tip: Profits are used to support future growth and expansion of the business.
To what extent do you want your business to grow, and how much money will it take?)

How much money do you have to invest?
(Tip: Most often, businesses are started using money that the entrepreneur already has.
You will need to invest your own funds as well as time.)

How much money do you believe you can raise from outside sources?
(Tip: How much money do you need from outside sources after your own contribution?
Often, outside investors/lenders assess your level of dedication to the business
by the amount of money you have invested.)

Step 4
Write a vision statement.

Review your answers to the previous questions. Based on the information
that you provided, write a short statement about your personal vision.
1.4 The Planning Process
1.4.1 Introduction

After the personal vision has been established, planning is the process used to develop a sound business concept, test its feasibility, and then create a business plan. This process can significantly increase the entrepreneur’s chance of success.

Written goals help entrepreneurs work smarter, rather than just harder. The process of analysis and setting goals enables them to better understand and clarify risks and devise ways to manage and reduce them. Setting goals keeps the business in a future-oriented mode, always anticipating new trends and directions. It also helps entrepreneurs develop strategies for testing the validity of projections in business planning documents.

Reality

One of the biggest mistakes entrepreneurs make is having someone else write a business plan for them. Much of the benefit of a business plan is lost if somebody else does the research and writing. Entrepreneurs who wrote their own business plans report that they were forced to rethink many aspects of their venture and to consider things that would not have occurred to them otherwise.

Business planning should continue after a business is launched in order to track performance against planned projections as a matter of course. The entrepreneur can then adjust direction as needed and keep a business running smoothly by learning from mistakes and successes.

from real entrepreneurs

Research at the Ewing Marion Kauffman Foundation has shown that firms having a written business plan have 50 percent greater sales growth and 12 percent higher gross profit margins than firms without written plans.
1.4.2 Value of Sound Business Planning

The purpose of the business planning process is to investigate all aspects of a potential business. It focuses thinking and forces an entrepreneur to take an objective, critical, and unemotional view of the business.

Business planning results in a fluid, dynamic plan that is continually changing with new information and experiences. It is similar to a roadmap, designed to lead the entrepreneur in a desired direction.

Business planning creates many benefits. It often:

- Highlights strengths of the business.
- Identifies current and potential problems by pointing out weak spots and vulnerabilities.
- Eliminates blind spots.
- Identifies major flaws in strategic directions.
- Communicates the business concept to others.
- Provides the necessary information needed to evaluate an idea.
- Uncovers hidden opportunities.
- Serves as an operating tool to help manage the business and achieve objectives.
- Identifies additional ways for the business to develop and grow.
- Clarifies financial requirements.
- Serves as documentation to obtain financing.
- Measures and monitors performance.

from real entrepreneurs

The back-of-the-napkin approach to business planning has a storied place in the mythology of entrepreneurship. The journey starts something like this: Over dinner, two promising entrepreneurs start talking about ideas for launching a company and sketch out their business plan on the nearest napkin. The next day, they show their back-of-the-napkin plan to a venture capitalist who immediately writes a check for what they need, and the two are off on their entrepreneurial odyssey.

Too bad it really isn’t like that! Bankers, private investors, and venture capitalists, even family and friends, want some assurance that a concept is feasible and expect to see a detailed, written business plan.

Savvy entrepreneurs realize that to wind up where they want to go on their own epic entrepreneurial journeys, they need a good map by which to travel. To get where you want to go, rely on a compelling business plan rather than the sketch on the back of a napkin.

—Raymond W. Smilor Author of Daring Visionaries: How Entrepreneurs Build Companies, Inspire Allegiance and Create Wealth

More Info

Resources for getting started writing a business plan.

sba.gov/category/navigation-structure/starting-managing-business/starting-business

Entrepreneur Magazine’s guide to writing a business plan.

entrepreneur.com/businessplan/
1.4.3 Planning Documents

Sound business planning begins with the planning documents. Two important planning documents are the business concept statement and the business plan.

The Business Concept Statement

An idea is not a concept. Good business ideas need to be turned into business concepts that can be communicated, expanded upon and interpreted by others. Writing a business concept statement helps change the focus of a business idea from what the entrepreneur wants to do to, what customers need, and how it will be sold to them. A business concept statement communicates to others the precise nature of the proposed enterprise. It is a set of cohesive ideas about how to create and deliver value to a market.

Tip

A business idea that reads, “I want to open a restaurant” does not sufficiently define a business concept. Instead, be specific about your concept. A successful concept statement might be, “Dos Amigos will be a local restaurant featuring moderately priced Mexican food served in an attractively decorated Spanish motif building located in the El Paseo Plaza of Palm Desert, California. Strolling musicians will play Spanish and Mexican music at mealtimes. In addition to the traditional fare served in such eateries, Dos Amigos will offer unique specialty dishes, appetizers, and drinks.” Now, readers have a clear understanding of this business concept.

The Business Plan

A business plan is a written document that articulates the business concept, opportunities, entry strategy, entrepreneur’s role, management team, potential market, and financial requirements. It also identifies potential risks, problems, and trade-offs.

A business plan is not a rigid, step-by-step blueprint to follow in running the business. It can be thought of as a road map that leads an entrepreneur in a desired direction. Detours and rough roads may be encountered along the way. Still, the business plan will help, even if it is continually changing with new information and new experiences. Changes will be consciously made rather than by happenstance.

Tip

A general rule is “when in doubt, put it in the plan.” It is easy to take something out later if the material proves to be unnecessary.
Business plans can be written for many different reasons. Entrepreneurs often write business plans for their own personal reasons. At other times internal and external forces necessitate a written plan. The exact purpose of the plan will determine the type of information included. For example, when an entrepreneur is writing a business plan to secure financing from an external source, specific information about how the money will be repaid needs to be included.

The business plan for a start-up business includes these sections:

1. Cover Page
2. Table of Contents
3. Executive Summary
4. Product/Service Plan
5. Management and Organization Plan
6. Marketing Plan
7. Financial Plan
8. Appendix

**Tip**

Developing a business plan involves thinking, researching, evaluating, planning, and writing. But don’t get hung up on the writing of the plan. The writing will be easy once the other processes are complete.

The business plan for an existing business includes additional sections—an operating and control systems plan and a growth plan. It also includes documents that reflect the financial history of the business. These sections are not discussed in this course.

**More Info**

Business Plans Handbooks—Compilation of actual business plans developed by small businesses throughout North America. Usually available in business libraries.
Exercise 1.4.3  
Critique a Start-Up Business Plan

**Learning Objective**
- Use a business plan checklist to evaluate a given plan’s strengths and weaknesses with regard to style, format and content.

**Overview**
For this exercise, you will evaluate a business plan for a start-up business, using the same checklist that your professor will use to critique your business plan.

**Step 1**
*Read the sample business plan.* Read the Run KC sample business plan or one provided by your instructor.

**Step 2**
*Use the checklist to critique a business plan.* Using the following checklist, evaluate each section of the business plan. In each section below, note specific aspects that make the plan strong. For weaknesses, explain how the writer could improve the plan.

### Planning the Entrepreneurial Venture Business Plan Checklist

<table>
<thead>
<tr>
<th>OVERALL READABILITY</th>
<th>YES</th>
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<tbody>
<tr>
<td>Language is concise (does not read like a novel or term paper).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Each section stands on its own and clearly defines and satisfies its objective.</td>
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<td></td>
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<tr>
<td>Facts are supported with sufficient documentation.</td>
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<td></td>
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<tr>
<td>Conclusions drawn from facts are reasonable.</td>
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<tr>
<td>Contents are supported with sufficient charts and graphs.</td>
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<th>OVERALL SPELLING/GRAMMAR/MATH</th>
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<td>Spelling is correct.</td>
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<tr>
<td>Grammar is clean.</td>
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<td></td>
</tr>
<tr>
<td>Math is error-free.</td>
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<table>
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<tr>
<th>OVERALL Formatting</th>
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<td>Font choice is readable.</td>
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<tr>
<td>Spacing between lines is sufficient.</td>
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<td></td>
</tr>
<tr>
<td>Plan contains headings and subheadings.</td>
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<td></td>
</tr>
<tr>
<td>Formatting on headings and subheadings is consistent.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plan includes page numbers.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formatting on page numbers is consistent.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plain contains enough white space for readability.</td>
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</tr>
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### Exercise 1.4.3

Critique a Start-Up Business Plan

<table>
<thead>
<tr>
<th>COVER PAGE/TABLE OF CONTENTS</th>
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<th>NO</th>
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<tbody>
<tr>
<td>Cover page contains name of business.</td>
<td>❑</td>
<td>❑</td>
</tr>
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<td>Cover page contains chief executive's name.</td>
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<td>❑</td>
</tr>
<tr>
<td>Cover page contains address, telephone and fax numbers, email and web addresses.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Cover page contains company logo.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Page numbers in table of contents correspond correctly.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Appendix includes a table of contents.</td>
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<tr>
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<tr>
<td>Does not exceed three pages and wholly describes the new venture.</td>
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<td>❑</td>
</tr>
<tr>
<td>Describes the unique features and benefits of the product/service.</td>
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<td>❑</td>
</tr>
<tr>
<td>Identifies the management team and supporting infrastructure.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Explains the opportunities found within the industry.</td>
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<table>
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<tr>
<th>PRODUCTS/SERVICES</th>
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<tbody>
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<td>Describes product/service in plain English (not too technical).</td>
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<td>❑</td>
</tr>
<tr>
<td>Describes product/service in specific terms (not too broad).</td>
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<td>❑</td>
</tr>
<tr>
<td>Provides evidence that the product/service is technologically feasible.</td>
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<td>❑</td>
</tr>
<tr>
<td>Identifies unique features.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Identifies special benefits.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Wholly explains product/service limitations and potential solutions.</td>
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<td>❑</td>
</tr>
<tr>
<td>If applicable, identifies production process and facility plans.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Provides backup suppliers and subcontractors.</td>
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<td>❑</td>
</tr>
<tr>
<td>Anticipates future related products/services and spin-offs.</td>
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<td>❑</td>
</tr>
<tr>
<td>Describes the ways intellectual property will be created and protected.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Lists requirements from regulatory agencies.</td>
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<th>MANAGEMENT AND ORGANIZATION</th>
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<td>Explains the legal form of business.</td>
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<td>❑</td>
</tr>
<tr>
<td>Lists key management positions, including primary job responsibilities.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Identifies the board of directors/advisory council members, including primary contributions expected.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Documents the process of recruiting and selecting employees.</td>
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<td>❑</td>
</tr>
<tr>
<td>Clarifies the compensation and employee reward systems.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Establishes credibility of the management team.</td>
<td>❑</td>
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<tr>
<th>MARKETING PLAN–INDUSTRY PROFILE</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focuses on current size and growth potential of the industry.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Discusses industry trends and opportunities associated with each.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Addresses geographic locations, seasonality, and industry profit characteristics.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Identifies existing distribution networks.</td>
<td>❑</td>
<td>❑</td>
</tr>
</tbody>
</table>
### Exercise 1.4.3
#### Critique a Start-Up Business Plan

<table>
<thead>
<tr>
<th>MARKETING PLAN–COMPETITIVE ANALYSIS</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifies direct, indirect and future competition.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Contains matrix to illustrate competitive position in marketplace. (May be in Appendix)</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Describes competitive advantage.</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MARKETING PLAN–MARKETING ANALYSIS AND PENETRATION</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contains customer profile.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Contains target markets.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Fully illustrates the image of the company.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Describes plans to reach the market, including customer service, location, sales force, licensing and distributing.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Addresses plans for advertising and promotion.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Includes plans for marketing through technology, including the internet.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Discusses other penetration strategies, including publicity, telemarketing/direct mail and trade shows.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Describes plans for evaluating market penetration effectiveness.</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MARKETING PLAN–PRICING</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Addresses pricing strategy.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Contains pricing information.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Includes volume and special pricing information.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Salaries and other benefits are in line with industry standards or entrepreneur's goals.</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FINANCIAL PLAN</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Start-up costs appear to be reasonable.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Sales and income projections appear to be reasonable.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Includes break-even analysis.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Cash requirements are clearly identified.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Sources of debt or equity financing are appropriately identified.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Exit strategy is clearly defined.</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Financial statements have been included.</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>APPENDIX</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contains documents such as resumes of management team and key personnel, legal agreements between partners or with distributors, marketing materials, industry studies and detailed descriptions of high-tech products.</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>
Exercise 1.4.3
Critique a Start-Up Business Plan

Summary Comments Overall

1. Strengths:

2. Weaknesses:

3. Suggestions for improvement:
1.4.4 Using Technology to Assist in the Planning Process

Technology is an invaluable resource for entrepreneur to use in the planning process. Technology brings information, formatting, editing, sample plans, entrepreneurial stories, and timesaving processes to the computer desktop. Consider the following ways to use technology to plan a business.

- **Research**—Access websites, library databases, research reports, trade journals, magazines, and other sources that are now available through technology.
- **Evaluation**—Financial tools are available on the web to evaluate a business against others in its industry. Such financial comparisons are invaluable in setting financial projections.
- **Financial projections**—Using a financial spreadsheet program with an electronic worksheet, such as the Financial Template provided in this course, can save hours of time in preparing financial statements. These templates allow specific financial data to be entered once to produce multiple financial statements for use in the business plan.
- **Writing**—Using word processing programs greatly improves the business plan writing process. With these programs writers can move, duplicate, or delete paragraphs of text without having to reformat or retype anything. In addition, built-in spelling and grammar checks provide helpful corrections for finalizing the plan.
- **Design/layout**—Many programs provide opportunities to give a business plan a professional-looking design or layout. This advantage could include graphs, pictures, and formatting options that create a professional touch. This is especially important for plans that are to be distributed to individuals outside the company, such as bankers, investors, suppliers, and mentors.

Scenario 1.4.4

Woven throughout the course, you will find scenarios for Run KC which supplement the sample business plan included as a part of this course. Each scenario provides an opportunity to apply concepts introduced in each chapter to a sample business prior to applying them to your own business.

Run KC — Part 1 will provide an introduction to Tim Clark, aspiring owner of Run KC. You will read about Tim’s background and his personal vision and then discuss and analyze the match.

**Learning Objective**

- Recognize the relationship between resources, competencies, commitment and goals when planning an entrepreneurial venture.
Overview

Entrepreneurship is a process through which people and teams pursue an opportunity, use resources and initiate change to create value. Entrepreneurs are driven by a need to control their own destinies and bring their dreams to the marketplace. Starting a business takes time. It requires balancing commitments, it costs money and it involves taking risks.

Step 1—Meet Tim Clark

For years, Tim Clark has had the dream of owning his own running shoe store. During that time, he saved money and gained experience in the field. He now feels that he is ready to turn that dream into a concept and investigate the opportunity by developing a business plan.

Tim is 33 and has been an avid runner since he joined the track team his sophomore year in high school. He hasn’t stopped running since. Throughout his remaining years in high school and college, he was a dedicated member of both the cross country and track teams. In addition, he ran for pleasure, participating in as many races as he could.

Tim graduated from college with an accounting degree and worked for a major accounting firm for five years. Because of his strong interest in running, he left the accounting firm and went to work for a specialty running shoe store, Runner’s Resource, in Boston, Massachusetts. His responsibilities included sales, inventory management, accounting, customer service and event management. During his five years at Runner’s Resource, Tim was captivated with the technical aspects of running shoes and became known as the “guru” of proper fit. And, of course, he was still an active runner, participating in numerous 5 and 10k runs, marathons and half Ironman events.

Tim recently married and moved back to Kansas City. His bride is a runner and totally supports his desire to open a specialty running store in Kansas City...if he develops a sound plan and the venture appears viable.

To start, Tim has written his personal vision:

“I envision having to commit 60 plus hours per week to the business in its first years of operation. Because both my life and that of my wife revolve around running, I believe this is manageable. We don’t plan to have children for at least 5 to 7 years, so we have the flexibility we need to start a business.

“I am young and physically fit and have the support of several brothers and parents who live in the Kansas City area close to where we want to establish the business. They have expressed a strong willingness to help both with time and investments of money. My wife has a full-time job with benefits and plans to stay employed. We have $50,000 of our own money to invest in the business. Family members have agreed to loan us $25,000 of ‘patient capital.’ A written agreement has been drawn up concurring that the loan will be repaid once cash flow is adequate and stable.

“My main motivation for starting this business is my love of running and the desire to share my knowledge of the technical aspects of running shoes and accessories to help other runners. I plan to be a hands-on owner in the beginning, but I also recognize the value of creating a business that can sustain itself. Therefore, I will empower my employees to build a team.

“For the first two years, I don’t plan to take a salary from the business. My wife and I have saved and will live off that savings and her salary. After year two, we will determine if I can start taking a salary from the business or need to continue putting money back into the business for growth.

“In five years, I picture myself as the owner of a successful store that can operate without me. At that time, I will develop detailed plans for expansion and expect that by year 10, we have two to three successful locations. At that point in time, I expect to take a salary of $100,000 plus a year.”
Step 2
In small groups, discuss the following:

1. What entrepreneurial characteristics does Tim possess and what evidence in the scenario supports this?

2. What steps has Tim taken to prepare himself to take on this business venture?
3. What are the lifestyle, professional and financial objectives Tim has identified in his personal vision?

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4. What should Tim’s next steps be?

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Summary

This chapter included the following key ideas:

• Entrepreneurs are people who recognize opportunities, take action, manage risk, use resources, utilize a network, and ask for help when necessary.
• Entrepreneurship takes time, requires balancing commitments, costs money, and involves risks.
• Entrepreneurs can reduce both the personal and financial risks inherent in starting a business.
• Planning an exit strategy is a critical piece of the overall plan.
• Successful entrepreneurs share a number of similar characteristics that are likely to lead to business success.
• Developing a personal vision should be the first step the entrepreneur takes in starting a business.
• Lifestyle criteria, professional criteria, and financial criteria make up the foundation of an entrepreneur’s vision and business.
• Sound business planning is critical for launching, operating, and growing successful businesses.
• The ability to construct solid planning documents is important to the larger concept of sound business planning.

The next chapter examines how an entrepreneur can learn to recognize and assess possible business opportunities.
Recognizing Opportunities

Overview
In today’s fast-paced business environment, entrepreneurial success is directly related to one’s ability to identify opportunities resulting from rapid change and new trends. Successful entrepreneurs know what is happening in an industry, look for expanding markets, and predict how change and trends will impact their business and industry.

To succeed, entrepreneurs must continually recognize, monitor, and stay abreast of what is going on in the economy, government, society, and technology. Entrepreneurs who will thrive are those who seek out this information and who are the first to build businesses to address the opportunities presented.

Objectives
In this chapter, you will learn to:
• Relate entrepreneurial success to the ability to identify market needs and spot trends.
• Identify how entrepreneurs come up with ideas for business concepts.
• Use specific activities to inspire creative thinking.
• Identify possible entry strategies for starting a new business.
• Evaluate ideas against your personal vision.
2.1 Recognizing Opportunities

2.1.1 Introduction

Entrepreneurs discover ideas for businesses in numerous ways. This chapter will explain what entrepreneurs can do to find inspiration.

**Tip**

“I don’t try to jump over seven-foot bars. I look around for one-foot bars that I can step over.”

—Warren Buffett

Entrepreneurs identify opportunities for business concepts by using the following tactics:

- Studying markets, industries, and competition.
- Researching demographics, lifestyles, and habits.
- Identifying problems and needs.
- Watching trends.
- Establishing a personal network.

**Reality**

“Great ideas need landing gear as well as wings.”

—C.D. Jackson

More Info

Video, Opportunity Recognition—Scott Kriens, 55 seconds, ecorner, Stanford University’s Entrepreneurship Corner—Scott Kriens describes how Juniper was able to compete and take advantage of the rapidly growing internet router space by solving unique problems. [ecorner.stanford.edu/authorMaterialInfo.html?mid=1629](ecorner.stanford.edu/authorMaterialInfo.html?mid=1629)


2.1.2 Study Markets, Industries and Competition

By studying markets, industries and competitors, an entrepreneur can identify opportunities and develop a potential advantage. The successful entrepreneur will gain an edge over the competition by developing the following habits.

- **Monitor society, industry, and the marketplace**—Changes in consumer tastes, lifestyles, and habits are constant and volatile. Changes in government regulations and laws also present opportunities to businesses quick to identify their implications. Entrepreneurs anticipating and responding to such changes greatly increase their chances of success.

**Tip**

Make it a practice to keep on the lookout for novel and interesting ideas that others have used successfully. Your idea must be original only in its adaptation to the problem you are working on.

—Thomas Edison
Recognizing Opportunities

• **Examine new knowledge**—Entrepreneurs scan trade journals, browse libraries and bookstores, and talk to people in their industries to discover what is new and exciting. They ask questions about markets, products, services, and challenges. They scan magazines and trade journals from their own and other industries.

• **Study the competition**—Entrepreneurs need to know what the competition is doing. This careful gathering and analyzing of data is known as market intelligence. Before launching a new business, an entrepreneur must scour the marketplace to see who is already there and ask industry people, customers, and suppliers about the competition’s strengths and weaknesses.

• **Read constantly**—Successful entrepreneurs spend a significant amount of time reading and scanning newspapers, magazines, journals, and other publications for trends and connections between seemingly unrelated events. They read intuitively, looking for what is different, new, and exciting. They read publications outside of their own industry as well as major metropolitan newspapers and local business journals, which cover community developments and trends in local markets.

• **Make use of commercial research**—Business reference librarians can provide assistance in finding research resources. Leading sources include Dun & Bradstreet and Robert Morris & Associates. Many commercial research companies charge a fee for services.

More Info

**Market Research.com**—The world’s largest collection of market research. Reports are fee based. Some reports can be accessed at some university libraries without a fee.

**County Business Patterns**—Annual series that provides state, county, and ZIP economic data by industry. [census.gov/epcd/cbp/view/cbpview.html](https://census.gov/epcd/cbp/view/cbpview.html)

**2.1.3 Research Demographics, Lifestyles and Habits**

The entrepreneur can examine consumer demographics, lifestyles, and habits to discover business opportunities.

• **Keep abreast of demographic changes**—Demographic changes are continual, but often their consequences are not readily apparent. Many opportunities relate to demographic changes surrounding births and deaths, age distribution, education, occupations, and geographic locations. 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 85 years or older. For this market, assisted living centers, recreational activities, and delivery services are fertile ground for new opportunities.

• **Engage in people watching**—Observing people can bring meaningful insights for new opportunities. Watching people’s behavior and listening to conversations can provide meaningful insights and ideas on needs and desires.
Successful entrepreneurs are excellent people watchers. For example, at social functions entrepreneurs do more than make small talk. They use the occasion as a focus group, asking questions and listening to others. These questions help identify opportunities.

### Tip

Sometimes the best way to gather information is the simplest way. Go directly to the source. Make telephone calls, personal visits and ask questions. Use your powers of observation to gather the information you need.

- **Search the internet**—Internet web pages, electronic bulletin boards, and e-commerce sites are great resources for the latest information in various industries.

### More Info

Library Databases—Libraries subscribe to Internet resource databases that provide access to periodical articles, research, and news releases through their library websites. These databases are not available on the Internet to the public at large. Check with your library for more information.

American Consumers—Publications that provide research about consumers such as demographics and spending patterns. Publisher’s website: [newstrategist.com](http://newstrategist.com)

U.S. Census Bureau—Using the web-based tool, you can select tabulations for various geographic areas based on residence or workplace. [census.gov](http://census.gov)

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A venture capitalist, an entrepreneur, and a Hell's Angel biker sat next to one another during a plane trip. A fly landed on the venture capitalist, who brushed it off. It landed on the entrepreneur, who brushed it off, and then landed on the biker, who grabbed it and ate it. Moments later another fly landed on the venture capitalist who brushed it off and then it landed on the entrepreneur. The entrepreneur grabbed the fly, turned to the biker and said, “Do you want to buy a fly?”

In his book, Daring Visionaries, Ray Smilor tells this story about one entrepreneur’s uncanny ability to identify opportunities.
2.1.4 Identify Problems and Needs

By identifying problems and needs, the entrepreneur can potentially become inspired by a gap in the current market.

- **Look for the unexpected**—One can find a wealth of opportunities by observing others’ experiences in the marketplace, capitalizing on their successes and improving on their mistakes.

- **Study problems**—Problems present many entrepreneurial opportunities. Can something be done better, more quickly, or more cheaply? People are perpetually looking for cost-effective solutions to their problems. Entrepreneurs are solution-oriented and good listeners. They are troubleshooters, uncovering ideas that make people’s lives easier, more economical, or more pleasurable. In business to business sales, problems such as the late deliveries of goods or the poor quality of merchandise present an opportunity to fulfill a marketplace need by the discerning entrepreneur.

- **Examine position within the industry**—One way entrepreneurs identify market needs is by examining the industry and their position within it. Reading, researching, networking, and listening to managers and coworkers discuss problems can bring important unsatisfied needs to light.

- **Identify a growth industry**—Frequently in the early stages of a growth market, customers’ needs are not being adequately addressed. Sufficient time has not elapsed for there to be an adequate number of suppliers in the marketplace. Entrepreneur can become one of a few providers for specific products/services in their particular growth segments. Industries offering services to the aging Baby Boomer population are seeing the demand for services such as health care and home services grow as this massive demographic age group begins turning 65.

---

**Reality**

Before settling on a specific growth industry, it is important to thoroughly research every aspect of the industry. Some ideas that appear promising may be subject to complex forces, which could hinder long-term success or profitability. Cable television services, for example, experienced rapid growth in 2000 – 2010. Entrepreneurs and investors committed large resources to it. Today these companies are grappling with how to prevent the growing trend of online TV viewing from undermining its business.

- **Identify people’s needs**—What is important to people today? What are their priorities? Is there a niche market whose needs have not been addressed? Entrepreneurs know their current and potential customers well and find out what these customers need. They ask open-ended questions to discover customers’ dissatisfactions with current products and services. A focus group provides a simple but effective way to gain consumer information. Another simple technique is to ask questions of and listen to prospective customers. This method of informal surveying can provide a wealth of information on consumer preferences.
More Info

The Two Faces of a Niche Market, Jenifer Lawton, Owner Just Books, Inc.

from real entrepreneurs

Family pets provided the source of the idea for Delena Stout’s business—a dog bath and pet nutrition store. The genesis for Delena’s idea was noting the need for cleanliness and reliable equipment in the local facilities she visited to bath her large dogs indoors in the winter time. Her subsequent market research into the topic of pet care revealed pet owners’ growing interest in pet nutrition and healthy food products. The combination of the two led to a winning business idea—Brookside Barkery and Bath—which has grown to three locations in a few short years.

2.1.5 Watch Trends

A great way to uncover opportunities for a new business is to watch trends. The wants and needs of customers can be anticipated or identified by examining trends in the markets. The following sources provide information on trends and new business opportunities.

**Trade and industry associations**—Discussing trade and industry information with colleagues, competitors, and professionals in the community is a productive way to identify trends. Entrepreneurs join associations that serve their industry. For new ideas and forecasts, they attend industry conventions and trade shows.

**Media**—The secret of this technique is watching the media and scanning the Internet and professional journals for recurring themes and emerging trends. Tracking best-selling nonfiction books may also provide entrepreneurs with information on trends that may present opportunities.

**Entrepreneurs**—Having already taken the entrepreneurial leap, these individuals have proven their ability to identify business opportunities and are typically very alert to industry changes and marketplace needs. Ask current entrepreneurs to share their insight on current trends.

**Market Trends That Impact Business:**

- Changing demographics
- Technology
- Information explosion
- Search for simplicity
- Outsourcing
- Service based economy
- Health and Fitness
- Consumer Connectivity
- Urbanization
- Globalization
- Time scarcity
- Eco Products
- Work at home

*Reality*

“The most prevalent trap, particularly among entrepreneurs with a technical background, is mistaking the ability to build a product for the ability to satisfy a market need.”
More Info

Trendwatching.com—A leading consumer trends firm, relying on a global network of hundreds of spotters.

*trendwatching.com/briefing/*


Trendwatching.com—A leading consumer trends firm, relying on a global network of hundreds of spotters.

*Trendwatching.com/briefing/*

Vendors and suppliers—Due to frequent interaction with customers, vendors and suppliers are a valuable resource for information about new products/services, as well as customers’ unmet needs.

Entrepreneur’s infrastructure (accountants, lawyers, bankers, etc.)—Professionals who work closely with small business can provide valuable information about changes or the latest trends affecting their industries and the marketplace.

Teachers and instructors—These professionals stay current in their specific fields and are a helpful source of information about related trends.

Various government agencies—The government has a host of agencies that collect and report information on the economy and society. Others provide valuable assistance to entrepreneurs launching and growing businesses.

Internet—Query your favorite search engine for trends in your area of interest.

from real entrepreneurs

Jane Winter visited a local breakfast meeting for entrepreneurs interested in doing business with the local and federal government. To her amazement, the government agencies provided lists of products and services that they needed. At this particular meeting, they were seeking minority and women-owned businesses to provide some of the products and services on the list. Jane walked out of the breakfast with a list of viable ideas for doing business with the government.

More Info

*Entrepreneur.com*—In the search box type in “trends” for links to articles and websites on the latest trends.

Small Business Administration—Search for “trends” to identify many links to articles and websites about today’s trends. *sba.gov*

Trends and Business Opportunities, Kauffman Foundation—Identify trends and related business opportunities using newspapers, periodicals, and the Internet. View this resource using the More Info link in the online course.

Trends on the Horizon, Michael Moe, a founding partner at ThinkEquity, discusses the importance of looking at what will permeate culture five or more years into the future rather than what’s hot and trendy now. Ecorner, Stanford University’s Entrepreneurship Center. *ecorner.stanford.edu/authorMaterialInfo.html?mid=2194*

Tip

A big difference lies between spotting a trend and developing a profitable long-term business based on some aspect of the trend.

Tip

Success as an entrepreneur is related to the ability to spot trends, which have long term staying power, and distinguish them from fads, which are of much shorter durations.
Exercise 2.1.5
Identify Venture Opportunities

Learning Objective

- Uncover possible business opportunities by identifying and analyzing trends in the environment.

Overview

Trends are a rich source of opportunities for the alert entrepreneur. Trends may be demographic, cultural, technological or economic. In this exercise, you will search your environment for trends and identify related business opportunities. You will then evaluate which business idea presents the greatest market opportunity.

Tools

Newspapers, periodicals, Internet access

Step 1

Collect information concerning trends in the environment. By talking with others, using the Internet, and scanning newspapers and periodicals, identify three trends in the environment.

Step 2

Brainstorm business ideas related to trends. For each trend identified, brainstorm until you identify three related ideas for possible business ventures. At this point, do not limit ideas to your industry. Be open and creative.

Step 3

Identify which business idea presents the greatest opportunity. From your list of business ideas based on trends, choose the idea you feel has the most potential to become a successful business and explain why.

Example

<table>
<thead>
<tr>
<th>Step 1 Trend</th>
<th>Step 2 Business Ideas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trend</td>
<td>Idea 1 Consult with individuals and companies on effectively developing and communicating their image/brand through social media.</td>
</tr>
<tr>
<td></td>
<td>Idea 2 Sell accessories to individualize cell phones and other electronic devices.</td>
</tr>
<tr>
<td></td>
<td>Idea 3 Provide interior decorating services that build upon the customer’s taste.</td>
</tr>
</tbody>
</table>
Exercise 2.1.5
Identify Venture Opportunities

<table>
<thead>
<tr>
<th>Step 1 Trend</th>
<th>Step 2 Business Ideas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trend A</td>
<td>Idea 1</td>
</tr>
<tr>
<td></td>
<td>Idea 2</td>
</tr>
<tr>
<td></td>
<td>Idea 3</td>
</tr>
<tr>
<td>Trend B</td>
<td>Idea 1</td>
</tr>
<tr>
<td></td>
<td>Idea 2</td>
</tr>
<tr>
<td></td>
<td>Idea 3</td>
</tr>
<tr>
<td>Trend C</td>
<td>Idea 1</td>
</tr>
<tr>
<td></td>
<td>Idea 2</td>
</tr>
<tr>
<td></td>
<td>Idea 3</td>
</tr>
</tbody>
</table>

Step 3 Business idea which presents the greatest venture opportunity and why
2.1.6 Establish a Personal Network

Successful entrepreneurs build a network or team of people to serve as mentors and advisors throughout the life of their business. This network provides insights and information concerning the entrepreneur’s market and industry.

Entrepreneurs often work so intently on the intricacies of their business that they lack a broader perspective of the business environment. A network of mentors, advisors and professionals can provide this more general and objective point of view. Such a network provides state-of-the-art information, helps the entrepreneur scan the environment for opportunities, and provides helpful feedback concerning the development of an opportunity.

Building a network of people to provide information and feedback is a great way to identify trends. Understand that it takes persistence to build this network.

The process of networking begins at the first introduction. From there, the initial contact can be developed into a business relationship. An entrepreneur can find mentors through industry and trade associations; professional and business organizations; accountants, attorneys, and bankers who work closely with small business; teachers and professors; and vendors and suppliers.

Tip

When you need a mentor, search professional associations and civic groups for people whose skills and expertise you respect. A mentor can take on the following responsibilities:

- Provide objective advice.
- Open doors to new opportunities.
- Introduce you to people and necessary resources.
- Assess business performance and provide guidance.

Reality

It will take numerous meetings to become thoroughly acquainted with potential mentors or advisors. Even when others know you well, transitioning to a mentoring relationship is challenging. The best way to encourage people to help you is to help them first.
More Info

Why You Need A Mentor—Mentoring is a time-honored tradition in many fields, and for good reason: It works. You need unbiased, direct (even blunt) advice and direction if you want to grow your company.

businessweek.com/magazine/content/07_09/b4023456.htm

Building My Network, Kauffman Foundation—Make your contacts count as you practice your networking skills. View this resource using the More Info link in the online course.

2.2 Entry Strategies

2.2.1 Introduction

After identifying opportunities, it is time to evaluate these opportunities and examine ways to convert an opportunity into a business. Some opportunities require a specific entry strategy. An entry strategy is simply the approach to getting started. Other opportunities may be developed into a business using many different types of strategies. Knowing the different entry options can help the entrepreneur proceed with an opportunity.

An entry strategy must match the entrepreneur’s situation, resources, and goals. For example, a young person might have the time and energy to start a business that takes a while to generate financial returns, while an older person may need a business that generates money right from the start. In this latter situation, buying an existing business or franchise may be a good strategy.

2.2.2 Have a Customer in Hand

The customer is the reason that the enterprise is created. It seems most appropriate to begin this examination of entry strategies with one of the best ways to get into business—having a customer in hand. One of the biggest questions entrepreneurs have when starting a business is whether there will be enough customers to make the enterprise profitable. Having a customer ready and willing to purchase a product/service removes many risks inherent in other types of start-ups. With this strategy, customers are ready to buy.

Tip

A good customer in hand, ready to buy, may make it easier to obtain financing. Indeed, in some instances, the customer is so ready to buy that it will furnish front money with which to start the business.
One saying in entrepreneurship claims a person is not in business until a sale is made. With a customer who wants to buy, the entrepreneur creates a business to make that sale. The customer is indeed the focal point for the business.

Customers must be evaluated. There are some whose word is no good, or their credit is less than bankable. Just because a business has a firm contract with a company does not mean that other parties will place much value on it. How enforceable is the contract? What bailout clauses are in the contract? What seems to be a firm contract may not be if there are provisions in it by which the customer can bail out at any time.

Reality
A word of warning. There are some customers that businesses do not want. A business may be better off without customers that require excessive staff time or make unrealistic demands.

Two women wanted to start a catering business for corporate functions. Because of their limited finances, the women needed customers before they could actually launch their business. They began their customer search by visiting individual offices and giving the receptionists a plastic-wrapped chocolate brownie with boxed-lunch menus attached. They explained to the receptionists that they were starting a new corporate catering business and would appreciate their business. For the next two weeks, they stopped by the same offices and gave away more brownies. By the third week, they started taking orders. Many firms ordered box lunches because of their loyalty to the “brownie girls.”

2.2.3 Transition a Hobby/Interest into a Business

Turning a hobby into a business can provide an excellent entry strategy. A key ingredient of success is the entrepreneur’s dedication to a business and willingness to spend time on it. A hobby can provide entrepreneurs with a viable business doing something they enjoy.
from real entrepreneurs

Kim Kindred used her hobby to start a lifestyle business. She worked full-time for a corporation and used her free time during lunch hours, in the evenings, and on weekends to establish her business, American Gardenscapes. The company sells a variety of standard, antique, rare, and heirloom plants, seeds, and fresh-cut flowers. Her primary customers are gardeners, landscape designers, business owners, and local nurseries and garden centers. An avid gardener, Kim enrolled in the Horticultural Science program at a community college to obtain a Master Gardener certification. In addition, she negotiated a contract with the Housing Authority and 4-H Youth Development Office to establish a community-based children’s garden.

One advantage of this entry strategy is that it often makes for an easy transition into a business, since growth can evolve naturally from expanding demand. Entrepreneurs typically find themselves spending more and more time with the business, until it is no longer part-time.

Another advantage is that when people work part-time at something, they learn whether or not they like it and what it takes to be successful at it. Moreover, the time spent at such part-time endeavors provides a solid foundation for the basic research and planning needed to start a business.

In considering a hobby as an entry strategy, look beyond the actual hobby to the industry that supports it. Business opportunities may exist within that industry’s supply chain as well. For example, a model airplane enthusiast purchases materials through various retailers. The products are supplied by distributors and wholesalers. Business opportunities may exist at the distribution level for the hobbyist, such as becoming a manufacturer’s representative for one of the suppliers. Their knowledge of the product and industry would be an asset in identifying these opportunities and running this type of business.

Hobbyists should also analyze market opportunities surrounding their hobbies. For example, a gardening enthusiast may write and disseminate a newsletter, publish a book, or teach others about gardening.

There are risks associated with using a hobby as an entry strategy. Inherent in this strategy are the following traps to be considered:

- Gaining a business but losing a hobby. What once was an enjoyable pastime may sour as it becomes a daily work effort.
- Focusing so much on the enjoyment of the hobby that it is detrimental to the business. The entrepreneur loses focus on customers’ needs. A business owner must please the customers, the government, and financiers.
- Spending too much time on the hobby aspects of the enterprise and not enough on the business aspects, such as selling and control systems. Such tendencies can rapidly lead the enterprise into difficulty.
2.2.4 Build on Skills and Professional Abilities

If an entrepreneur is particularly adept at something, that skill can form the basis upon which to build a business. For example, the information technology industry provides many opportunities for technically adept entrepreneurs to develop new products/services.

Today, companies of all sizes are increasingly outsourcing their management and support functions to focus their resources on improving primary products/services. Outsourced services are now expanding beyond routine tasks, such as payroll and bookkeeping. Now such services include internal auditing, human resources, information technology, manufacturing, and customer services.

Providing outsourced skills or services is an excellent entrepreneurial opportunity to pursue through a contract or strategic alliance with an organization.

from real entrepreneurs

Don Vinson was a professor of marketing who provided consulting work for IBM. He developed a research technique called the ghost jury, which proved to be very effective in winning court cases. Immediately, Vinson was deluged by other consulting contracts. His business grew so quickly within two years he was forced to retire from teaching in order to devote his full-time efforts to his new business, Litigation Sciences, Inc. A few years later, he sold his enterprise to Sache and Sache of London.

from real entrepreneurs

Merrill left her job as director of research at a Midwestern pharmaceutical company to start her own business. Her first customer was her former employer, who outsourced parts of their drug testing functions to her new company.

Many entrepreneurs have thrived in a limited geographical area. Today changes in technology, transportation, and communications have transformed a narrow marketplace into a global one. Outsourcing is a natural outcome of these changes.

Driven by the desire to cut costs and increase efficiencies, common functions to be outsourced include:

- Customer Service
- Financial Services
- Sales and Marketing
- Human Resources
- Research and Development
- Security
- Information Technology
- Quality Assurance

The growth in outsourcing basic business functions has provided many entrepreneurial opportunities for those with relevant skills to launch businesses that supply these resources.
2.2.5 Invent a Product/Service

Stories like Steve Jobs’ and Steve Wozniak’s development of Apple Computer are folklore in the entrepreneurial community.

from real entrepreneurs

Steve Jobs and Steve Wozniak believed that people would want a desktop-sized home computer that could be programmed by the user. They also knew how to build it and market it. Today, Steve Jobs’ unique vision of style and functionality continues to keep Apple computers in front of some of the most passionate users of any product.

But contrary to popular opinion, new inventions are generally a poor vehicle for starting a business because of the high research and development costs and marketing challenges. For every successful invention, there are thousands that will never become profitable products.

When inventing a new product/service, entrepreneurs should:

• Look for a need in the market. Many new ideas or inventions are simply not wanted or needed.
• Examine the idea’s effectiveness in the real world. Many products that work in a laboratory are too complex to work for the average customer.
• Develop a basic working knowledge of how to start, market, and operate entrepreneurial ventures. Many inventors have technical expertise, but lack basic business skills. Marketing expertise—how to reach and penetrate the market—is particularly crucial for a new product.
• Find a business partner with significant business skills. Successful entrepreneurs either need to develop business skills or partner with someone who has them.
• Try to develop an entire product line. New enterprises that are based on one idea or one invention usually fail when they are unable to follow their initial success with other products.
• Consider the amount of time and money required to bring a new idea to market, and consequently to a point of profitability.
• Protect products and ideas with a patent. New inventions can be quickly copied if they prove successful. For instance, Netscape’s early domination of the browser market was replaced by Explorer in the mid 1990s. More recently Explorer has seen its market share eroded by search engines such as Safari and Mozilla Firefox. This also exemplify the rapidly diminishing window of opportunity early entrants into the marketplace typically enjoy. It is especially short in the technology sector.

Even patent protection can be illusory, as people are able to design around the patent, ignore it, or successfully challenge it in court. Few companies defend their patent positions successfully. Those that can, do so at enormous costs.

Purchasing a franchise or licensing the rights to a well-known product/service are two additional entry strategies for entrepreneurs.

Reality

Various studies have indicated that it takes seven to eight years for a new business to develop into a mature firm with some claim to success. Many businesses built on inventions cannot survive the time it takes for sales to reimburse the research and development costs already spent.

Tip

Be wary of invention-marketing companies. Many inventors have paid lots of money to these types of companies that in the end are rarely successful in actually marketing and selling the inventions. Many are out-right scams.
2.2.6 Become a Franchisee or Licensee

Franchise
Many entrepreneurs have successfully invested in a profitable franchise. Equally true, many people have lost a lot of money by joining the wrong franchise. Picking the right franchise to buy into is not an easy decision. Highly successful franchise systems require large sums of money to join, while low-cost franchises are typically high-risk propositions that may offer the franchisee little in return.

A good franchise should offer the franchisee the following:

- Experience and know-how. Above all, the franchisor should provide management training to the franchisee. This key ingredient and major justification for franchising is a big advantage for untrained people starting a business.
- Proven operating procedures. Some franchise organizations will build the operation and mentor the entrepreneur in the early stages of the business.
- Customers. Strong franchise systems have created a demand for their products/services that will immediately benefit the franchisee. The franchisee steps right into a ready-to-buy market.

Frequent concerns expressed about becoming a franchisee include the following:

- A percentage of the revenue is paid to the franchisor, thus lowering the franchisee’s profit.
- Supplies often must be purchased from the franchisor, often at costs higher than would be paid elsewhere.
- Franchisees are not free to manage the business as they would like.
- The franchisor’s policies and procedures must be followed.
- The business cannot be sold to just anyone.
- The franchisor may sell another franchise within the same operating area, which could negatively affect the original franchisee’s sales. Some franchising agreements, however, define franchisee’s operating territories, thus protecting against this risks.

Entering into a franchise agreement is an entry strategy that appeals largely to people who do not want to start a business from scratch and feel a franchise will improve their chances of success.

Reality
The front-end cost of a franchise is often higher than what an entrepreneur would pay if he or she started the business from scratch. This needs to be evaluated against what benefits the franchise affords the entrepreneur.
Licensing

Another entry strategy is to buy the licensing rights to manufacture and/or market a well-known product/service. Some companies license both the marketing and the manufacturing for the property, while others license one or the other.

Licensing gives the entrepreneur a unique selling advantage over competitors with unlicensed products. In many cases, perceived value of a licensed product allows entrepreneurs to generate profit margins above industry averages.

The apparel industry is a natural for licensing, since purchases are often made based on perceived value and reputation. Goods that have been licensed successfully include logos and products representing universities, sport teams, Disney and cartoon characters, toys, television shows, movies, and artists.

Obtaining a license can be challenging, since many licensors prefer to do business with companies that have strong financial backgrounds, manufacturing capabilities, and established marketing departments.

A good source of licensing ideas comes from trade shows and association meetings where entrepreneurs can meet distributors and sales representatives. Other resources for licensing information are:

- Colleges and universities, corporations, and nonprofit research institutes.
- Information services, such as the National Technical Information Service.
- The International Licensing Industry Merchandiser’s Association (LIMA), which sponsors an annual show in New York City.
- The Licensing Resource Directory, published annually by Expocoen Management Associates, which lists alphabetically more than 3,000 owners and categories of products/services as well as tips, support organizations, consultants, designers, and other professionals specializing in licensing.
- The Licensing Letter and The Licensing Letter Resource Sourcebook from EPM Communications, which lists the top 4,000 executives involved in the licensing industry.
- Licensing Report, a weekly newsletter, and The Licensing Book, a monthly magazine, from Adventure Publishing.

More Info

Link—Global licensing information. licensemag.com/licensemag/Cover+Story/TOP-100-Licensors/ArticleStandard/Article/detail/508354

Franchise Opportunities—Online resource for franchise business opportunities and information. franchiseopportunities.com

Book, The Licensing Business Handbook, Karen Raugust—All the tools needed to create and implement a successful and profitable licensing program.
2.2.7 Buy an Existing Business

Many entrepreneurs seek to purchase an existing business. Buying an existing business is an entry strategy with many advantages.

- Entrepreneurs can often obtain a better location by purchasing an existing business. It is not so much buying a business as buying a place in which to do business.
- Entrepreneurs can experience fewer start-up pains. It takes time to get a business going and profitable. An existing enterprise should provide instant revenue from an established clientele.
- Entrepreneurs can benefit from a range of financing options. Sellers, in their eagerness to make a deal, often give highly advantageous financing terms to buyers. The deal may allow the business to buy itself. That is, the buyer pays the seller from the operating profits of the business. If the buyer seeks outside financing, they have historical financial statements to provide the lender or investor. In other words, they can document the ability of the business to generate cash flow. A new business doesn’t have this ability.

The success of this entry strategy depends a great deal upon how advantageously a person can buy the business. Typically, the best buys are unsuccessful businesses whose difficulties lie in areas for which the buyer has the expertise to turn the business around and make it profitable.

from real entrepreneurs

A boat service business was on the market for $35,000. When a potential buyer examined it, all that the seller had to offer was a boat, a trailer, and a customer list. The boat was worth only $5,000 on the open market. The buyer didn’t believe that the customer list was worth the remaining $30,000 so he started his own business from scratch instead.

More Info

Buying a Business—The Ewing Marion Kauffman Foundation takes a look at issues entrepreneurs should evaluate when considering the purchase of an existing business. View this resource using the More Info link in the online course.


2.2.8 Use Technology Systems

New communications technologies allow entrepreneurs to find ready markets for their products/services. Even a relatively simple understanding of technology allows them to have a website, use an Internet storefront site to showcase a catalog of products/services, or sell to the highest bidder at one of the many Internet auction sites.
Recognizing Opportunities

Entrepreneurs can offer services, such as consulting or training, through the use of e-mail, online chatting, and web conferencing to customers all over the world. They do not need to be part of a huge enterprise to take advantage of a global market.

If a business requires technical expertise, the entrepreneur must have it, acquire it, or hire it. Suppliers or contractors can often furnish technical help. It is critical, however, that the entrepreneur take the time to identify the specific technical knowledge needed for the new enterprise and make certain that it will be available when necessary.

from real entrepreneurs

Understanding the technology helps an entrepreneur identify the needs of a new industry. Pumatech founders Brad Rowe and Steve Nicol saw that the popularity of hand-held computing devices like the Palm Pilot or the Pocket PC meant that people were going to want to get data from their desktop computer calendar and address books into these mobile devices. Getting multiple devices to talk to multiple contact and appointment managers—not to mention all the various operating systems and types of computers—could be a nightmare. Pumatech set up key relationships with Palm and other manufacturers to include the IntelliSync™ software with the product package. As a result, most data sent to PDAs today get there via Pumatech technology.

2.2.9 Look at Other Opportunities

Entrepreneurs should examine several other sources of opportunities:

- **Friends**—Sometimes friends or coworkers can be a source of opportunity. Many entrepreneurial success stories begin with two friends and an idea.

from real entrepreneurs

Friends going into business together can lead to success, such as the case with Chris Sullivan, Tim Gannon, and Robert Basham, founders of Outback Steakhouse. The secret of their success, according to Sullivan, is their respect for the others' talents, clear roles and responsibilities, and shared goals.

- **Inheritance**—Some people find themselves in a business simply because they inherited it. This entry strategy often leads to difficulty if the person does not really like or understand the business.

- **Network (multilevel) marketing**—Network, or multilevel, marketing is a $15 billion industry of home-based businesses with minimum start-up costs. These firms have gotten a bad name because some are pyramid schemes in which people make money by recruiting others instead of by selling goods. Many legitimate network marketing companies, however, do exist. Prior to joining an MLM firm, it is crucial to thoroughly investigate their operating, financial, and legal history.

- **Forming a nonprofit company**—A successful nonprofit venture must meet a critical need in the community. One of the first steps in launching a nonprofit venture is to identify funding sources, such as private individuals, foundations, or corporations. Since competition for funding among nonprofit corporations is intense, market research and a highly targeted strategy can be the competitive edge.

Reality

Going into business with friends is challenging, and friendships rarely endure the strain of a business situation. If you plan to enter into a business with friends, establish ground rules beforehand and put everything in writing.
• **Spin-offs**—Perhaps one of the most highly publicized entrepreneurial entry strategies is the enterprise initiated as a spin-off from an existing company. This technique is common in high-technology industries. Some of the better known spin-offs include that of AOL from Time Warner and Embarq CORP from Sprint Nextel Corporation. In some cases, the existing company will offer support to the spin-off in terms of funding, physical resources or customers. Other times the spin-offs come about simply because people are frustrated in the desire to do what they want under the existing corporate bureaucracy. They see little reason to use their ideas to make the corporation prosper. They would rather work for themselves.

### from real entrepreneurs

Gene Amdahl left his high-ranking position with IBM to form Amdahl Corp., which subsequently developed a very large computer. The spin-off developed when IBM did not allow Amdahl to develop his computer for IBM, despite the fact that he had been instrumental in developing the IBM 360 series. IBM simply did not believe that there was a sufficiently large market for the monster computer to warrant its development. Amdahl proved IBM wrong.

### 2.3 Assessing Opportunities

#### 2.3.1 The Assessment Process

The process of assessing opportunities is a critical step in selecting a business concept that matches the entrepreneur’s goals. Some tough decisions arise throughout the process, but the process itself is not hard. In fact, assessing opportunities is somewhat like choosing a destination for a vacation destination. In Chapter 1, we compared starting a business to going on a journey. The following steps show the similarities between these two events.

1. **Determine the criteria for selecting a destination.** This step is like establishing a personal vision when starting a business. The personal vision contains a list of criteria for a business. In this personal vision, lifestyle, professional, and financial goals are identified.

2. **Collect names of possible destinations that could match the criteria.** This step is similar to the process of looking for opportunities. In addition to looking for opportunities that seem to match the criteria, look at opportunities that initially don’t seem to match.

3. **Reduce your list of possible destinations by comparing them to your criteria.** This step is comparable to the critical step of analyzing opportunities against a personal vision. An entrepreneur should sift through the opportunities to identify a small number that match with the personal vision and warrant additional review.
4. Based on the evaluation thus far and feedback from others who have been there, identify the one or two destinations that sound best. This step parallels the critical step of comparing business opportunities to the model business. The Model Business Reality Check is a valuable tool to evaluate business opportunities. Comparing opportunities to the model business will provide critical information about how feasible the business is from an external standpoint. In other words, the business may meet personal criteria but may not have a market that wants to buy the product/service and make it profitable. These questions must be answered to make a sound decision about starting a business. Chapter 4 is dedicated to the Model Business Reality Check.

from real entrepreneurs

A large number of people become entrepreneurs out of sheer desperation. Either they are frustrated with a current job, cannot find a job, or are not achieving their financial goals. You need to determine whether a business is right for you, regardless of your motives for starting it.

More Info

How to Test Your Business Idea, Four ways to prove there is a market for your product. Brad Sugars. entrepreneur.com/article/2175631

2.3.2 Evaluate Opportunities against a Personal Vision

The first step in assessing opportunities is to compare them against one’s personal vision. The personal vision includes criteria for lifestyle goals, professional goals, and financial goals. Refer to the personal vision created in Assignment 1. Your own personal criteria for successfully starting and operating a business are incorporated into this assignment. Take a minute to review Assignment 1 and make any changes you feel are necessary to adequately define what success means to you.

Applying a higher importance to the criteria that are essential to success can make the assessment process even more valuable. For example, an entrepreneur may expect a personal income of at least $40,000 from the business. If this criterion cannot be compromised, that makes it essential. There may also be non-essential criteria. For example, the entrepreneur may prefer some travel, but it’s not a requirement. This criterion is non-essential and should not have the same impact on the assessment outcome.

After reviewing your personal vision, eliminate opportunities that do not match your criteria. Sift through opportunities, as if panning for gold, to identify a small number that are worthy of continued investigation.
Exercise 2.3.3
Personal Vision Evaluation

Learning Objective
• Analyze three business opportunities to see how well they match your personal vision.

Overview
There is no guaranteed, statistically accurate way to calculate the probability that a business opportunity that matches your personal vision exists. Much of this evaluation must be done subjectively. There are some helpful tools to guide you through the process. These tools help you identify the personal vision criteria that are most important to you and give you a mechanism to judge how well a business idea meets your personal vision. You can further use this tool to compare the ability of one business idea against another.

With your personal vision in hand you can eliminate opportunities that do not come close to matching your criteria. Using the tool below you will sift through the opportunities as if you were panning for gold to identify three that deserve your continued investigation. Resist the urge to hang onto an opportunity that does not meet your personal vision. In the long run, you will be happier for letting someone else start a business to meet that opportunity.

Tools
Internet access; copies of Personal Vision Evaluation Grid.

Step 1
Review your personal vision from Assignment 1. Take a minute to review the personal vision you created in Assignment 1. Make any changes you feel are necessary to adequately define what success means to you.

Step 2
On the Personal Vision Evaluation Grid, enter an “*” in the Priority column to identify essential criteria. This asterisk applies a higher importance to the criteria that are essential to your personal success. For example, maybe the number of hours you are willing to work per week is a critical number. An “**” indicates that this criterion cannot be compromised.

Step 3
Identify three business opportunities that are of interest to you and that you consider viable business opportunities for you to start.

1.

2.

3.
Step 4

Using the Personal Vision Evaluation Grid, rate how well each business opportunity meets your personal vision. Using a scale of 1 to 10 (1 meaning that the business opportunity does not at all meet your personal vision and 10 meaning that the opportunity perfectly meets your personal vision), identify the level that each of your personal vision criterion is met by the business opportunity. Note: You will need a separate copy of this grid to evaluate each business opportunity.

Personal Vision Evaluation Grid

<table>
<thead>
<tr>
<th>Criteria — Step 1 and Step 2</th>
<th>Step 3</th>
<th>Rating — Step 4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Priority*</td>
<td>How well does the business concept meet your personal vision?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Not at all — — — — — — — — — — — — — — — — — — — — — — — — — — Perfectly</td>
</tr>
<tr>
<td><strong>Lifestyle Criteria</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hours of work per week</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Flexible work hours</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Desired business location</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Business travel</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Morals, beliefs, or standards</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Family support</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td><strong>Professional Criteria</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level of power or status</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Involvement in daily operations</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Match with skills and abilities</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Job security</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Lifestyle business</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Growth business</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
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<tr>
<td><strong>Financial Criteria</strong></td>
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<td></td>
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<tr>
<td>Personal financial obligations</td>
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<tr>
<td>Future income level</td>
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<td>Business profits</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
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<td>Personal investment</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Money from outside sources</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
</tbody>
</table>

* Add asterisk (*) for essential

Total Score

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Step 5

Total the score for each business opportunity and then summarize how well each business opportunity matched your personal vision. In addition to total score, consider the score for your essential criteria. Summarize here:
Scenario 2.3.3

Run KC—Part 2

Learning Objective

- Identify methods by which entrepreneurs recognize and research business opportunities

Overview

In today’s fast-paced business environment, entrepreneurial success is directly related to one’s ability to identify opportunities. Successful entrepreneurs know what is happening in an industry, look for expanding markets, and predict how change and trends will impact their business and industry.

Becoming an entrepreneur requires spotting trends, observing society, asking questions, and listening. Entrepreneurs who will thrive are those who seek out this information and who are the first to build businesses to address the opportunities presented.

Once an opportunity is identified, the entrepreneur must then determine how they will enter the market. Some entry strategies are better than others. Remaining open to multiple entry strategies will lead to identifying more and better opportunities.

Step 1—Meet Tim Clark—continued...

Tim began research on his business concept, a running shoe store, by looking at the various entry strategies available to him: become a franchisee, purchase an existing business or start his own business. He studied the materials provided by franchisors and decided that wasn’t the right option for him. Tim feels that franchisors have too many restrictions and that he won’t be able to manage the business as he would like. He looked around the area in which he wants to locate his business and found there aren’t any existing businesses for sale right now, so he has decided that starting his own business is the best choice.

Experience has taught Tim that a specialty running shoe store needs to develop a competitive edge. Runners can purchase their shoes at the large sporting good stores or online for less. He needs to give the customer a reason to shop at his business, Run KC.

During his time at Runner’s Resource, Tim listened to customers’ complaints and comments and kept a notebook of their ideas. He also has his notes from the sessions he attended at national trade shows and from reading trade publications and business periodicals. He developed a network of sales representatives and vendors in the Boston area and utilized them to connect with their counterparts in the Mid-West, where he now lives.

Using his experience and the advice he received from industry contacts, Tim decided to develop his competitive edge around what he has found to be the critical factors contributing to a successful running experience: proper fit, advice, and support. He knows that shoe technology is rapidly changing and debates over structure versus minimalistic shoes are baffling. To help runners determine
the shoe that works for their particular foot and for their style of running, he plans to research and carry the best products available, offered by the most knowledgeable sales staff in the city. Tim also plans to take the concept of personal customer service to another level by providing a club-like atmosphere within the store. This will provide runners, both new and seasoned, with support from the store staff and camaraderie with other runners. He will also use social media, including Facebook and Twitter, to further strengthen connections with customers.

Tim believes his experience has given him the insight he needs to get started. But, he also knows that he needs to do further industry research to validate his assumptions, to uncover hidden opportunities, and to identify any flaws in his approach.

**Step 2**

Entrepreneurs identify opportunities for business concepts using many of the following means. In small groups, identify which of the following Tim used to select his chosen business opportunity. Discuss how he has used each resource.

Study markets, industries and competition

Research demographics, lifestyles and habits

Identify problems and needs

Watch trends

Identify areas he needs to research more.
Summary

Becoming an entrepreneur requires spotting trends, observing society, asking questions, and listening. The successful entrepreneur uses creative idea sources to help identify new business opportunities. Once an opportunity is identified, the entrepreneur must then determine how they will enter the market. Some entry strategies are better than others. Remaining open to multiple entry strategies will lead to identifying more and better opportunities.

This chapter included the following key ideas:

- Study markets, industries, competitors, demographics, lifestyles, and habits to identify new business opportunities.
- Look at consumer needs and trends to determine opportunities in the current marketplace.
- Establish a network of mentors and advisors to increase the likelihood of success.
- Consider beginning a venture with established customers as a low-risk entry strategy.
- Build on hobbies and activities or professional skills and abilities when examining potential opportunities.
- Utilize strategies to identify opportunities, such as studying trends, markets and the competition.
- Evaluate entry strategies, such as licensing a product, entering into a franchise agreement, or buying an existing business.
- Keep in mind that many opportunities arise out of the technology sector.
- Remember that the process of assessing opportunities is vital to starting a successful business.
Defining a Business Concept

Overview

A business concept communicates to others the precise nature of the proposed venture. Or, more formally, a business concept is a set of cohesive ideas about how to create and deliver value to a market. A business concept may be simple, such as providing computer repair and support services. Or it may be complex, such as developing, manufacturing, marketing, and servicing a line of computerized devices that monitor and centrally record the usage of power, gas, and steam by individual tenants in large apartment complexes. Whatever the idea, successful entrepreneurs are able to articulate their business concept clearly and concisely.

A dream is not a concept. Just about everybody dreams of economic success, but most do little or nothing to make their dreams a reality. True, a dream may be the beginning of a workable concept, but it takes much more than a dream to be a successful entrepreneur. Similarly, an idea is not a concept. An idea is closely related to a dream. Entrepreneurs do not need a lot of ideas. They need just one idea that can be developed into a business concept and become a reality. In this chapter, you will discover ways to develop your idea into a clear business concept that communicates the precise nature of the business.

Objectives

In this chapter, you will learn to:

- Define a product/service for the business.
- Identify potential customers.
- Explore ways to reach the market.
- Begin researching a business concept.
- Write a business concept.
3.1 Defining Products and Services
3.1.1 Solve a Problem or Fulfill a Need

Successful entrepreneurs are able to clearly communicate the precise nature of their concept. Defining the product/service is a critical piece of this communication. The entrepreneur needs to be able to answer these questions:

- What are the physical or technical features of the product/service?
- What is the purpose of the product/service?
- What problem does the product/service solve, or what need does it fill?
- What makes this product/service unique—better than the competition?
- Is the product/service workable? Does it do what it is intended to do?
- Are there enough customers who perceive a need for the product/service?

Most entrepreneurs are intimately aware of the physical or technical features of the product/service they wish to market. Communication becomes more difficult when they try to explain the purpose of the product/service.

What problem or need does the product/service fill? Are there enough customers who perceive a need for the product/service? When Kellogg’s introduced Kellogg’s Breakfast Mates they felt sure it would be a hit. Breakfast Mates filled a need. It was the answer to morning meals on the go – cereal, milk (non refrigerated Cereal Mate) and a spoon all in one package. However, in the customer’s mind, room temperature milk was not worth the convenience offered by the product. Kellogg’s tried to explain the product using ads showing parents sleeping while children fed themselves but the packaging was not child-friendly. Despite their marketing efforts, customers did not perceive a need for the new product.

from real entrepreneurs

When a woman wanted to get help for her 9-year-old’s weight problem, she found that many gyms didn’t allow children to use the facilities. So, she opened a fitness center for tweens and teens and set it up with equipment and amenities specific to this market niche. This business model starts with one demographic and builds its services around that customer. For more details about this business, see More Info at the end of this section.

Convenience is a perceived need for many potential customers. If a business concept somehow makes life far more convenient for its intended customers, it will likely be valued. Many people grapple with longer work hours, less leisure time, and long commutes. Time-starved consumers need and demand quick and convenient solutions for routine tasks. Examples of ventures that provide convenience to consumers include: mobile dog grooming, drive through dinners to go, the expanding assortment of prepackaged foods, and products such as hand sanitizers.
More Info

Articles:

entrepreneur.com/startingabusiness/businessideas/article170790.html

entrepreneur.com/startingabusiness/youngentrepreneurscolumnistscottgerber/article202900.html

entrepreneur.com/article/217498

entrepreneur.com/article/217476

3.1.2 Identify the Uniqueness of a Product/Service

Successful concepts have products/services that differ significantly in meaningful ways from competitors. Just copying the competitors’ products/services typically will not lead to a successful product/service. Perhaps, the concept is bigger or smaller, cheaper or more expensive, faster or slower, better or otherwise distinctive. It is necessary to set the product/service apart from those of the competition.

The point of difference, or uniqueness of the concept, is defined by how the product/service meets the needs of a market niche. Small businesses can make money by serving a smaller segment of the market with a unique product/service. Some small specialty soap companies are successful despite having large companies as their “competitors.” The key is to position such endeavors in a way that they really are not competing directly with the large companies. Specialty soap is positioned as a luxury product designed to pamper the user and bring the spa experience into the home.

from real entrepreneurs

Sarah Allbee became violently ill and was diagnosed as having a chemical imbalance in her system. In time, she was able to determine that the foods she ate, especially those with preservatives, were the culprit. After discovering this, she started a very successful natural health food store. In addition to the regular line of health foods, Sarah offers health classes and health screening to differentiate her store from the competition.

Uniqueness in the business concept may also provide an opportunity to legally protect the concept from being easily copied by a competitor. By protecting the products/services with patents, copyrights, trade secrets, trademarks, and/or service marks, the entrepreneur may be able to secure a more lucrative market position as well as build wealth in the business.
3.1.3 Prove That the Product/Service Works

Many concepts sound great until the realities of developing them are confronted. Customers don’t buy products/services, they buy benefits. They buy solutions to their problems, which are not solved until the concept is in place and working satisfactorily. Testing the products/services in the marketplace is a critical step.

If a product/service fits nicely into the existing market, resistance to it will be much less than if it does not fit. Big-screen TVs originally encountered acceptance problems because they did not fit into many homes. Since they were big and awkward, there was no place to put them. Today, many big-screen TVs are less than two inches deep.

Reality
Some products/services just don’t work. All sorts of great-sounding inventions are used as a basis for a concept. Many never get to market; the inventor cannot make the invention work satisfactorily outside the laboratory.

from real entrepreneurs

An innovative home heating unit was designed by some clever engineers. The first six units tested well when installed in the homes of company executives. The next winter, 200 units were installed in homes in Dallas. All 200 had to be replaced. The product’s unique control unit was too sensitive to withstand the rigors of being installed by the heating contractors in the field, whose motto is, “If it doesn’t fit, get a bigger hammer.” The problem was never solved, so the project was finally cancelled after a loss of several million dollars.

3.2 Identifying and Learning About the Customer
3.2.1 Identify Customers

One of the most challenging roles of an entrepreneur is to identify potential customers for the business concept. Who is going to buy the product/service? Who will use the product/service? This task can be difficult when the market is broad or the customer is not the consumer of the product/service. The customer is the individual who pays for the product/service. The consumer is the end user of the product/service.

Often, the customer and the consumer are the same person. Other times, customers may be far removed from consumers. In fact, entrepreneurs may have little to do with the people who ultimately consume their products/services, as is the case in many business-to-business sales transactions. Entrepreneurs are most concerned with the person they deal with directly, that is, the immediate customer who buys the product/service. Yet user needs must always be taken into account if the business is to succeed long-term.

Tip
The first task is to identify who will be the most likely customer for the concept.
from real entrepreneurs

American Gardenscapes sells a variety of standard—as well as antique, rare, and heirloom—plants, seeds, and fresh-cut flowers. Initially, the founder had some difficulty identifying the characteristics of the customers she expected to purchase her products. She started out by identifying one target customer—gardeners. After some time and effort, she was able to identify the business’ primary customer groups as gardeners, landscape designers, business owners, and local nurseries and garden centers.

A business may only sell its product/service to one type of customer. For example, a parakeet food manufacturer might only sell to pet stores. This company only has to research one buyer. Many companies, however, sell their products/services to more than one type of customer. For example, a telephone company has both businesses and individuals as customers. The firm that sells to different types of customers, each of whom buys a significant portion of the output of the firm, must research all of them.

3.2.2 Recognize Customer Roles

A business concept must be established around a perceived need in the market place. Understanding the different customer roles in the buying process can help the entrepreneur to identify a customer’s perceived needs. Customers are generally classified into the following four roles.

- The user
- The decision maker
- The buyer
- The influencer

In some instances, a customer may play more than one role. A person working in an office may be the one to make a decision about office supplies, issue a purchase order to buy them, and then use the office supplies. This person may be influenced by a catalog, another worker, or personal experience.

from real entrepreneurs

Bob Teller has been successful selling ice-cream bars and lemonade from kiosks located in shopping malls. He uses this convenient location to sell his products to thirsty, weary shoppers. His customers play multiple roles. They make the decision, buy the product, and then consume it.

In other transactions, many people may be involved in each role. There may be several users, several decision makers, several buyers, and many influencers. In such instances, marketing becomes quite complicated. An entrepreneur may encounter any combination of roles and people.

The User

Even when the user is not the immediate customer (the buyer of the product/service), the user’s needs and preferences must be considered. The concept must be designed primarily for the user. For example, the dog is the “user” or consumer of dog food. However, it is the caretaker, not the dog, who is the customer (the one who purchases the product). If the dog does not like the dog food and will not eat it, the customer will make a different selection in the future.
The Decision Maker

The business concept must be designed with the decision maker in mind as well. Marketing efforts are aimed at the decision maker. In some situations, the decision-making power is shared, so several parties must be considered. Marketing divisions typically spend more effort on the decision maker than on any of the other parties in the transaction.

The Buyer

Often the decision maker and the buyer are the same person, particularly with consumer goods. This would most likely be the case in the dog food example mentioned earlier.

Industrial buying is different. The decision maker is often hidden somewhere in the organization, yet the actual buying is done by a purchasing agent who takes direction from the decision maker. Buyers frequently look for quality, reliability, and service from suppliers. If the concept is not also designed with the buyer’s needs in mind, sales will be hard to come by.

The Influencer

The influencer encourages a customer to try or to continue using a certain product/service. It is difficult to design a concept based on the influencer’s needs because the identity of the influencer is often unknown. Influencers range from a professional athlete or celebrity who endorses the product/service to a next-door neighbor who recommends it. In our dog food example, the veterinarian or the owner of the local pet store might be the influencer.

3.2.3 Create a Customer Profile

As a part of the business concept, entrepreneurs develop a profile of the “typical” potential customer for their products/services. This profile is a more detailed description of the target market based on user-group, demographics and psychographics. Understanding the customer profile helps the entrepreneur locate, identify, communicate with, and market to potential customers.

Customers are usually first described in terms of the user group to which they belong. One common classification based on product/service usage differentiates business users from individual users. For example, a golf club manufacturer might sell to retail shops and driving ranges. This is usually referred to as B2B or business to business. Or, the manufacturer might sell directly to individual customers. This is referred to as B2C or business to consumer.

Customers are then described in demographic terms. If the customer is an individual, attributes such as age, gender, education, occupation, geographic location, religion, nationality, race and income are common descriptors. For example, a golf club manufacturer might profile their “typical” individual.

Reality

Unless the influencer is paid to endorse the product, the entrepreneur has no control over what the influencer says. “Word-of-mouth” advertising is the term used to describe the positive comments of an influencer. Unfortunately, the negative comments of an influencer can have an even greater impact on a business.

Tip

Word-of-mouth advertising can be one of the best and least expensive ways to market a product/service.
customer as male, between the ages of 45 – 70, in warmer climates, with an income over $60,000 per year. If the customer is a business, the demographic characteristics would include characteristics such as revenue, number of employees, years in business, geographic market and distribution channel.

Psychographic attributes relate to personality, values, attitudes, interests and lifestyle. In psychographic terms, the golf club manufacturer might describe their customer as outgoing, competitive and someone who values leisure activities.

3.3 Reaching the Market
3.3.1 Solve a Problem or Fulfill a Need

A well-defined product/service with clearly identified customers still has to find a way to reach the market. Entrepreneurs must develop a strategic position in the market for their product/service and determine a distribution model that best suits it.

The key to strategic positioning is to establish a business concept that provides products/services in a unique way within the industry. There are two primary ways to differentiate a business. One is to provide products/services that are different from those offered by the competition. The other is to provide the same products/services in different ways than the competition.

Before establishing a strategic position, entrepreneurs must understand how each of their competitors is positioned in the market. This information will help them determine a distinct position for their own product/service. Determining competitors’ strengths and weaknesses will uncover opportunities that can be the basis for a successful strategic position. Armed with this understanding, an entrepreneur can establish a strategic position. Consider these possible strategies:

- **Provide a unique product/service**—Many business concepts are started based on identifying a unique product/service that the industry has not previously seen. Offering a specialty item such as a purse made out of automobile seat belts is an example of this strategy.

- **Offer a unique combination of products/services**—By grouping a unique selection of products/services, a business can establish a strategic position. A sandal with a built-in bottle opener is an example of this strategy.

- **Meet the needs of a target group of customers in a unique way**—An entrepreneur may identify a group of customers whose needs are not being met by the competition. One example of this strategy is the service of renting textbooks to college students.

- **Provide the same products/services in a unique way**—Some businesses meet customer’s needs simply by providing products/services in a different manner than the competition. A mobile dog groomer uses this strategy.

A successful plan may use several strategies. When a business concept is being formed, however, it is critical that a primary strategic position be identified. This choice will enhance the ability of the entrepreneur to focus on the activities necessary to achieve the goals of the business plan.
3.3.2 Strategy Traps to Avoid

Entrepreneurs should be aware of several traps that are commonly encountered in strategic positioning:

- **Misreading industry trends**—Entrepreneurs must thoroughly research the industry to understand the opportunities that can provide a basis for the strategic position. Industries that offer the greatest opportunities are not always those that are fast growing, innovative, or attractive.

- **Thinking everyone is a potential customer**—There is nothing that everyone will buy—nothing. Yet many entrepreneurs feel that the product/service is so great that everyone is a potential customer. It is important to identify the people who will actually buy the product/service and develop a strategic position that focuses on their needs.

- **Basing decisions on a percentage of the market**—Entrepreneurs often decide to start a business because only one percent of their target market needs to become customers for the business to succeed. That one percent ultimately proves to be more difficult to sell than anticipated.

- **Having no real competitive advantage**—An entrepreneur may see the competitive advantages very clearly, but does the potential customer? Potential customers need to recognize the competitive advantages of the product/service in order to be motivated to buy.

- **Relying on gut feeling rather than facts**—Business strategies must align with the realities of both the market and the firm. The target market may not want what the company has to sell, or the company may not be able to furnish what the target market wants to buy. Strategy must fit into the reality of the world in which it will operate.

- **Having unrealistic expectations**—It is a waste of energy to develop elaborate strategies that the firm cannot execute. The strategies must be achievable. Money definitely limits strategic marketing alternatives. A company must live within its budget. Entrepreneurs also must live within their own capabilities and make the strategies fit their talents. If the entrepreneur is a great manager of salespeople, then those skills should be used in the entrepreneur’s corporate strategy.

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**Reality**

Strategy alone will not make entrepreneurs successful. Great strategies will fail if not adeptly executed. Often it matters not so much what entrepreneurs do, but how well they do it.
from real entrepreneurs

When Danny O’Neill wrote his first business plan in 1993, it was a little lofty, admits the founder of The Roasterie, a specialty coffee company in Kansas City, Missouri. “I had this grandiose idea to combine a coffee shop and roastery,” O’Neill explains. “There would be a glass wall down the middle separating the two and people in the café could sit and drink coffee while they watched roasting operations on the other side.”

O’Neill met with a counselor at the small business counseling organization SCORE. In this counseling session, it became obvious that “there was no way I could handle everything I wanted to do.” So, O’Neill decided to scale back and focus on the wholesale coffee roasting business with the goal of winning two new accounts each month. The revised plan was less exciting, but it was manageable, it lowered risks and reduced the collateral needed. Instead of the $300,000 he had originally projected, he was able to launch The Roasterie with $20,000 in personal savings.

Twelve years later, O’Neill decided to revisit his original vision and open a retail store. Although a retail location is a significant investment, he now had the financial wherewithal – and experience – to support it. With patience and smart decision-making, he eventually achieved a version of his original concept.

3.3.3 Product Distribution Models

Entrepreneurs sometimes struggle with how to get their products to market. Most often, they can develop their products and prove that customers will purchase them, yet they do not know how to distribute them. For many new concepts, the key to long-term success lies in an ability to either build an effective distribution system or introduce their products into existing distribution channels.

For product distribution, building a distribution system may involve getting middlemen who serve the target market to represent the products. Middlemen can be either retailers or wholesalers. The term distributor is also used to refer to the wholesale middleman who sells either to the retailer or to the end customers.

The easiest way to get a product to market is by placing it in an established distribution network that already serves the desired market. Entrepreneurs can make it easier for the middleman to sell their goods by furnishing them with sales literature, sales training, demonstration units, price sheets, point-of-purchase displays, or anything that will help the distributor’s sales force make the sale. Giving a distributor a cutaway model of a product may help the distributor’s salesperson sell the product. It also serves as a continual reminder to the salespeople of the item’s presence in the product line.

from real entrepreneurs

Diane Kaminski was a trained food technologist who had been forced to retire because of health problems. Even though she was officially retired, she didn’t leave the kitchen. She loved to bake—muffins were her favorite. Diane took advantage of this interest and began trying out different recipes for muffins. She developed a highly nutritional muffin that was very tasty. As she began selling them in a few selected stores, success came rapidly. Within three years, she owned a bakery and was operating a business, which she called “Mrs. Applegate’s,” on a highly profitable basis. Ms. Kaminski was able to structure her business using established distribution systems—first, using retailers to sell her products and second, becoming the retailer and selling it herself.
The decision to build a new distribution system is strongly influenced by the product, the desired target market, and how the product/service will be sold. The distribution method cannot be planned until those three factors have been considered.

One of the most celebrated distribution systems is the Internet. Many existing distribution systems have slightly altered the way they work so that they can operate with the help of technology. What may seem like a new distribution method, such as auctioning products on an Internet website, is really just a new spin on a long-standing distribution method.

One cannot begin marketing a service until those three factors have been considered.

Communication is key to “distributing” a service. Many service entrepreneurs are able to open their doors by working with people who are already familiar with their work. Successful marketers of service concepts make it easy for customers to use their services. They usually market directly to potential clients and furnish literature outlining the scope of services including prices, a portfolio of creative works, or anything that will help the client make a decision to use the services provided. Phone calls to keep in touch and remind potential clients of available services help gain and retain relationships with clients.

While service providers don’t typically have middlemen, referral partners or third parties might be involved in the process. For example, a nutritionist might receive referrals through a local doctor. The home supply store may have an arrangement with an independent business person to provide installation. Many service companies are also finding ways to sell their services through the Internet. This marketing strategy is not new; the distribution channel is.

### 3.3.4 Service Distribution Models

Entrepreneurs may have extensive backgrounds in the services they offer, but they do not always know how to branch out to expand their client base. For many new service businesses, the key to long-term success lies in entrepreneurs’ ability to market and sell their services to new clients as well as retain existing clients. In a service business, distribution is referred to as marketing.

The means of marketing a service are similar to distributing a product. The entrepreneur must consider the type of service, the target market, and how the service will be sold. One cannot begin marketing a service until those three factors have been considered.

Reality

Although established distribution systems make it easier to reach the customer, such systems may not welcome new entrants as readily as less established systems.
3.3.5 Combined Product and Service Businesses

Some distribution models include both products and services. Since distribution for products and services vary considerably, this combination adds complexity to an already involved process. It is best to establish the business by concentrating efforts on either the products or services to start. Then, as distribution processes are perfected, new products/services that respond to the changing market needs of the industry can be added.

Some businesses must offer both a product and service component from the start, such as a bicycle shop or computer repair business. However, in both cases, the primary distribution method supports the overall operations of the business. For example, the bicycle shop is primarily in the product distribution business. In starting this type of business, the entrepreneur should concentrate on selling bicycles and bicycle accessories. Providing bicycle repairs may become a necessary service based on market demand. The same holds true for service businesses. The computer repair company should concentrate on the service side of the businesses initially. As this business model is established, computer products may be added as a result of customer demand.
from real entrepreneurs

Additional methods of distribution can often be added to an established business to create additional profit potential. An online gift basket business which operated out of warehouse space prided themselves in the quality of the gourmet cookies they included in their gift baskets. When the supplier of gourmet cookies closed their business, the owner of the gift basket business expanded operations to include a bakery which produced their own brand of cookies. The popularity of their cookies eventually prompted them to open a retail store.

Expanding into a combined product and service distribution model may be the best way to meet the needs of the market. For instance, when customers buy copy equipment, they can purchase a service plan to cover regular maintenance on the machine. This strategy applies to many high-ticket items—cars, computers, and televisions.

3.4 Conducting Research

3.4.1 Purpose of Research

To develop effective concept statements, entrepreneurs must conduct a fair amount of research. Entrepreneurs must become detectives to learn as much as possible about their markets and their industries. Information gathered by entrepreneurs will yield high returns, helping to launch and grow the business. It will also increase the entrepreneurs’ credibility with those listening to their concepts or reviewing their business plans.

As with assessing opportunities in Chapter 2, the research process can be compared to going on a vacation or an anticipated trip. All successful journeys require a certain amount of research prior to the trip. Before setting out, travelers want to know where they are going, how they are going to get there, and what they are going to do when they reach their destination.

Entrepreneurship is a greater commitment of resources—time, money, energy—than a vacation. Research will help protect those resources.

Research is also critical to completing the business plan. The written plan is a the result of decisions meant to bring success to the aspiring entrepreneur’s business. These decisions must be made based on facts discovered about the market, industry, and finances surrounding the business concept.

Through research, entrepreneurs try to determine if anyone will purchase their products/services. Likewise, they consider whether their products/services meet customer needs. Is there a difference between their products/services and those of the competition? How many and what kinds of competitors exist? How can they differentiate their products? How large is the market? What marketing strategies should be adopted?
As they research the financial aspects of the business, entrepreneurs try to determine the profitability of the business concept. What price should be charged? Will that price yield a profit? How much money is needed for start-up? When will the company break-even? These questions and more can be answered only after adequate research.

The entrepreneur will conduct research for the business plan in five broad areas: industry, market, competition, financial, and legal. Questions that specifically need to be researched for the concept statement relate to who will be buying and why; the how the product/service differs; the how the product will be sold; and the how the product/service will be promoted.

**from real entrepreneurs**

The idea for PROTEC came to founder Michael Matthews while he was a police officer attending law school. Researching a paper in employment law, he learned the high cost to employers of employee liability lawsuits and rapid changes in employment law. Thinking there might be a demand for employee screening services, he spent seven months interviewing employers, studying competitors, and researching public record and law databases. Today, his firm keeps clients abreast of their employee obligations and verifies prospective employees’ Social Security number, criminal history checks, motor vehicle records, civil record checks and much more.

In spite of its importance to writing both the concept statement and the business plan, research is frequently the weakest part of the planning process. It requires the most action, such as talking to potential customers, conducting research at libraries and on the Internet, and visiting competitors. Entrepreneurs cannot obtain this kind of information sitting at a desk. Therefore, entrepreneurs often neglect research and make decisions based on gut instinct rather than hard facts. Knowing in advance the questions to be addressed will help the entrepreneur plan the time and resources it takes to do a thorough and effective job conducting research.

**Tip**

Begin your research knowing the questions you want answered.

**Tip**

Start early conducting your research. It frequently takes more time than most entrepreneurs anticipate.
Exercise 3.4.1
Market Research Worksheet

Learning Objective

• Identify sources of information when researching the areas: industry, market, competition, financial and legal to develop a business concept or business plan.

Overview

To develop effective concept statements, entrepreneurs must conduct a fair amount of research. Entrepreneurs must become detectives to learn as much as possible about their markets and their industries through both primary and secondary research. Information gathered by entrepreneurs will yield high returns, helping to launch and grow the business. It will also increase the entrepreneurs’ credibility with those listening to their concepts or reviewing their business plans.

The entrepreneur will conduct research for the business plan in five broad areas: industry, market, competition, financial, and legal.

Tools

Internet access

Step 1

Review the Market Research Worksheet to become aware of the types of information needed to develop and analyze a business concept and business plan.

Step 2

In small groups, discuss and research possible sources of the information needed.

Step 3

In a class setting, report back the individual group findings regarding sources of research information.
### Exercise 3.4.1
Planning the Entrepreneurial Venture

**Market Research**

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<thead>
<tr>
<th>CATEGORY — Information Needed</th>
<th>Possible Sources</th>
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<tr>
<td><strong>INDUSTRY/OPPORTUNITY</strong></td>
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<td>What is the history of this industry?</td>
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<td>What is the current state of the industry?</td>
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<td>What are the trends?</td>
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<td>What are the long-term prospects?</td>
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<td>Are there seasonal factors?</td>
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<td>What are the existing distribution networks?</td>
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<td>How does the industry treat new enterprises or the introduction of new products?</td>
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<td><strong>MARKET</strong></td>
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<td>What are the customer perceived benefits of what you are selling?</td>
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<td>How do your products/services differ from competitive products/services?</td>
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<td>If your product/service is not special, why would people buy from you?</td>
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<td>What is the present size and growth potential of the market as a whole?</td>
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<td>What percent of the market will you have now and in the future?</td>
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<td>What is the present size and growth potential of your target market?</td>
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<td>What are the characteristics of your target customers?</td>
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<td>What are customer reactions to your product/service?</td>
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<td>What market penetration strategies will you implement?</td>
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<td><strong>COMPETITION</strong></td>
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<td>Who are your direct and indirect competitors?</td>
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<td>Are competitors’ sales steady? decreasing? increasing?</td>
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<td>How are competitors’ operations similar and dissimilar to yours?</td>
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<td>What products do competitors offer? What price? How do they promote?</td>
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<td>What is your competitive advantage?</td>
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<td>What are the industry’s pricing policies?</td>
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<td><strong>FINANCIAL</strong></td>
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<td>What start-up costs are required for this business? or purchase price?</td>
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<td>How much working capital is needed before the business breaks even?</td>
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<td>How much additional capital is needed for continued growth?</td>
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<td>What are the costs of obtaining the necessary funds?</td>
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<td>What is the gross margin potential of this business?</td>
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<td>What is the cash flow potential of this business?</td>
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<td><strong>LEGAL AND ENVIRONMENTAL</strong></td>
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<td>What legal issues may have an impact on your business?</td>
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<td>What environmental issues may have an impact on your business?</td>
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3.4.2 Types of Research

To thoroughly research their business concepts, entrepreneurs must uncover numerous sources of information. Two types of research provide this information—primary research and secondary research.

Primary Research
Primary research involves gathering information directly from the source. Answers are sought through various methods including interviews, questionnaires, surveys and conversations with industry experts. This type of research is time-consuming and backing up the primary research with unbiased statistics is difficult. Still, primary research is a valuable tool and may be the only way entrepreneurs can obtain the specific type of information they need.

Secondary Research
Secondary research utilizes data from already published sources. In other words, someone has already done the work of collecting facts, drawing conclusions, and publishing the information. An entrepreneur need only find the published works and the information is available, although sometimes for a fee.

Sources for secondary research include libraries, trade associations, government reports, and university bureaus of business research. A great deal of data is available from the Census Bureau, Department of Commerce, the Small Business Administration (SBA), Standard & Poor’s, Moody’s, and the Internet. Helpful online resources are listed under More Info.

The more entrepreneurs know about industry trends, market statistics, customer needs, and competition, the greater their chances of launching successful ventures and continually adding innovation to their business concepts.

from real entrepreneurs

Caryl and her husband, Ken, came from the East Coast where Caryl worked in higher education for 12 years. Ken was in investments and insurance. As he was unhappy with his job, Ken and Caryl started thinking about creating their own business together. They had an interest in doing business with the Pacific Rim, so they started their research.

First, they took a two-month research trip through China. Armed with contacts given to them from a Chinese student in the business school where Caryl worked, they began their search. During each interview they would ask, “Tell us what you need. Tell us what you want. Tell us where you think we can work best together and then we’ll take it under advisement.” The two came back to the States with lots of ideas. Through additional research and a review of their personal vision, they decided on a business concept.

“The idea about grains was one we discovered when we were traveling in the Hunan province of China,” said Ken. Every meal included steaming bowls of black rice. Back in the United States, they began to test market the rice by taking it to the top gourmet restaurants in the San Francisco area. Each chef loved the black rice. With this information and many more ideas, Lotus Foods was built. Lotus Foods continues to provide food products that no one else is marketing.

More Info
morebusiness.com—Basic resources and tools for starting a business.

entrepreneur.com/article/217345

Market Research. business.gov/manage/marketing/market-research/

Inc Market Research Primer. inc.com/guides/marketing/24018.html
Exercise 3.4.2
Research the Business Concept

Learning Objective

- Use basic resources and tools to research useful information about your business concept.

Overview

Understanding the industry, potential competitors and their product/service offerings, price points, and customer demographics are all possible with the aid of research. This exercise enables you to write your business concept and gets you started in the search for the information needed to complete the business plan.

Tools


Step 1

Conduct research for the industry and the market for your business concept. Using the Internet and other reference materials, answer the following questions. Note the source, including the web address or the title and page number of the reference book. If you need assistance, ask your instructor or a business librarian for guidance. Additional sources include chambers of commerce and Small Business Development Centers.

Step 2

Expand your research. After you complete this assignment, you are strongly encouraged to contact your trade association for industry information. This will help you refine your business concept and begin developing your marketing plan.
### Exercise 3.4.2
Research the Business Concept

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. In what industry would you classify your business (i.e. information technology, entertainment, food service, etc.)?</td>
<td></td>
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<tr>
<td>2. Who buys the type of product/service you will offer?</td>
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<tr>
<td>3. Why do they buy it?</td>
<td></td>
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<tr>
<td>4. How do current product/service providers differentiate themselves?</td>
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<tr>
<td>5. Where/how is the product/service currently sold? Is the Internet a distribution channel?</td>
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<tr>
<td>6. How is the product/service currently promoted?</td>
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<tr>
<td>7. What are the trends in the industry?</td>
<td></td>
<td></td>
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<tr>
<td>8. Are there industry trends that can help your business stand out from the competition?</td>
<td></td>
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<tr>
<td>9. Is there a need in your area for this product/service? If so, how do you know?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. What is the name and website address of a trade association for your business concept?</td>
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</tr>
</tbody>
</table>
3.4.3 Technology

Technology can be a valuable tool in collecting information on an industry, market, product/service, and finances. Many of the advances in technology are centered on improved communication. Cell phones, pagers, personal digital assistants, electronic organizers, e-mail, satellite communication, e-magazines, and websites all improve communication. Communication is the key to information whether it is electronic, oral, written, video, or audio. These advances in technology have made information more abundant than ever.

Technology can be used to help uncover secondary research. Libraries have subscriptions to information databases such as Business and Company ASAP that can be searched by keyword or industry codes. The Internet is an extensive bank of secondary information which can be found on trade association websites, electronically published magazines, journals and competitor websites. Online marketing research companies provide information concerning the market or industry for a fee.

Using technology to find an abundance of information may be easy, but finding the right information is a challenge. When information cannot be found through secondary research, it is time to try primary research. Technology can also be helpful when collecting information through primary research. E-mail is a great way to communicate with people in the industry to gather information. Surveys can be conducted easily using tools like surveymonkey.com. Discussion groups on the internet can also prove helpful, as well as reading/posting questions on an Internet bulletin board for people in the industry.

Whether secondary or primary research is used to collect information, using technology can provide information to help make decisions about the business concept.

Tip

If you are not comfortable with using technology for research, talk with other entrepreneurs, business librarians, and researchers to get tips. You can save time and find more useful information by relying on advice from people who have experience researching in this way.
3.4.4 Libraries

Libraries usually contain the following sources of secondary research material:

- General business periodicals provide good sources for research. This might include periodicals such as Business Week, Fast Company, Forbes, Money, Fortune, Nation’s Business and The Wall Street Journal.
- Entrepreneur, Success, Inc., and Home Office Computing, are good publications focused on entrepreneurship.
- Periodicals that report on industries, products, services, companies, competitors, and proposed products can be helpful sources of information.
  - The Small Business Sourcebook is an excellent guide for sorting through the many business references and data available.
  - Financial information and statements from existing businesses appear in Dun & Bradstreet corporate reports and Standard & Poor’s Profiles.
  - The Statistical Abstract of the United States, which provides basic information about income levels, employment figures, industry outputs, and more, can provide useful market information.
- Publications by the Small Business Administration (SBA) on various topics can assist entrepreneurs with the many challenges of starting a business.

Librarians are trained to use library resources. Seek out their assistance. This one step can save you many hours. Librarians can direct you to databases and research tools to which the library has a subscription. These resources are not available through general online searches. If the local library is small, try a university or larger public library. Local newspapers may also offer research-information services on a variety of topics that have been printed in their papers. Sometimes research can be conducted through their website.

Many colleges and universities have research centers. Some of these research centers have business divisions that assist aspiring entrepreneurs and business owners in reviewing the technical feasibility of an idea or new business.

from real entrepreneurs

Tom needed specific information about a pet care product he wanted to market. Although he hadn’t been to a library in years, he knew he needed the information that a library could provide. He got a library card and walked around to check the resources that were available. After meeting with a librarian a few times and attending a library orientation session, he was able to access information online, at the circulation shelves, and through articles in periodicals. Tom was able to find all the information he needed to write his business plan.
3.4.5 Local Resources

Useful local resources may include either private or government entities.

- Many local chambers of commerce either provide market research information or refer people to local sources that might have information about their specific markets, including population and sales data.
- The Small Business Development Center (SBDC) in an entrepreneur’s local area might also be able to assist with the collection of needed marketing information. Assistance is usually free of charge, and most have business libraries.
- The U.S. Department of Commerce (USDC) has many offices throughout the country. It has a vast amount of data at its disposal, both published and unpublished. Typically, it can provide information by industry type, size, and geographic location. Contact the USDC directly and ask staff members for assistance in collecting needed information. They may charge to prepare this data or they may do it for free, depending on the amount and complexity. You can locate your local office through the USDC website at commerce.gov.
- The Small Business Administration (SBA) of the federal government at sba.gov has many regional offices to assist entrepreneurs. The SBA website is also a valuable source of information.

3.4.6 The Internet

The Internet is a powerful information tool. The entrepreneur can electronically access major publications, periodicals, company home pages, information clearinghouses, and interactive discussion groups. Many different databases are also available online. These databases come from a variety of sources, including associations, government agencies, and private organizations. Some of these databases require a subscription fee.
The Entrepreneurship.org website of the Ewing Marion Kauffman Foundation provides the answers and support entrepreneurs need to organize and operate a business venture, create wealth, and employ people. This information, offered by an unprecedented collaboration of organizations, is consolidated and organized into categories that make it easy for entrepreneurs to find the support they need to advance their great ideas.

### 3.4.7 Trade and Industry Associations

Almost every industry has a trade association. Many trade associations publish a journal that represents one of the best sources of industry data, market statistics, demographic information, and financial data for the industry. Trade associations furnish industry guidelines that can assist entrepreneurs in planning and tracking their businesses.

Most trade associations also typically provide information on industry sales. Much of their information is reported in percentages, which is helpful when comparing the performance of one business to a similar business. These percentages are broken down further by the size of business, sales volume, and geographic area. For example, they can tell the entrepreneur the average inventory turnover for a particular type of business, typical gross and net margins for comparable businesses, and average sales and marketing expenditures. While most associations charge for in-depth research, some provide limited data at no charge.

Trade associations conduct national and regional meetings. Entrepreneurs can attend these meetings to obtain industry information. At such meetings, an entrepreneur can identify major competitors and discover leaders in the industry. An entrepreneur might also meet suppliers and distributors, learn about the future direction of the industry, spot new trends, and preview the newest products and services.

Attendees of these meetings can talk to experts in their field. Technical sessions will reveal information about future products and new technology. And, in conjunction with their annual meetings, many organizations hold trade shows, which may provide a wealth of additional information and contacts.

**More Info**

Associations on the Internet—Search for trade associations, industry associations, and professional associations that have a presence on the Internet. ipl.org/div/aon/

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**from real entrepreneurs**

During the planning stages for a self serve dog wash, a budding entrepreneur determined that she could not generate enough revenue washing dogs to make the profit she needed. By attending a national trade show for the pet industry, she identified a growing trend in natural pet products. She added these to her business concept and created a business that matched her personal vision.
3.4.8 Conduct Research

Entrepreneurs can also conduct their own research through primary research methods—interviews, questionnaires, observation, and conversations with industry experts. Customer surveys and focus groups are two specific primary research tools that entrepreneurs can use to collect information concerning the potential customer, market, pricing, product/service benefits, and other related topics.

Customer Surveys

A common, inexpensive, and effective way to research customers is to use customer surveys. Customer surveys are used to ask customers about a product/service either in person, by telephone, or through a written questionnaire. One can learn about their needs, problems, and opinions regarding a product/service. This form of research is up-to-date and helpful in preparing a business plan that convinces others a market for a product/service exists. Also, surveys can result in future sales by giving potential customers a preview of the product/service.

The first step is to select key questions and then decide the best method for surveying customers. Questions often address such issues as customers’ preferences regarding product/service features, pricing, location and marketing. The complexity of the questions will determine the best method for surveying. For example, if feedback is sought on consumer taste preferences, a survey site would be established which allows customers to sample products.

After collecting enough data, it is time to summarize and evaluate the information gathered. Do similar responses indicate a trend? Many times, survey information may be suspect because respondents are not committing to purchase the product but merely giving an opinion. Also, since most surveys are very brief, it is not possible to collect in-depth information. See More Info - Primary Marketing Research: Customer Surveys following this section for a helpful guide to conducting customer surveys.

Focus Groups

Focus groups can provide additional customer insight while identifying the hidden needs of future customers. This popular technique is widely accepted because it produces useful information at a reasonable cost. Most entrepreneurs can benefit from using this research technique especially when identifying niche markets and forecasting potential market share. Valuable insights can be obtained. Entrepreneurs must remember, however, the viewpoints of a small number of persons in a focus group may not reflect the market as a whole.

A typical focus group takes about one to two hours and is scheduled at a convenient time for the people involved. The atmosphere should be relaxed to ensure an informal discussion of participants’ opinions and feelings. The discussion format and interview questions should be carefully prepared ahead of time. Choose participants that have demographics similar to the potential customers.

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 that the entrepreneur wants to obtain. Moderators skillfully probe the group, stressing the importance of sharing different points of view and emphasizing that there is no right or wrong answer.

Tip

Test your survey with a small group prior to administering it to a larger group. Testing often reveals questions that are unclear or that do not gather the type of information you are seeking.
It is best to record or video tape the focus group discussion. Findings are then analyzed to interpret feedback from participants and relate it to the business.

Entrepreneurs should get in the habit of continually researching customers’ needs and opinions. It can give them a renewed sense of clarity and purpose that will guide them through intense competition in the ever-changing marketplace.

See More Info—Primary Marketing Research: Conducting Focus Groups, following this section for a helpful guide to conducting focus groups.

More Info
Primary Marketing Research: Customer Surveys—Helpful information guide to conducting customer surveys follows this section. View this resource using the More Info link in the online course.

Primary Marketing Research: Conducting Focus Groups—Questions and answers to help you plan an effective focus group follows this section. View this resource using the More Info link in the online course.

Surveys and Interviews—Two sample surveys/questionnaires to demonstrate how to gather market research. View this resource using the More Info link in the online course.

surveymonkey.com—An online survey site that allows users to create their own web-based surveys.

3.5 Writing a Business Concept
3.5.1 Components of a Business Concept

A business concept is a brief document that answers the following questions:

- What does the product/service do?
- How is it different from other products/services?
- Who will buy the product/service?
- Why will they buy the product/service?
- How is the product/service different from other products/services?
- Where will the product/service be sold/offered?
- When will the product/service be ready to be sold/offered?
- How will the product/service be promoted and sold/offered?

Successful entrepreneurs can clearly and succinctly describe the precise nature of their business. Entrepreneurs that cannot do so cause others—potential suppliers, customers, investors, lenders and resource team members—to question their ability to successfully launch and grow a business.

Tip
The acid test for a well-defined concept statement is to hand it to a stranger and have him or her relate it back precisely.

Writing a business concept statement is an important task to complete before proceeding further. The business concept is then tested for feasibility prior to the preparation of a business plan. It is common for the initial business concept statement to change during feasibility testing and while writing the business plan. It will change as a result of researching the market and the profitability of the business.
3.5.2 Attributes of Successful Business Concepts

Certain attributes help a product/service succeed in the marketplace. Businesses that offer a product/service with the following attributes have a better chance of success:

- **Involves significant savings**—Great concepts create products and services with clear-cut, recognizable value. When a concept saves the customer money, people see that they are better off financially with the product/service than without it.

- **Solves a serious problem**—Concepts that deal with serious problems like diseases or safety issues are given full consideration by the market.

- **Offers convenience**—If a concept somehow makes life far more convenient for its intended customer, it will likely attract attention.

- **Fits into the existing scheme of things**—If a product/service fits nicely into an existing system, resistance will be minimal.

- **Attracts media attention**—If a product/service attracts the attention of the news media, its promotion will be greatly facilitated. Is the concept interesting? Does it have news value? If not, it is just another product fighting for a place in the market.

- **Clearly identifies a market**—Can the potential customers for the concept be clearly identified? Can they be named? Who is the first customer? Who is the next customer? These questions are critical to targeting potential customers. If they cannot be answered, it will be difficult to determine where to direct marketing efforts.

- **Captures a monopoly**—Entrepreneurs find monopolies irresistible, because monopolies can produce large profits. If the concept falls into a market in which it will be the only supplier or has few competitors, a profitable business may be in the making.

- **Joins a rapidly expanding market**—A rapidly expanding market, like e-learning or biotechnology, is more attractive to investors than mature or stagnant markets.

- **Promises a big upside and a low downside**—A concept that promises large potential profits with a modest downside risk naturally gains attention.

**Reality**

Even when the concept is clear, it will change over time as the entrepreneur learns more about the market and the economics of the new business. In fact, if your business concept does not change as you are writing the business plan, you may not be “listening” to the market and financial facts.

**Reality**

Just because the concept is dealing with a serious problem does not guarantee success. The same standards of consumer demand and profitability must be met. Many investors lose money from faulty concepts that were given the go-ahead just because they deal with serious matters.

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**from real entrepreneurs**

John was a photographer who specialized in taking team photos for sports leagues. He enjoyed it, but the profit margins were low. In seeking a higher margin, he decided to target the wedding industry. He found that this market was easily identifiable and he was able to purchase a list of brides who had attended a local wedding trade show. His cold calls to these individuals were warmly accepted, and he was able to secure numerous weddings that first year. His business has taken a dramatic change. He loves the weekend work and the increased margins.
Scenario 3.5.2

**Evaluate Concept Statement for Run KC**

**Learning Objective**
- Using the key components of an effective concept statement, evaluate the overall effectiveness of a given business concept statement.

**Overview**
Having a clear, concise and complete concept statement is critical in clarifying your business concept and communicating that concept to others. In this exercise you will identify the key components of a concept statement and evaluate a statement’s overall effectiveness. An effective concept statement includes answers to these key components.

- WHAT does the product or service do?
- HOW is it different from other products/services?
- WHO will buy it?
- WHY will they buy it? Is the product or service different from other products/services?
- WHERE will it be sold?
- WHEN will it be ready to be sold?
- HOW will it be promoted and sold?

**Step 1**
Read the following concept statement for Run KC.

**Step 2**
Identify key components. For the Run KC concept statement, answer the questions related to key components of an effective concept statement.

**Step 3**
Evaluate the concept statement for overall effectiveness. Identify ways in which the Run KC concept statement might be improved.

**Sample Business Concept Statement—Run KC**
Run KC is a retail store offering proven brands of footwear, apparel and accessories for serious and aspiring runners. The product lines offered by Run KC are of a high quality in the mid to high price range.

The goal of Run KC is to provide personal service and advice to help runners select products that increase their chance of developing and maintaining a long term love for the sport. All staff are experienced runners with exceptional product knowledge. Support after the sale sets Run KC apart from the competition. The atmosphere of the store invites customers to frequent the store to seek advice and the companionship of other runners. Customers are also invited to become part of the Run KC Running Team.
Visibility in the running community will be strong and promotion of the store will be accomplished through advertisements in running publications, participation in running events, sponsorships and recognition of customer’s milestones both in store and on the store website.

Run KC is in planning stage with a projected opening in January 2012 in Leawood, Kansas.

**WHAT** does the product or service do?

**HOW** is it different from other products/services?

**WHO** will buy it?

**WHY** will they buy it? Is the product or service different from other products/services?

**WHERE** will it be sold?

**WHEN** will it be ready to be sold?

**HOW** will it be promoted and sold?

**HOW** effective is the concept statement for Run KC?

What suggestions (if any) do you have for its improvement? What areas does Tim need to research in order to strengthen his concept as he develops the plan?
3.5.3 Fatal Flaws of Business Concepts

Many new enterprises are doomed from the start because the basic concepts upon which they are based are somehow fatally flawed. Perhaps the concept sounds good, but it will not work in the real world. Perhaps the concept solves a problem that only exists in the entrepreneur's head, and the intended customer has no need for it. Or perhaps the market is just not large enough to make the enterprise successful. Many business concepts are doomed or handicapped by the following all-too-frequent flaws.

- **It will not work**—All sorts of great-sounding inventions are used as a basis for starting a business. Many never get to market because the inventor cannot make the invention work satisfactorily outside the laboratory.

**from real entrepreneurs**

A water purifying expert began a business to market his new concept in water purifiers. Supposedly, it would purify even seawater in agricultural quantities at a cost of 30 cents per 1,000 gallons. This individual believed that it would revolutionize the world food supply. So far, after five years and five million dollars, the expert has yet to do anything but play show and tell in the lab. Evidently, the expert has not been able to make it work as intended.

- **No real need**—Businesses fail when they do not fill some need that is perceived by enough people to make operations profitable.
- **Hidden traps**—A marketing barrier may lie hidden in the marketplace. For instance, a product may threaten the career of the person who is supposed to buy it. When first introduced, the concept of interactive, computerized, company-specific video training programs was stifled largely because training and development people in companies saw it as a threat to their jobs. They rationalized that off-the-shelf training was not as effective as face-to-face training. Always assess the customer's reaction to the concept.
- **Unfortunate economics**—A concept may work and people may perceive a need for the product/service. However, if costs are too high, customers will not be willing to pay enough for the business to be profitable. The market must be willing to pay a sufficient price for the concept before the business can be profitable.

**from real entrepreneurs**

An avid fisherman was able to develop a fishing lure that was used by some of the most successful tournament fishermen in the country. Word of mouth led to a contract to sell a thousand to a major sporting goods retailer. He found, however, that he could not produce these hand-made lures at a price economical enough to attract a broader market. He discovered mass producing lures was not technically feasible. Ultimately, the fisherman decided that making lures was a nice hobby.

- **No protection**—Some concepts can be easily copied by other companies that are capable of quickly exploiting the market, perhaps driving the entrepreneur out. Investors are leery of new enterprises that have no protection, no patents, no copyrights, no trade secrets, no organizational or distributive advantages, no location monopoly, or no cost advantage.
- **Obsolescence**—How long is the life of the concept? Many concepts are so faddish that an enterprise based on them has only a few months to make its
Defining a Business Concept

profits. One large firm had to write off millions of dollars in research on a new type of microprocessor when a competitor surpassed it technically with another approach to the same problem.

- **Potential installation problems**—Many concepts sound great until the realities of placing them into use are confronted. Many things that work well in the laboratory will not work in the field.

- **Requires education**—If the new product will be successful only after the customer has been trained to use it, watch out. Education is a slow, costly process that poses many risks. Few people welcome having to learn how to use a new product. It is much more comfortable to continue using old familiar products or ways.

- **Requires change in consumer behavior**—Consumer behavior is learned over time through numerous experiences in the marketplace. Experience has taught consumers to solve a problem in certain way. If a product requires a change in consumer behavior, it may be resisted unless the rewards are sufficient to motivate the change.

**from real entrepreneurs**

The developers of computerized grocery stores failed when they assumed that shoppers would prefer to telephone in their food orders to a computerized grocery warehouse rather than shop in supermarkets. In fact, studies show that most people like shopping in supermarkets rather than dealing with the problems posed by other grocery shopping systems, which have shown only limited success.

- **Inaccurate assumptions**—People frequently get into trouble with assumptions. One important procedure in developing a business plan is to identify all of the assumptions on which it is based and question them. For example, the assumption that the market will love the product (since the entrepreneur does) or that the target market will continue its present state of prosperity needs to be examined closely. What facts support these assumptions?

- **Inconvenience**—Many new products and services fail because they are inconvenient to use. For example, products that people must assemble themselves may be rejected in favor of those that are pre-assembled.

- **Service requirements**—Does the concept require service? If so, by whom? A service aspect to a concept greatly complicates it. Costs rise, organizational difficulties multiply, and buyer resistance stiffens. Entrepreneurs have to be prepared to explain how they propose to handle whatever service requirements are connected with their concepts.

**Reality**

The low carb diet fad did not last long. Neither did the specialty stores that dedicated themselves to low carb foods. Quiches and crepe restaurants used to be hot, but today, frozen yogurt shops, organic foods, and coffee houses are in.

Logistical difficulties have ruined many concepts. An entrepreneur who wants to sell a certain product but not offer service to the customer to maintain that product has a flawed concept.
Assignment 3: Business Concept Statement

It’s time to take that business idea that sounds fantastic in your head and turn it into a clear description of your business concept. Articulating the business concept in a written statement is an important step towards entrepreneurship. In addition to helping define the precise nature of the business, the concept statement will communicate to others what you want to accomplish.

The business concept statement explains what a business is all about, what it hopes to become, and how it plans to get there. The first part of the assignment is a worksheet to help organize your thoughts as you prepare your concept statement. The second part of the assignment is the actual writing of the concept statement.

For the final part of the assignment you will ask three people to read your concept statement and give you feedback. Learn to really listen to the feedback.

Tip
Make sure the business concept matches the personal vision you established in Assignment 1. Each aspect of the business concept and business plan should be aligned with the personal vision. If they don’t match, you will need to revise your concept.

Learning Objectives
• Discover and record the key components of your business concept.
• Write a clear, succinct concept statement for your business.

Overview
Successful entrepreneurs can clearly and succinctly describe the precise nature of their businesses. Writing a business concept statement is an important task to complete before proceeding further. The business concept is then tested for feasibility prior to the preparation of a business plan. It is common for the initial business concept statement to change during the feasibility testing and while writing the business plan. It will change as a result of your market research and what you learn about the business and market.

Step 1
Identify the key components of your business concept. Answer the questions on the Business Concept Development Worksheet to identify the key components of your business concept. In Column A make notes or general points that you want to include. In Column B, write a brief summary to your answers in sentence format. These sentences will be combined to form the final business concept statement.

Step 2
Write the business concept statement. Cut and paste the sentences from Column B together to form one statement on the Business Concept Statement page. A sample business concept statement for Run KC is provided for your reference.
Tips:
• Keep the statement less than 200 words.
• Write it in the name of the business –DO NOT use words like we, I, our, your.
• The statement should NOT read like an advertisement.
• Begin with a simple straight forward statement stating exactly what the business is. For example: ABC Business is a retail shop offering...or XYZ is a consulting service for...an upscale restaurant...a boutique, etc
• If you don’t have a name for the business, make one up for now or use something like ABC Consulting.
• Be sure to include something about why the business is different, better than the competition; why people will purchase from this business.

Step 3
Get feedback about your concept statement. The acid test for a well-defined concept statement is to hand it to someone else and have him or her relate it back precisely. Give your concept statement to three people. Have them relate back to you the concept as they understand it. After receiving their feedback, you will most likely need to make adjustments to your statement to clarify your business concept.

Step 4
Report feedback you received. Tell how you will use the feedback you received.

SAMPLE BUSINESS CONCEPT STATEMENT

Run KC is a retail running shoe store offering footwear, apparel and accessories to serious and aspiring runners. Products are of a high quality in the mid to high price range.

Run KC differentiates itself from other running shoes store by the level of service provided during and after the sale. During the sale, Run KC provides gait analysis, individual fit assistance, carefully selected inventory and well trained staff to help runners select the best shoes and accessories to enhance their running experience. In addition, a customer file is kept on purchases, documenting preferences and interests to develop a history with customers as well as a personal relationship.

After the sale, the atmosphere of Run KC is similar to that of a club where individuals hang out, make friends and exchange information. The store offers training programs, boot camps and a running club. Involvement in local running events by staff and sponsorship of these events also strengthens relationships with runners.

Visibility in the running community will be strong and promotion of the store will be accomplished through participation in running events, sponsorships and recognition of customer’s milestones both in store and on the store website.

Run KC is in the planning stage with a projected opening in January 2012 in Leawood, Kansas.
## Assignment 3: Business Concept Statement

### Business Concept Development Worksheet

<table>
<thead>
<tr>
<th>Column A</th>
<th>Column B</th>
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<tbody>
<tr>
<td><strong>What</strong> does the product or service do?</td>
<td></td>
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<tr>
<td><strong>How</strong> is it different from other products/services?</td>
<td></td>
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<tr>
<td><strong>Who</strong> will buy it?</td>
<td></td>
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<tr>
<td><strong>Why</strong> will they buy it?</td>
<td></td>
</tr>
<tr>
<td>Price?</td>
<td></td>
</tr>
<tr>
<td>Convenience?</td>
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<tr>
<td>Provide sense of safety/security/well-being?</td>
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<td>Better?</td>
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<tr>
<td>Pleasurable experience?</td>
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<tr>
<td>Uses new technology? etc.</td>
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<tr>
<td><strong>Where</strong> will it be sold?</td>
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<td>Geographic location of business and customers</td>
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<td><strong>When</strong> will it be ready to be sold?</td>
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<tr>
<td>Concept, start-up, initial operations phase</td>
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<tr>
<td><strong>How</strong> will it be promoted and sold?</td>
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Assignment 3: Your Business Concept Statement

Business Concept Statement


Report feedback you received after sharing your business concept with three people.


Summary

Successful entrepreneurs can clearly describe the precise nature of their business concept. This description provides potential suppliers, customers, lenders, and resource team members a clear idea of what they want to do.

Getting feedback from potential customers is one way to determine whether a concept statement is well defined. Even when the concept is clear, it will change over time as the entrepreneur learns more about the market and the economics of the new business. It is perfectly natural for most good business concepts to change. If they do not change, there may be reason to worry.

The concept statement will be reviewed and modified as additional information is gathered from the answers to questions presented in the planning process. The concept statement becomes the basis for the executive summary, the last section completed in the business plan. The concept should also be tested for feasibility. It is common for the initial business concept statement to change during this process. It will change as a result of learning about the market and the profitability of the business. Remember that the purpose of testing for feasibility is to learn about strengths and problems, create solutions to strengthen the business concept, and test the solutions.

This chapter included the following key ideas:

- Entrepreneurs must define their product/service based on whether it fills a consumer need, is unique, and actually works.
- Entrepreneurs need to learn about the consumers of their products/services by identifying their customers, determining their roles, and creating profiles for them.
- Entrepreneurs get their product/service to the market by utilizing strategic positioning, avoiding strategy traps, and taking advantage of product or service distribution models.
- Entrepreneurs who engage in research will enhance their chances adding innovation to their business concepts and launching a successful business.
- Entrepreneurs can research their business concept through libraries, other local resources, the Internet, trade and industry associations, or through their own primary research.
- A savvy entrepreneur will incorporate the positive attributes of a successful business concept and avoid the fatal flaws of an unsuccessful one.
Model Feasibility Checklist

Overview
After the business concept has been defined, the entrepreneur must test the feasibility of the concept to determine if it should be developed further. Feasibility means that a product/service can be sold to an identifiable market at a profit sufficient to support the entrepreneur’s personal vision and business goals. A good test for feasibility is to compare the business concept against a “model business.” Among other things, the model business has a saleable product/service, an identifiable market, and adequate profitability.

The evaluation of a business concept against the model business should be based on researched facts. Only by reviewing the facts can an entrepreneur make an informed decision concerning a business concept.

If the business concept is deemed feasible, it is time to write a business plan. Researching the business concept will continue throughout the business planning process. If the business concept compares poorly to the model business, the entrepreneur should examine the business concept more closely. Some aspects of the business concept should be changed to create a more feasible concept.

If changes are not possible, entrepreneurs should avoid investing money, time, and other resources into the concept.

Don’t be disappointed if the feasibility test indicates your concept is not workable or profitable. You have gained a valuable skill you can use to evaluate other business concepts.

Objectives
In this chapter, you will learn to:

- Identify the characteristics of the model business.
- Determine product/service feasibility.
- Determine market feasibility.
- Determine financial feasibility.
4.1 Determining Feasibility

4.1.1 Testing the Concept Using the Model Business

Determining feasibility for a business concept can be a difficult task. Using the model business as a tool for comparison can simplify the process of assessing a concept. The Model Business Feasibility Checklist is a helpful self-assessment tool for evaluating the potential success of a business. The process provides valuable insight into the strengths of the product/service, the accessibility of the market and the profitability of the venture. This tool will save time and money if it provides direction for strengthening the business concept or helps avoid starting a business that is not feasible.

This chapter gives entrepreneurs an opportunity to compare the characteristics of their business concept with characteristics of the model business. This comparison should be made after the concept has been adequately researched. It will help identify the strengths and weaknesses of the business concept. When problems are identified early, they can often be reduced or avoided at this stage in the planning process.

Assignment 4, the Model Business Feasibility Checklist asks you to rate your business concept against the model business criteria on a scale from 1 to 5 (1 meaning that your concept absolutely does not meet these criteria and 5 meaning that your concept entirely meets these criteria). At this stage in the process, you may not be able to rate all the criteria. For these, rate the criteria later as information becomes available. Rating the criteria will provide you with an overall score for the business.

Tip

At this point in the course, you should have identified one or two business concepts that match your personal vision. This match does not guarantee feasibility. A business is feasible when it not only matches your personal criteria but also shows potential for success according to some external criteria as well.

Reality

Assessing a business concept against the model business without adequate research to back up the assessment is meaningless. What entrepreneurs think about the business concept doesn’t matter nearly as much as what the market research says about the business concept.

4.1.2 Using the Model Business Feasibility Check

The model business tests for feasibility in three areas: the product/service, the market and the financial. A business with a perfect score of five in each in each criterion would be a model business. No real model business exists, but it is helpful tool for measuring actual businesses.
As is true in most aspects of business, answers are not black and white. A good rule of thumb is that for a business concept to be feasible, it must, when tested against the model business, achieve at least one-half of the possible points overall and no less than one-half of the possible points in any of the three areas—product/service, market, and financial. A score of less than three for any individual criterion indicates a weakness in the business concept that requires further consideration. It is unlikely that any business will have scores of five in every criteria but that doesn’t mean an entrepreneur shouldn’t try to reach that level. Each of the criteria is explained in detail in 4.2, 4.3 and 4.4.

### Tip

The model business doesn’t just test the feasibility of a business concept. It can also be used to score one concept against another or to establish goals for improvement.

Entrepreneurs can also use the model business feasibility score to compare one concept against another. When doing this, they should compare each individual criterion score and not rely solely on the total score. The highest scoring concept could rate very low in one or two critical criterion needed for success.

The score can also be used to establish areas of improvement. A score can be improved by finding additional information and developing plans to improve the overall situation that affects this criterion. For example, the business concept may initially score low for financial feasibility because funding for the business is not easily obtainable. However, after considerable research, working with mentors, and talking with potential investors, a funding source may be discovered. This change would increase the score against that model business criterion.

### 4.1.3 Testing the Product/Service against the Model Business

The first section of the Model Business Feasibility Checklist determines whether the product/service is viable. Many businesses have failed simply because the product/service was costly, too regulated, or simply not needed by the customer. These criteria will be discussed in greater detail in 4.2 Product/Service Feasibility.

#### Model Business Feasibility Checklist—Product/Service Test

In evaluating the product/service, research can be used to rate a business concept against the following criteria:

- Customers perceive a need for the product/service.
- Product/service is ready to sell.
- Product/service has unlimited life.
- Product/service is unique and protectable.
- Product/service is not regulated by the government.
- Product/service line has expansion potential.
- Product/service has no liability risk.
4.1.4 Testing the Market against the Model Business

The second section of the feasibility test is that the business concept must have a market. In other words, people must want to buy the product/service. Entrepreneurs often think everyone in the world is a potential customer. Even with the global marketplace, this view is not realistic. This second test may keep the entrepreneur from misreading or underestimating the competition. These criteria will be discussed in greater detail in 4.3 Market Feasibility.

Model Business Feasibility Checklist—Market Test

In evaluating the market, research can be used to rate a business concept against the following criteria:

- Market can be recognized and measured.
- Existing competition has identifiable weaknesses.
- Distribution system is established and receptive.
- Customers purchase frequently.
- Business has great news value.

4.1.5 Testing Profitability against the Model Business

The third section of the test of feasibility covers financial criteria. Money must be found to start and operate the business. Even if the product/service can be sold to potential customers, the sale must result in an acceptable profit. This test of profitability is sometimes the hardest for entrepreneurs to apply, but it may be the most important. In order to determine profitability, the entrepreneur must have an adequate understanding of financial concepts. These criteria will be discussed in greater detail in 4.4 Financial Feasibility.

Model Business Feasibility Checklist—Profitability Test

After gaining a basic understanding of financial concepts, a business concept can be rated against the following criteria:

- Funding is easily obtained.
- Revenue stream is continuous.
- Money is collected prior to sales.
- Hiring and retaining employees is easy.
- Inventory and service providers are dependable.
- Gross margin is 100 percent.
- Legal problems do not exist.
- Wealth is generated through an exit strategy.
4.2 Product/Service Feasibility

4.2.1 Customers Perceive a Need for Product/Service

When the customer already wants the product/service, the tasks of marketing and selling are simplified. The model business has customers who perceive a need for what the business has to sell. Customers will seek out the model business’ products/services because they need or want them.

An example of a product with a perceived need is a cream that relieves the symptoms of poison ivy. People exposed to poison ivy buy products to alleviate the itching. On the other hand, a product that would prevent people from getting poison ivy is not as marketable because people probably would not buy it unless they were particularly sensitive to poison ivy and knew they were going to be exposed to it. Products with a readily perceived need sell easily.

from real entrepreneurs

Before the advent of the high-pressure, low-volume toilet, the developer of an ecological water-saving device used in the toilet tank unrealistically estimated his market to be everyone in the world who owned a toilet. His device, when installed, lowered the amount of water used for each flush, making it an excellent choice for the ecology-minded consumer.

After six months of marketing to homeowners without making a sale, he consulted a plumber about the situation. The plumber quickly answered that he had been recommending bricks to his customers for years. “Properly installed,” he said with a smirk, “the brick lowers the amount of tank water used by 30 percent.” This entrepreneur would have benefited from exploring the need in greater detail before producing 15,000 water-saving units now sitting in his garage.

4.2.2 Product/Service Is Ready to Sell

The model business has a product/service that is ready to sell. They offer a product/service that is trouble free and works easily with no problems.

In the model product business, all goods are fully developed, tested, and ready to be sold. Many products look good in a prototype or start-up phase but cannot be mass-produced or provided efficiently to a large customer base.

In the model service business, procedures are created, tried, and proven to work before mass marketing. The model business develops systems to provide additional services when the market demands it. Often with start-up service businesses, the service provider is the entrepreneur. A successful entrepreneur is able to keep up with demand and provide exemplary service that keeps customers calling back. If business continues to increase, eventually the entrepreneur cannot meet demand without additional help. The model business plans for growth, and the entrepreneur is prepared to hire additional service providers or subcontractors.
4.2.3 Product/Service Has Unlimited Life

The model business has a product/service with an unlimited life. In a model business, the product/service is not perishable and it will not become obsolete, out of fashion, or affected by weather. Demand for the products/services offered by a model business goes on and on.

Consumer-driven trends, new innovations, and technological advances can greatly shorten the life cycle of a product/service. Fashion, for instance, only lasts months. Entrepreneurs who produce or sell fashion may end up with extra inventory they cannot sell because the product is no longer in style. Similarly, perishable products like foods and flowers have a limited shelf life and must be sold within a short period of time.

Weather can also affect sales of a product/service. For landcapers, snow removal firms, and ski-area owners, weather can make or break their business. The model business is not affected by the weather.

### Reality

Obsolescence is one of the major difficulties with high-tech ventures. Many computer hardware products become obsolete in a short period of time. Computer software has an even shorter life cycle. Developers need to generate profits quickly to cover their costs.

### Tip

If your business concept has a short product life cycle, you must continue to add innovation to improve existing products/services or add spinoffs to replace the obsolete products.

### from real entrepreneurs

An accountant purchased a bakery that specialized in freshly baked sourdough bread. The bakery was not profitable at the time of purchase. The new owner’s plan was to inject some capital into the business, buy more ovens, purchase more delivery vans, hire more sales people, and expand the sales territory. The new owner did not recognize the importance of product perishability for sourdough bread. Sourdough bread only has a 24-hour shelf life. Delivery to new locations was time consuming. Sourdough not purchased the same day had to be thrown away. The business failed.

### from real entrepreneurs

An online company (coastaltool.com) boasts an online inventory of more than 1,000 power tools and related supplies, from 45-cent screwdriver bits to $975 power saws. This company can afford to carry a large inventory because tools have a long shelf life and do not change often.

The founder of igogolf.com wanted to offer the finest golf equipment worldwide at discount prices. He launched a multilingual site, with pages in English, French, Spanish, German, and Japanese, and staffed his company with golf experts instead of clueless order takers. By selling internationally, he takes advantage of the differences in seasons.
4.2.4 Product/Service Is Unique and Protectable

The model business has a product/service with unique aspects that can be protected from competitors. Intellectual property such as patents, trademarks, copyrights, and trade secrets, are important forces in warding off competition. Proprietary rights add value and give the entrepreneur the legal right to prevent others from the unauthorized use and production of protected aspects of the business. Even an agreement to distribute certain products in profitable markets can be a valuable proprietary right.

The entrepreneur can greatly increase the value of the business by developing intellectual property. Protecting a product/service to prevent others from benefiting from the proprietary aspects is only one reason to develop intellectual property. Intellectual property increases the overall value of a business. It can be sold or licensed to create additional profit for the business, and it can greatly increase the value of a business when the entrepreneur implements an exit strategy.

Tip
Consider which aspects of your business (including business name, logo, trademark, trade secrets, and so on) to protect from competitors.

from real entrepreneurs

The owner of a t-shirt manufacturing facility wanted to print t-shirts bearing school logos for an upcoming college basketball tournament. It was necessary for the business owner to secure a licensing agreement with each school to gain permission to use their trademarked logo. The agreement required that the business owner comply with certain criteria, maintain a designated quality level and pay a royalty to each school.

This business owner was also a creative artist and had developed his own unique characters which he printed on t-shirts and protected with a trademark. He then licensed a company to use his artistic creations on backpacks and collected a royalty of his own.
4.2.5 Product/Service Is Not Regulated by the Government

Complying with local, county, state, and federal laws and regulations can be very time consuming and costly. The model business has a product/service and business operation not regulated above and beyond the normal issues that pertain to all businesses and individuals.

It is important for the aspiring entrepreneur to do adequate research concerning possible governmental regulations for a business concept. Costs to start or operate a business can increase dramatically when the government gets involved. In some places, the government requires car washes to recycle water. The owners must buy special equipment, which in turn increases the price of washing a car for consumers.

Reality
An entrepreneur who is planning a business that is or could be heavily regulated by the government may find it difficult to start the business, secure funding, or keep operating costs low.

Tip
Before starting any business that could require governmental approval, consider these points:

- Compliance with governmental regulations requires an investment of time and money.
- Compliance with governmental regulations imposes guidelines about how business is conducted.
- Regulations can be set by city, county, state, or federal governments.

From real entrepreneurs
The founder of a retail wine firm took it online at Sendwine.com. To solve the problem of the many state laws regulating sales of alcohol, the company built a nation-wide network of existing wine shops. With about 100 retailers, the Internet company can easily and legally arrange shipments to more than 80 percent of the U.S. population. Future regulations, however, could create additional hurdles.

4.2.6 Product/Service Line Has Expansion Potential

The model business has potential to expand through additional products/services and new product/service lines. One product/service, or product/service line, is rarely sufficient to keep a company profitable over time. The company’s products and services must be continually reevaluated for possible enhancement or discontinuation. In addition, the company must constantly look for ways to expand the product/service line and bring in new products/services.

Product/service additions to the existing product/service line should be driven by customer demand. Being in tune to the needs of the customers makes it easier to
add a marketable product/service. Customer-driven products/services are easier to sell because the customer is already demanding them. The entrepreneur only needs to communicate the availability of the new product/service and its benefits over that of the competition.

To identify new product/service opportunities, look at how business is conducted in the industry. Research the processes that are necessary to transform a product/service from raw materials to the completed form and into the customer’s hands. New businesses are generally integrated internally, horizontally, or vertically.

- **Internal integration** refers to marketing products/services within a company or organization. An example of internal integration is a company-owned copy center marketing its printing services to new departments.

- **Horizontal integration** refers to marketing products/services within the current distribution channel. An example of horizontal integration is a hotel seeking out business travelers to even out its irregular tourist customer base.

- **Vertical integration** refers to marketing products/services to different positions throughout the distribution channel. An example of vertical integration is a clothes retailer expanding into the business of designing and manufacturing clothes.

An entrepreneur may find new opportunities in any or all of these areas.

### Reality

Businesses generally don’t survive over time if they only have one product/service to offer customers.

### Tip

Beware of adding a new product/service every time a customer requests it. The addition of products/services has to make sense. Don’t fall into the trap of meeting customer demands for products that don’t fit within your operating structure, that require additional research and development, or that have a lower profit margin. Evaluate the concept to be sure that adding a new product/service is the right decision.

### from real entrepreneurs

The partners who started theknot.com thought the Internet would be a good place for couples to shop before they married. The website began by offering one-stop wedding information and planning—including an online gift registry, a tool for locating the right gown, and review of honeymoon locations. The Knot quickly expanded beyond their award winning website to include The Knot books, The Knot magazines and The Knot TV.

#### 4.2.7 Product/Service Has No Liability Risk

The model business has products/services with no liability risk. Some products and services have significant potential liability. As a general rule, any tangible product that comes into contact with people has the potential to hurt them, particularly
anything that is ingested. For caterers, the potential liabilities are obvious. Ideally, entrepreneurs should avoid products that might harm someone. Service businesses, those selling advice, especially expert advice, face similar risks.

In this litigious age, the potential liabilities of every product/service should be carefully evaluated and every effort should be made to lessen these risks. Entrepreneurs can reduce product/service risks by purchasing liability insurance, becoming self-insured, or seeking the assistance of risk-avoidance advisors.

**Reality**

The largest growing expense for a business today is product-liability insurance. Astute entrepreneurs look carefully at the liability potential for their concepts.

**from real entrepreneurs**

While doing research, an entrepreneur who planned to manufacture children’s sleepwear discovered that the sleepwear would have to be 100 percent fireproof and a comprehensive product-liability insurance policy would need to be obtained. These requirements would have significantly increased production costs and reduced gross margins and net profit. After evaluating the business concept for feasibility, the entrepreneur decided to abandon the concept.

4.3 Market Feasibility
4.3.1 Market Can Be Recognized and Measured

The model business has a market for its products/services that is easy to recognize and measure. Feasibility can be determined by finding a market for the product/service and defining its size. This information is easiest to establish when the market of potential customers can be identified and measured by its characteristics. A business is not a good opportunity if sufficient numbers of people are not willing to buy the product/service or if the market is not large enough to create profits.

It is not just by chance that most major corporations sit on the sidelines during the pioneering stages of a new product/service. They are waiting for the market to confirm that it wants the new item. Many products simply do not have a market.

**from real entrepreneurs**

In the mid ’90s, McDonalds introduced a line of sandwiches “Especially for Grown-Up Tastes.” The Deluxe line was created by an executive chef and targeted to a more mature, sophisticated market. This was a market even McDonald’s couldn’t identify despite the fact that they had invested $300 million into the product line.
4.3.2 Existing Competition Has Identifiable Weaknesses

Competition is often good for business. Does that sound hard to believe? The legendary stories of rags-to-riches tycoons who have made it big selling products with no competition are few and far between. With over 20 million businesses currently operating in the United States, according to the U.S. Small Business Administration, it seems as though many businesses thrive on competition.

In most towns one street hosts multiple restaurants—a restaurant strip. Why do these restaurants locate so close to each other? Wouldn’t it be better to locate away from competition? On the contrary, restaurants—like many other businesses—thrive on competition. People will head to the restaurant strip and then decide where to eat. The restaurant with the best atmosphere, the shortest lines, or the best food wins customers. The restaurant that sits alone only attracts customers who specifically choose it as a destination. Usually restaurants have to be very well established to survive seclusion.

The model business has competition with identifiable weaknesses. This means that the competition has left room for others to improve on certain aspects of their products/services. It is not enough for a restaurant to be located on a restaurant strip. It must also take advantage of the weaknesses in the food, service, menu choices, atmosphere, or entertainment offered by its competitors. Research is necessary to understand the strengths and weaknesses of the competition.

After conducting market research, some entrepreneurs might identify a lack of competition. This lack may seem to present a clear-cut opportunity. However, it is important to evaluate the condition of the market and to determine the reason why there is no competition. There may be no perceived need for the product/service.

Reality

Competition is a double-edged sword. Too much or too little can both be dangerous.

from real entrepreneurs

Before launching Amazon as “the world’s largest bookstore,” founder Jeff Bezos studied many products that could be retailed on the web. He was particularly interested in the structure of each product industry. He researched the number of competitors, the power the suppliers had, and the power of the distributors. He quickly focused on a key weakness of the book selling business: the high capital investments in inventory and retail store. In the start-up years of Amazon, his alternative, low-assets strategy was one of its most important competitive advantages.

If a concept is relatively new, the lack of competition may be expected. The entrepreneur may be able to take advantage of this newness and charge top dollar for the product/service. The additional revenue may be needed to help cover the extra marketing costs associated with selling to potential customers who may not see the product/service as a need. If the business is successful, competition is sure to follow. As more competitors enter the marketplace, the price will eventually be reduced and so will profits. Astute entrepreneurs are ready to establish advantages so that customers keep purchasing their products/services.
4.3.3 Distribution System Is Established and Receptive

The model business has an established and receptive distribution system. The distribution system includes the various companies responsible for moving the product/service from the producer to the customer.

A business can benefit by selling a product/service to an established distributor who needs it and is eager to handle it. The advantage of tapping into an established distributor is that established distributors can immediately begin marketing new product/service lines to their existing customers. Established distributors understand how the new item fits into their current customers’ needs.

If a product/service does not have an established distribution channel, the entrepreneur may be forced to create channels for moving products/services. This additional step increases the cost of doing business because the entrepreneur must first identify and locate distributors, sell them on carrying the products/services, and then educate and train their sales staffs before a sale can be made.

Reality
Without a distribution system, the entrepreneur will spend significant time and effort trying to establish one.

Tip
Whenever possible, look for a concept with an existing distribution system that is open to newcomers.

from real entrepreneurs
Sally Smith and a business partner in Iowa used a process called reverse marketing to identify their business opportunity. As she researched, Smith realized that the mail-order industry was experiencing significantly higher growth than brick and mortar retailing. She also found that food was becoming a best-selling category within that distribution system. Further research led her to study companies like Omaha Steaks and Honey Baked Ham. She realized that the answer was right in front of her….she was sitting in a state known for their pork. Chops of Iowa was so successful that it acquired its own USDA plant at the end of their second year in business and in year four, Smith and her partner implemented their exit strategy by selling to a regional corporation.

4.3.4 Customers Purchase Frequently

The model business has customers who purchase the product/service frequently. Therefore, fewer dollars are spent to convince new customers to try the product/service. If a customer bought a product/service only once each year, the seller would have to wait a year before the next order from that customer. This would require extensive marketing dollars in order to retain the customer. If a customer buys daily, the seller has a chance each day to make a sale. In this case, marketing is more a matter of customer service than of customer education.

In addition, a frequent purchaser is probably more likely than an infrequent one to try something new. Therefore, additional products/services can be sold to existing customers with a relatively low marketing cost.
from real entrepreneurs

A major manufacturer of razor blades gave razors with the Greek letters of each fraternity printed on the handle to fraternity members on major college campuses. The purpose of this promotion was to tap young male adults and get them hooked on using their razors. The only razor blades that would fit these razors were those manufactured by the company. As a result, the company significantly expanded its razor blade sales within this market segment.

from real entrepreneurs

An online drug store, planetrx.com, built its business around selling nonprescription items to customers when they returned to the site to renew prescriptions. Just like a traditional drug store, planetrx offers incentives and special offers on products that customers do not have to buy, but want to buy.

4.3.5 Business Has Great News Value

The model business has great news value. Smart entrepreneurs find the newsworthy feature of their concept and then obtain free publicity through press releases, feature stories, or phone calls to the media.

The media is not going to get excited about the opening of another hamburger stand, but suppose the hamburgers were made from processed algae. In this case, the news media might pick up the story. If the product or service isn’t particularly newsworthy, the entrepreneur needs to “create” news—a grand opening, guest celebrity or charity event.

In some cases, a business may enjoy long-term rewards from one good story in the right media. Depending on the type of business, however, repeated or ongoing media coverage may be needed.

Tip

The key to getting good publicity is to have something newsworthy that attracts people’s attention.

Reality

Astute entrepreneurs know that customers consider write-ups in newspapers and magazines as more credible than paid advertising.

from real entrepreneurs

A temporary employment agency staffed primarily by part time working seniors got off to a slow start until a blizzard hit the city. One 68-year-old woman showed up for work but found that the business was closed due to weather. The woman called the agency and wanted to know why the business had closed. The owner, recognizing the news value of what had occurred, immediately called the newspaper praising the commitment of senior workers. The story was featured on the front page of the business section the following day. Immediately, sales dramatically increased. The owner had to install two more phone lines and hire three more placement counselors.
4.4 **Financial Feasibility**

4.4.1 **Funding Is Easily Obtained**

It takes money to start a business. Individuals and organizations that regularly contribute to financing start-ups look for certain paybacks. These financiers would like to receive an adequate return on their investment. This return varies considerably depending upon the needs and desires of the individual investors or organizations. For the model business, start-up funding is more easily obtained because the financial rewards are apparent.

The key to obtaining money for business start-up and future growth is choosing the right funding sources. Some money sources are interested in initial start-ups, but most are interested in businesses with an operating history. Some finance only small amounts of money while others have no limit. Some finance only debt in which the borrower, or entrepreneur, must repay the funds along with a service charge such as interest. Some finance only equity in which the equity contributor becomes an owner in the business. Some look for a combination of debt and equity. Some investors want to be a part of the management team while others don’t want to be involved. This variety of financing sources, terms, and conditions makes raising money challenging.

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**Reality**

Looking for start-up funding is an increasingly difficult task as more and more entrepreneurs compete for the same money.

**Reality**

If start-up money is extremely difficult to obtain, maybe potential investors/funders are seeing an inherent weakness in the concept to which the entrepreneur is blind.

Success in obtaining financing also depends on the following factors:

- Type of business
- The industry
- Financial contacts
- Referrals
- The amount of money sought
- Collateral
- The entrepreneur’s personal credit history
- The amount of money the entrepreneur has already invested in the business

The most common mistakes entrepreneurs make are ignoring these factors and failing to match the money source to their business needs.

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**Tip**

If you are turned down for financing, ask why. The answer may reveal a weakness in your concept that you can work to correct.
Finding money to start a business is a standard problem for most entrepreneurs. Funding sources that provide the best avenue for aspiring entrepreneurs include the following:

- **Self-financing**—Outside investors are not needed.
- **Relatives and friends**—Friends and family provide the money to start the business.
- **Customers**—Some customers will either put a deposit down or supply the money needed.
- **Suppliers**—Some suppliers allow 30 – 60 days before bills must be paid.
- **Sale of distribution rights**—Rights to distribute the product/service are sold to another person/company.
- **Hard-asset lender**—Some assets can be used as collateral for a loan.
- **Leasing**—Equipment leasing is a larger source of financing for US businesses than commercial loans.
- **Banks/SBA-backed loans**—Programs are available to help small business owners obtain loans.

**Reality**

If an entrepreneur loses family money, he or she may pay for it forever—not in money, but in respect and relationships.

**Tip**

External funders want to know how much money you have contributed to the business before they are willing to provide financing. They evaluate your dedication to the business by how much of your own money is at stake.

**from real entrepreneurs**

Dixie Junk and her husband Robert launched Junk Architects, PC and quickly established a positive cash flow. This continued for several years so they saw no reason to cultivate a relationship with bankers. When it came time for an expansion loan, they realized they had made a mistake. They should have developed an association with a small independent bank in preparation for this moment.

**4.4.2 Revenue Stream Is Continuous**

The model business generates a continuous flow of revenue after the initial expense of marketing to solicit potential customers. In other words, a separate marketing campaign is not needed to generate additional revenue. Revenue continues to stream into the business from existing relationships with customers. Good examples of continuous revenue stream businesses are:

- A lawn care company that provides fertilization and weed control on an annual contract.
- A payroll service company that processes payroll and employer tax payments for an agreed-upon contract period.
- Professionals such as attorneys and certified public accountants who work on a monthly retainer.
It can be very difficult and costly to operate a business that has to seek out new business with each sale. Consider a construction company that must compete for each contract or a wedding coordinator who is hired for that once-in-a-lifetime event. It can be feast or famine for these businesses. In such instances, marketing costs rise since management must continually seek out additional sales. Successful entrepreneurs in these types of businesses find ways to build revenue from relationships with past customers. For example, the construction company may give a discount to a developer who provides projects for the next three years, and the wedding coordinator may give resort gift certificates to past brides and grooms who refer new customers.

**Tip**
Develop a concept that allows customers to make repeat purchases, such as buying additional supplies, renewing an annual contract, or contracting for regular maintenance and service.

### 4.4.3 Money Is Collected Prior to Sales

The model business collects money from customers when the order for products/services is placed. Sales and profits alone may not be enough to generate sufficient cash within the business. Many entrepreneurs record significant revenue but have cash flow problems. This occurs even though they send out timely bills requesting payments. Unfortunately, many customers do not return payments to the company on a timely basis. This delay creates a cash crunch because money has been spent on creating the product or providing the service, but no money has been collected on the sale.

Planning for collections begins before the sale is made. Whenever possible, money should be collected from the customer at the time the order is placed. In addition, if a business creates a custom product for the buyer, all money should be paid up front. Up-front money greatly reduces capital requirements and bad debts.

If customers are unwilling to pay in full, the next best strategy is to require a deposit. The deposit should cover the direct costs of the product/service and allow the company to fill the order without using any of its own operating cash.

**Reality**
One-shot businesses in which separate deals must be made for each sale are costly in terms of time and money.

**Tip**
If collecting money prior to delivering the product/service will not be accepted in your industry, consider these procedures to ensure good collections:

- Qualify the new account to make sure it meets your standards or requirements—check its credit, bank and trade references before giving payment terms.
- Develop billing procedures to include timely invoices, reminders, aging accounts and statements.
- Have a back-up plan for customers who do not pay on a timely basis. Use a collection clerk or collection agency to help collect overdue amounts.
from real entrepreneurs

An artist who paints portraits of people’s pets charges the customer according to the size of the painting. The customer pays 50 percent up front and the remaining 50 percent when the painting is delivered. It takes approximately one week to complete the portrait. The artist works on five or six paintings at the same time. The prepayments provide good cash flow while the artist completes the paintings. If the customer does not accept the painting, the artist keeps the deposit and then sells the painting to an art gallery.

4.4.4 Hiring and Retaining Employees Is Easy

In the model business, hiring and retaining employees is easy because the entrepreneur has developed a plan to meet employee needs. This plan includes an environment that rewards employees for contributing to the success of the business and offers potential growth opportunities for those who desire it.

Successful entrepreneurs are able to hire the right people at the right time. The person hired for each position and the importance of each position is dependent on how critical each task is to the success of the enterprise. If the enterprise requires marketing skill to be successful, then it follows that the marketing slot will be filled with a marketing expert. Whoever is evaluating the prospective venture will be looking closely at the marketing clout assembled on the team.

In a situation that requires production or technical expertise, those slots on the management team are critical. If an entrepreneur plans to open a bank, for example, the management team should include people with financial expertise.

The successful entrepreneur can also retain key employees by providing a stimulating work environment in which employees truly make a difference. They match employees’ abilities to the needs of the company. They also meet the needs of employees for continued advancement, development and growth, and salary incentives and rewards.

Reality

The following drawbacks affect all businesses with employees:

- Recruiting, hiring, and training employees costs money.
- High turnover increases labor costs.
- Government regulates how businesses manage labor.
- Some businesses will have to deal with organized labor.

Tip

Answer these questions as you establish your employee policies:

- What will you do to make sure your staffing needs will be met?
- What incentives will you offer people?
- What areas of continued development and growth will you allow and what will you require?
from real entrepreneurs

An owner of multiple McDonald’s franchises said that the average turnover of employees is approximately two weeks. In addition, it takes an average of eight hours to train an employee. Costs include wages plus training and materials. This particular owner employs about 450 people. Instead of being in the fast-food business, the owner feels he is in the employee training business. The high costs of labor and turnover reduce profit margins. If the turnover rate could be lengthened by one week, the profit margin would be increased greatly.

4.4.5 Inventory and Service Providers Are Dependable

The model business has dependable companies providing inventory, raw materials and services. Many concepts are never launched if they have only one source of supply for the material needed in the final product/service. The future dependability of the source is not secure. For this reason, the leaders of most large corporations want to control the companies that provide critical inventory and services. They do not want to rely on sole-source suppliers. The American Hospital Supply Co. even went so far as to start a company to make the stainless steel micro tubes used for disposable hypodermic needles when only one supplier was available.

Successful entrepreneurs research suppliers and service providers carefully to make certain that supplies can be obtained when needed and that the costs of supplies or services are reasonable.

Reality

Businesses that depend on one source of supply can be held hostage to back orders and price increases.

from real entrepreneurs

A pair of young entrepreneurs had a business concept that involved producing and selling scented T-shirts that would withstand washings. The test market was to produce a T-shirt with a rose scent for the annual Rose Bowl football game played in Los Angeles. The process for adding the scent to the T-shirt was owned by a major corporation. The corporation demanded a large initial order that was unrealistic for these relatively young and inexperienced entrepreneurs to make. They were unable to meet the supplier’s demand and were forced to drop the concept.

4.4.6 Gross Margin Is 100 Percent

The model business has a gross margin of 100 percent. Gross margin, which is also called gross income or gross profit, is the amount of money businesses have left after they pay direct material and labor costs. Gross margin represents the dollars available to cover the operating costs of the business. Gross margin minus operating costs results in a profit or loss for the business. The model business has no direct material or labor costs. With a gross margin of 100 percent, the model business has all of the money received from the sales of products/services to cover operating expenses.

Although it is unrealistic in most cases for any business to have a gross margin of 100 percent, the larger the gross margin, the better the business. Service businesses generally have larger gross margins than product businesses.
The problem with low-gross-margin industries is that slight errors in calculations quickly result in losses. That is why so many discount retailers get into financial difficulty. A one percent error can result in substantial losses. On the other hand, a business with a high gross margin can easily cover a margin of error in projections without sustaining catastrophic financial losses. High-gross-margin businesses can make substantial profit on modest sales volumes.

**Reality**

The projected gross margin of a business is the main key to profit. Investors making a commitment to a new venture consider gross margin a major factor in their decision to invest.

**from real entrepreneurs**

Most tire stores sell their tires with relatively low gross margins, between 20 and 30 percent. They increase the gross margins of the stores, however, by selling the customer accompanying products and services with higher gross margins. These can include valve stems, mounting and balancing tires, alignment and road hazard insurance.

**4.4.7 Legal Problems Do Not Exist**

In the model business, legal problems do not exist. It is a fact of doing business, however, that all real businesses have some legal considerations. The type of entity chosen for the business such as a partnership, corporation, or LLC has particular laws and regulations that apply. Contracts, the very essence of doing business, are fraught with legal ramifications and can be especially confusing for the new entrepreneur. Intellectual property must be protected, governmental regulations complied with, environmental laws met, and land use restrictions observed.

Some businesses come with inherent lawsuits and legal entanglements. Any business whose products will be ingested by, worn by or applied to humans, especially children, has a multitude of applicable laws and regulations. The same applies to a service business that involves giving expert advice, such as medicine, law, or accounting.

Potential legal problems are multiplied several times when an existing business is being purchased. The founder or a key employee may have signed a non-compete agreement with a previous employer. The technology used may be challenged in a patent infringement suit. Environmental barriers may arise. Contractual obligations or liability issues may lie hidden deep in the records. Such legal costs can cripple a new business before it even gets its doors open.

The able entrepreneur investigates the entire array of potential legal factors that could affect the business concept or the purchase of an existing business. The advice of an experienced business lawyer is imperative.
from real entrepreneurs

Airport shuttles that transport travelers to and from airports have run into continual legal battles with cab companies. Cab companies file legal suits and argue that airport shuttle services threaten to put them out of business. Legal fees can be quite significant, and the shuttle service owners have to be prepared to spend time and money in court defending their position.

4.4.8 Wealth Is Generated through Exit Strategy

All entrepreneurs will leave their businesses one day, even if they transfer their businesses to their families as a gift or upon death. When an entrepreneur dies or retires without a planned exit strategy, the business may simply cease to exist or its assets may be sold for a few cents on the dollar. The model business is structured so that wealth is generated through the exit strategy. The model business does not merely cease to exist; it builds wealth for its owners by accumulating assets and building future profit potential. This wealth is collected at the point of the entrepreneur’s choosing.

The model business is structured from its inception to create wealth for the entrepreneur through selling the business, merging with another business or by selling shares in the business to the public at large. Planning the harvest is the key to success.

In addition to creating wealth for the entrepreneur, the exit strategy provides a process to drive the day-to-day operating decisions from the first day the business is open. It also has a profound effect upon financial decisions such as the amount of retained earnings, off balance sheet assets, officers’ compensation and business expenses. The exit strategy of selling the business as a going concern will dictate that the financial records accurately reflect the financial status of the business.

from real entrepreneurs

Three college students operating a Macintosh-equipped desktop publishing business from their dorm room became aware of a knowledge gap in that many people knew how to use PCs but not many could use Macs. They moved their business from their dorm room to a storefront and converted it to a temporary employment agency that specialized in people who were trained to use Macs. Ten years later, they had expanded service with offices in 35 cities. MacTemps was then sold to Aquent Partners.

from real entrepreneurs

ZDC, Inc., a high-tech firm, was purchased by a 47-year-old man who took over the presidency. It was his third business, and he had a personal vision to harvest wealth in the company within two years. Consequently, his every decision was aligned with that personal objective. For instance, the growth plan was targeted to be great enough for him to have a prosperous exit within his two-year period. ZDC merged with Synergetics International within 24 months. This exit strategy was accomplished as planned.
Assignment 4: Model Business Feasibility Checklist

The Model Business Feasibility Checklist is a useful tool to evaluate a business concept. It focuses the entrepreneur’s attention on aspects of the business that may otherwise be overlooked. The results can be used to assess the risk of starting the business, plan how to best achieve personal goals, and to avoid potential problems.

While going through the checklist, refer to the business concept statement created for Assignment 3. You will be evaluating your concept against a model business, one considered perfect.

The checklist is formatted so that the ideal answer would be a 5 for each item. A score of 4 or 5 on most items indicates a good chance for success. Several or many answers with a 1 or 2 mean that you should reevaluate your concept or address the critical areas for alternative solutions. After addressing these issues, you will be ready to begin writing your start-up business plan in Chapter 5.

Tip

Think through each response. Be as objective as possible. For additional perspectives, ask others to read your business concept and then use this checklist to evaluate the concept.
Scenario 4.4.8

Run KC Model Feasibility Checklist

Run KC….continued

Tim is passionate about running and has had the desire to open a running shoe store for many years. He has experience and has done his research. He knows that it is now time to step back and take an unbiased look at his business concept. After being introduced to the Model Business Feasibility Checklist, he has decided that is the ideal tool for him to use to 1. Determine if the concept is feasible and 2. Identify areas he needs to strengthen from the “get go.”

Learning Objectives

• Understand the model business factors that determine feasibility
• Compare a business concept to the model business
• Identify areas that require improvement to enhance feasibility

Overview

The Model Business Feasibility Checklist identifies the major criteria that can make or break the success of a business. By evaluating a business concept against these criteria, an aspiring entrepreneur can determine the level of risk he/she might be taking in starting that business. The criteria can also be used to develop benchmarks for improvement in the areas of product/service, market and financial.

Tools

Run KC Model Feasibility Checklist

Step 1

Review the criteria found on the Model Business Feasibility Checklist. The model, or perfect, business has all these things. If you need help understanding one of the criteria, refer to the criteria explanation page.

Step 2

Rate the Run KC business concept against the model business criteria. Using a scale from 1 to 5 (1 meaning that the concept absolutely does not meet these criteria and 5 meaning that the concept entirely meets these criteria), rate the Run KC business concept against the model business criteria by marking an “X” in the box that corresponds to the number you choose. The owner, Tim Clark, has made notes from his research in the column to the right. This will provide you with the information needed to make this judgment.

Step 3

Evaluate the score. When testing a business concept against the model business no score guarantees a feasible business. Generally, for a business concept to be feasible it must achieve at least one-half of the possible points overall and at least one-half of the possible points in any of the three sections. A score less than 3 for any individual criterion indicates a weakness in the business concept, which requires further consideration. Total your scores for each of the three sections and overall.

Step 4

Identify one or two criteria that you rated low. Consider ways that these scores could be improved. Is more information needed? Is there a unique marketing strategy that would help? Or is there another creative solution? Most scores can be improved over time. List several options that could raise the scores of the low criteria you identified.
### Run KC Model Feasibility Checklist

For help with rating see the criteria explanations.  
1=Low 5=High

<table>
<thead>
<tr>
<th>MARKET FEASIBILITY</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>RUN KC NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers perceive a need for product/service.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Customers see the need for the product but I am the new business in town.</td>
</tr>
<tr>
<td>Product/Service is ready to sell.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>I’ve screened the products out there and know the best brands to carry.</td>
</tr>
<tr>
<td>Product/Service has unlimited life.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Running shoes have a shelf life of about two years before soles begin to harden – they should be sold within a year so they are fresh for customers. Styles change yearly as well.</td>
</tr>
<tr>
<td>Product/Service is unique and protectable.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>The company logo will be protected with a trademark. In addition, I have been approved to carry brands and styles of running shoes that not every store can carry.</td>
</tr>
<tr>
<td>Product/Service is not regulated by the government.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>No special regulations.</td>
</tr>
<tr>
<td>Product/Service line has expansion potential.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Expansion options are numerous within running and related to other sports.</td>
</tr>
<tr>
<td>Product/Service has no liability risk.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Since we give advice, we will be open to liability. Treadmills and equipment within the store increase liability.</td>
</tr>
</tbody>
</table>

**Total:** 35/35

### Run KC Business Model Feasibility Checklist

For help with rating see the criteria explanations.  
1=Low 5=High

<table>
<thead>
<tr>
<th>MARKET FEASIBILITY</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>RUN KC NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market can be recognized and measured.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Research indicates a significant growth in running and the running shoe industry; the customer profile is clearly defined; running clubs and teams are also opportunities to connect with runners.</td>
</tr>
<tr>
<td>Existing competition has identifiable weaknesses.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>The competition is easily identifiable as are there weaknesses.</td>
</tr>
<tr>
<td>Distribution system is established and receptive.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Distribution system is established. Stores have to be accepted to carry each manufacturer’s line. I’ve been approved by 3 and working on 3 more.</td>
</tr>
<tr>
<td>Customers purchase frequently.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Runners replace shoes every 300 to 500 miles which is between 3 to 6 months for most people. They tend to own multiple pairs.</td>
</tr>
<tr>
<td>Business has great news value.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>The industry doesn’t have “great” news value but acknowledging accomplishments of local runners will help gain exposure.</td>
</tr>
</tbody>
</table>

**Total:** 25/25
## Run KC Business Model Feasibility Checklist

For help with rating see the criteria explanations.  
1=Low  5=High

<table>
<thead>
<tr>
<th>MARKET FEASIBILITY</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>RUN KC NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding is easily obtained.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>I need to determine the investment I need. I have some money. Loans will be a challenge since the business is new.</td>
</tr>
<tr>
<td>Revenue stream is continuous.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Business will slow during winter months.</td>
</tr>
<tr>
<td>Money is collected prior to sales.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Money is collected when the sale is made. Credit cards will be accepted.</td>
</tr>
<tr>
<td>Hiring and retaining employees is easy.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>I want all employees to be runners so that does limit the potential pool of employees. Serious runners often like to work in running stores to be around other runners and to get the discount.</td>
</tr>
<tr>
<td>Inventory/Service providers are dependable.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Suppliers are established/dependable.</td>
</tr>
<tr>
<td>Gross margin is 100 percent.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Gross margin is 45 – 50%.</td>
</tr>
<tr>
<td>Legal problems do not exist.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Legal liabilities within the industry are there but not significant.</td>
</tr>
<tr>
<td>Wealth is generated through an exit strategy.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Unless I grow the business into multiple locations, “wealth” potential is probably limited.</td>
</tr>
</tbody>
</table>

Total: /40  
Overall Total: /100
Step 4: Identify low rated criteria and consider ways to improve score.

Identify two or three criteria that you rated low.

__________________________________________________________________________

__________________________________________________________________________

__________________________________________________________________________

__________________________________________________________________________

__________________________________________________________________________

Consider ways that these scores could be improved for each criteria listed above.  
Is more information needed? Is there a unique marketing strategy that would help?  
Or, is there another creative solution?

__________________________________________________________________________

__________________________________________________________________________

__________________________________________________________________________

__________________________________________________________________________

__________________________________________________________________________
## Model Business Feasibility Checklist—Criteria Explanations

If you need help rating your business using the Model Business Feasibility Checklist, check out the following guidelines. Look closely at the options for each model business factor. Then, choose the one that most closely represents your situation. Be honest!

### PRODUCT OR SERVICE FEASIBILITY

| Customers perceive a need for product/service. | 1. Customers are totally clueless about my products/services.  
2. Customers must be educated about my products/services before they see a need for it.  
3. Customers must be convinced to buy from me instead of my competitors.  
4. Customers need my products/services and will often select them over competitors’.  
5. My customers need my products/services and want to buy from me. |
| --- | --- |
| Product/Service is ready to sell. | 1. I have not started developing my product/service.  
2. I could have problems; I’m still developing my products/services.  
3. I have sold some products/services, but they are not completely tested or trouble free.  
4. I have thoroughly tested my products/services and am fixing the problems.  
5. My products/services work well with minimal problems. |
| Product/Service has unlimited life. | 1. My products/services must be sold quickly so they don’t perish or become obsolete.  
2. My products/services have a relatively short life cycle which makes profits minimal.  
3. No sweat, I can make a profit before the life cycle ends for my products/services.  
4. My products/services have a fairly long life cycle which will allow for ample profits.  
5. The life cycle of my products/services is unlimited. |
| Product/Service is unique and protectable. | 1. I don’t have anything proprietary; all that I offer is similar to the competition.  
2. My product/service is not proprietary, but it stands out from the competition.  
3. I’m going to do my best to create proprietary rights for my products/services.  
4. My product is somewhat unique in function or style and can be legally protected.  
5. Got it covered! My products are unique in function and style and can be legally protected. |
| Product/Service is not regulated by the government. | 1. Complying with regulations is going to require lots of time and money.  
2. The regulations are undergoing change, possibly requiring more time and expense.  
3. It’s okay. The regulations are reasonable, but I’ll have to watch them closely.  
4. It’s easy to comply with regulations for my specific products/services.  
5. Regulations are limited to those imposed on all businesses. |
| Product/Service line has expansion potential. | 1. My product/service has no expansion potential.  
2. Right now, I only have one product/service to sell.  
3. Definite expansion potential. Will require hard work to make it happen.  
4. I have the beginnings of a product/service line with several things to sell.  
5. My products/services complement each other, and I can easily add more to sell. |
| Product/Service has no liability risk. | 1. I’m worried; I may encounter a large legal risk selling my products/services.  
2. I’m not sure what the risks are in selling my products/services.  
3. I can afford to protect myself for the risk involved in selling my products/services.  
4. I will have minimal risk selling my products/services; I can afford to protect myself.  
5. I’ll have no liability risk selling my products/services. |
## Model Feasibility Checklist

### Model Business Feasibility Checklist—Criteria Explanations

#### MARKET FEASIBILITY

| Market can be recognized and measured. | 1. My customers could be just about anyone, so targeting a certain group may not be easy.  
2. I have many potential customers, so I need to do more research to find my target market.  
3. I have identified my potential customers, but they will be somewhat difficult to reach because of their demographics/buying patterns.  
4. With some effort, I can use my customers’ demographics/buying patterns to find them.  
5. My potential customers are easy to find because of their demographics/buying patterns. |

| Existing competition has identifiable weaknesses. | 1. I have lots of competition who have been in this business longer than I.  
2. I have no competition! Hmmm, I wonder why?  
3. I have identified my competition, but I do not know their weaknesses.  
4. I know my competition and their weaknesses, but I need more research.  
5. I have limited competition, and I know their weaknesses. |

| Distribution system is established and receptive. | 1. I must develop a brand new distribution system.  
2. My current distribution system offers only limited options.  
3. I’ve found a distribution system already established with several options.  
4. Several distributors seem receptive to carrying my products/services.  
5. Distributors are calling me wanting to carry my products/services. |

| Customers purchase frequently. | 1. Customers will only buy once from me, so I must find new customers all the time.  
2. Most customers will only buy once from me.  
3. Customers will buy more than once, but not frequently.  
4. Some customers will purchase products/services frequently.  
5. My existing customers purchase products/services very frequently. |

| Business has great news value. | 1. My business has zero news value.  
2. My business just doesn’t seem to have great news value.  
3. I think I can come up with an angle to get some publicity.  
4. I know my business has news value, and I can get some good media coverage if I work at it.  
5. My business is so new and interesting that getting in the news is easy! |
### Model Business Feasibility Checklist—Criteria Explanations

#### FINANCIAL FEASIBILITY

| Funding is easily obtained.                              | 1. I’m going to have to invest a large amount, maybe more than I am willing to risk.  
|                                                         | 2. I’m not really sure how much funding my business will require.  
|                                                         | 3. I need to invest quite a bit of money, but I can afford to risk it.  
|                                                         | 4. I need to invest a moderate amount of money; I can afford to risk it.  
|                                                         | 5. I don’t have to invest much money at all; I can comfortably risk it.  |
| Revenue stream is continuous.                           | 1. I never know what’s going to come in because of seasonality, large contracts, etc.  
|                                                         | 2. Monthly sales will fluctuate significantly but are somewhat predictable.  
|                                                         | 3. Our sales vary somewhat from month to month due to sales cycles and products offered.  
|                                                         | 4. Most of the time, sales will be steady from month to month.  
|                                                         | 5. We can always count on steady sales from month to month.  |
| Money is collected prior to sales.                      | 1. We send out a bill for products/services and wait over 30 days for customers to pay.  
|                                                         | 2. We send out a bill for products/services and the typical customer pays within 30 days.  
|                                                         | 3. Customers pay at the time of service or when they receive the product.  
|                                                         | 4. Our customers make an upfront deposit that covers the direct costs of the product/service.  
|                                                         | 5. Cash is King! The entire price of the product/service is paid prior to delivery.  |
| Hiring and retaining employees is easy.                 | 1. Turnover will be high. The cycle of hiring and training will be continuous.  
|                                                         | 2. I will spend lots of time and money hiring and training employees.  
|                                                         | 3. For now, I can control labor costs by using sub-contractors as the company grows.  
|                                                         | 4. I have well-qualified employees and expect a low turnover rate.  
|                                                         | 5. I have top employees and a zero turnover rate!  |
| Inventory/Service providers are dependable.             | 1. I do not have a clue where to get most of the inventory/supplies I need.  
|                                                         | 2. I’m not completely sure about where I’m going to get the inventory/supplies I need.  
|                                                         | 3. I’ve found them, but only a few companies can give me what I need.  
|                                                         | 4. Many companies can supply what I need.  
|                                                         | 5. Numerous companies with good reputations can supply what I need.  |
| Gross margin is 100 percent.                            | 1. My gross margin is low since our costs of direct materials and labor are high.  
|                                                         | 2. My gross margin is fairly low since our costs of direct materials and labor are relatively high.  
|                                                         | 3. My gross margin is average with average costs of direct materials and labor.  
|                                                         | 4. We have some costs of direct materials and labor, but they are lower than average.  
|                                                         | 5. My gross margin is nearly 100 percent. No significant direct costs of materials or labor exist.  |
| Legal problems do not exist.                            | 1. I’ve got problems. I am already facing legal action. For example, violation of a non-compete from a former employer.  
|                                                         | 2. I will have problems. I have multiple business owners, high liability products, leasing issues or products that must be legally protected.  
|                                                         | 3. I am concerned about protecting my personal assets from legal liability.  
|                                                         | 4. Legal problems do occur in this industry, but most can be anticipated and managed with proper planning.  
|                                                         | 5. Few lawsuits or legal harassments occur in this entire industry.  |
| Wealth is generated through exit strategy.              | 1. I will not be able to sell my business when I am ready to exit.  
|                                                         | 2. I don’t know if I can sell my business without me as the owner.  
|                                                         | 3. I will be able to sell some of the proprietary assets of the business.  
|                                                         | 4. I will be able to get a reasonable amount of money since I plan to build proprietary assets.  
|                                                         | 5. My exit strategy will allow for a profitable way out of the business.  |

* The gross margin is the amount left over after the business pays direct materials and labor costs of the product/service.
Assignment 4: Model Business Feasibility Checklist

Learning Objective
• Identify strengths and weaknesses in your business concept as compared to the Model Business.

Overview
The Model Business Feasibility Checklist identifies the major criteria that can make or break a business. By evaluating a business concept against these criteria, aspiring entrepreneurs can determine the level of risk they might be taking in starting that business. The criteria can also be used to develop benchmarks for improvement in the product/service, the market and the financial aspects of the business.

Tools
Model Business Feasibility Checklist

Step 1
Review the Model Business Feasibility Checklist. Review the criteria found on the checklist. The model, or perfect, business has all these things. If you need help understanding one of the criteria, refer to the criteria explanations.

Step 2
Rate your business. Using a scale from 1 to 5 (1 meaning that your concept absolutely does not meet these criteria and 5 meaning that your concept entirely meets these criteria), rate your business concept against the model business criteria by marking an “X” in the box that corresponds to the number you choose. In the boxes to the right, make notes from your research to provide a basis for your rating. If you do not know some of the answers right now, do not rate those criteria. As you go through this course and learn more, you will continue to rate your business against these criteria.

Step 3
Evaluate your business. In a comparison of a business concept against the model business no score guarantees a feasible business. Tally the total score for each feasibility section of the checklist. Generally, for a business concept to be feasible it must achieve at least one-half of the possible points overall and at least one-half of the possible points in any of the three feasibility areas—product or service, market, and financial. A score less than 3 for any individual criterion indicates a weakness in the business concept, which requires further consideration.

Step 4
Identify one or two criteria that you rated low. Consider ways you can improve these scores as you go through the course. Do you need more information, a unique marketing strategy, or creative solutions? Most scores can be improved over time. List several options that could raise the scores of the low criteria you identified.
## Business Feasibility Checklist—Criteria Explanations
For help with rating see the criteria explanations. 1=Low 5=High

### MARKET FEASIBILITY

<table>
<thead>
<tr>
<th>Criteria</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market can be recognized and measured.</td>
<td></td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Existing competition has identifiable weaknesses.</td>
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</tr>
<tr>
<td>Distribution system is established and receptive.</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customers purchase frequently.</td>
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<td></td>
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</tr>
<tr>
<td>Business has great news value.</td>
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</tbody>
</table>

Total: 25

### PRODUCT OR SERVICE FEASIBILITY

<table>
<thead>
<tr>
<th>Criteria</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers perceive a need for product/service.</td>
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<tr>
<td>Product/Service is ready to sell.</td>
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<td>Product/Service has unlimited life.</td>
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<tr>
<td>Product/Service is unique and protectable.</td>
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<tr>
<td>Product/Service is not regulated by the government.</td>
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<tr>
<td>Product/Service line has expansion potential.</td>
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<tr>
<td>Product/Service has no liability risk.</td>
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</tbody>
</table>

Total: 35

### FINANCIAL FEASIBILITY

<table>
<thead>
<tr>
<th>Criteria</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding is easily obtained.</td>
<td></td>
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<tr>
<td>Revenue stream is continuous.</td>
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<tr>
<td>Money is collected prior to sales.</td>
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<tr>
<td>Hiring and retaining employees is easy.</td>
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</tr>
<tr>
<td>Inventory/Service providers are dependable.</td>
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<tr>
<td>Gross margin is 100 percent.</td>
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<tr>
<td>Legal problems do not exist.</td>
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<tr>
<td>Wealth is generated through exit strategy.</td>
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Total: 40
Model Business Feasibility Checklist—Criteria Explanations

If you need help rating your business using the Model Business Feasibility Checklist, check out the following guidelines. Look closely at the options for each model business factor. Then, choose the one that most closely represents your situation. Be honest!

**PRODUCT OR SERVICE FEASIBILITY**

| Customers perceive a need for product/service. | 1. Customers are totally clueless about my products/services.  
2. Customers must be educated about my products/services before they see a need for it.  
3. Customers must be convinced to buy from me instead of my competitors.  
4. Customers need my products/services and will often select them over competitors'.  
5. My customers need my products/services and want to buy from me. |
| --- | --- |
| Product/Service is ready to sell. | 1. I have not started developing my product/service.  
2. I could have problems; I’m still developing my products/services.  
3. I have sold some products/services, but they are not completely tested or trouble free.  
4. I have thoroughly tested my products/services and am fixing the problems.  
5. My products/services work well with minimal problems. |
| Product/Service has unlimited life. | 1. My products/services must be sold quickly so they don’t perish or become obsolete.  
2. My products/services have a relatively short life cycle which makes profits minimal.  
3. No sweat, I can make a profit before the life cycle ends for my products/services.  
4. My products/services have a fairly long life cycle which will allow for ample profits.  
5. The life cycle of my products/services is unlimited. |
| Product/Service is unique and protectable. | 1. I don’t have anything proprietary; all that I offer is similar to the competition.  
2. My product/service is not proprietary, but it stands out from the competition.  
3. I’m going to do my best to create proprietary rights for my products/services.  
4. My product is somewhat unique in function or style and can be legally protected.  
5. Got it covered! My products are unique in function and style and can be legally protected. |
| Product/Service is not regulated by the government. | 1. Complying with regulations is going to require lots of time and money.  
2. The regulations are undergoing change, possibly requiring more time and expense.  
3. It’s okay. The regulations are reasonable, but I’ll have to watch them closely.  
4. It’s easy to comply with regulations for my specific products/services.  
5. Regulations are limited to those imposed on all businesses. |
| Product/Service line has expansion potential. | 1. My product/service has no expansion potential.  
2. Right now, I only have one product/service to sell.  
3. Definite expansion potential. Will require hard work to make it happen.  
4. I have the beginnings of a product/service line with several things to sell.  
5. My products/services complement each other, and I can easily add more to sell. |
| Product/Service has no liability risk. | 1. I’m worried; I may encounter a large legal risk selling my products/services.  
2. I’m not sure what the risks are in selling my products/services.  
3. I can afford to protect myself for the risk involved in selling my products/services.  
4. I will have minimal risk selling my products/services; I can afford to protect myself.  
5. I’ll have no liability risk selling my products/services. |
### MARKET FEASIBILITY

**Market can be recognized and measured.**

1. My customers could be just about anyone, so targeting a certain group may not be easy.
2. I have many potential customers, so I need to do more research to find my target market.
3. I have identified my potential customers, but they will be somewhat difficult to reach because of their demographics/buying patterns.
4. With some effort, I can use my customers’ demographics/buying patterns to find them.
5. My potential customers are easy to find because of their demographics/buying patterns.

**Existing competition has identifiable weaknesses.**

1. I have lots of competition who have been in this business longer than I.
2. I have no competition! Hmmm, I wonder why?
3. I have identified my competition, but I do not know their weaknesses.
4. I know my competition and their weaknesses, but I need more research.
5. I have limited competition, and I know their weaknesses.

**Distribution system is established and receptive.**

1. I must develop a brand new distribution system.
2. My current distribution system offers only limited options.
3. I’ve found a distribution system already established with several options.
4. Several distributors seem receptive to carrying my products/services.
5. Distributors are calling me wanting to carry my products/services.

**Customers purchase frequently.**

1. Customers will only buy once from me, so I must find new customers all the time.
2. Most customers will only buy once from me.
3. Customers will buy more than once, but not frequently.
4. Some customers will purchase products/services frequently.
5. My existing customers purchase products/services very frequently.

**Business has great news value.**

1. My business has zero news value.
2. My business just doesn’t seem to have great news value.
3. I think I can come up with an angle to get some publicity.
4. I know my business has news value, and I can get some good media coverage if I work at it.
5. My business is so new and interesting that getting in the news is easy!

### FINANCIAL FEASIBILITY

**Funding is easily obtained.**

1. I’m going to have to invest a large amount, maybe more than I am willing to risk.
2. I’m not really sure how much funding my business will require.
3. I need to invest quite a bit of money, but I can afford to risk it.
4. I need to invest a moderate amount of money; I can afford to risk it.
5. I don’t have to invest much money at all; I can comfortably risk it.

**Revenue stream is continuous.**

1. I never know what’s going to come in because of seasonality, large contracts, etc.
2. Monthly sales will fluctuate significantly but are somewhat predictable.
3. Our sales vary somewhat from month to month due to sales cycles and products offered.
4. Most of the time, sales will be steady from month to month.
5. We can always count on steady sales from month to month.

**Money is collected prior to sales.**

1. We send out a bill for products/services and wait over 30 days for customers to pay.
2. We send out a bill for products/services and the typical customer pays within 30 days.
3. Customers pay at the time of service or when they receive the product.
4. Our customers make an upfront deposit that covers the direct costs of the product/service.
5. Cash is King! The entire price of the product/service is paid prior to delivery.
### Hiring and Retaining Employees is Easy

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>1.</td>
<td>Turnover will be high. The cycle of hiring and training will be continuous.</td>
</tr>
<tr>
<td>2.</td>
<td>I will spend lots of time and money hiring and training employees.</td>
</tr>
<tr>
<td>3.</td>
<td>For now, I can control labor costs by using sub-contractors as the company grows.</td>
</tr>
<tr>
<td>4.</td>
<td>I have well-qualified employees and expect a low turnover rate.</td>
</tr>
<tr>
<td>5.</td>
<td>I have top employees and a zero turnover rate.</td>
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</table>

### Inventory/Service Providers are Dependable

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>1.</td>
<td>I do not have a clue where to get most of the inventory/supplies I need.</td>
</tr>
<tr>
<td>2.</td>
<td>I'm not completely sure about where I'm going to get the inventory/supplies I need.</td>
</tr>
<tr>
<td>3.</td>
<td>I've found them, but only a few companies can give me what I need.</td>
</tr>
<tr>
<td>4.</td>
<td>Many companies can supply what I need.</td>
</tr>
<tr>
<td>5.</td>
<td>Numerous companies with good reputations can supply what I need.</td>
</tr>
</tbody>
</table>

### Gross Margin is 100 Percent

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>1.</td>
<td>My gross margin is low, our costs of direct materials and labor are high.</td>
</tr>
<tr>
<td>2.</td>
<td>My gross margin is fairly low since our costs of direct materials and labor are relatively high.</td>
</tr>
<tr>
<td>3.</td>
<td>My gross margin is average with average costs of direct materials and labor.</td>
</tr>
<tr>
<td>4.</td>
<td>We have some costs of direct materials and labor, but they are lower than average.</td>
</tr>
<tr>
<td>5.</td>
<td>My gross margin is nearly 100 percent. No significant direct costs of materials or labor exist.</td>
</tr>
</tbody>
</table>

### Legal Problems Do Not Exist

<p>| | |</p>
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<tbody>
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<td>1.</td>
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<td>2.</td>
<td>I will have problems. I have multiple business owners, high liability products, leasing issues or products that must be legally protected.</td>
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<td>3.</td>
<td>I am concerned about protecting my personal assets from legal liability.</td>
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<td>4.</td>
<td>Legal problems do occur in this industry, but most can be anticipated and managed with proper planning.</td>
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<tr>
<td>5.</td>
<td>Few lawsuits or legal harassments occur in this entire industry.</td>
</tr>
</tbody>
</table>

### Wealth is Generated through Exit Strategy

<p>| | |</p>
<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>1.</td>
<td>I will not be able to sell my business when I am ready to exit.</td>
</tr>
<tr>
<td>2.</td>
<td>I don’t know if I can sell my business without me as the owner.</td>
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<tr>
<td>3.</td>
<td>I will be able to sell some of the proprietary assets of the business.</td>
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<tr>
<td>4.</td>
<td>I will be able to get a reasonable amount of money since I plan to build proprietary assets.</td>
</tr>
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<td>5.</td>
<td>My exit strategy will allow for a profitable way out of the business.</td>
</tr>
</tbody>
</table>

*The gross margin is the amount left over after the business pays direct materials and labor costs of the product/service.*

---

**Step 4: Identify low rated criteria and consider ways to improve score.**

Identify two or three criteria that you rated low.
Consider ways that these scores could be improved for each criteria listed above. Is more information needed? Is there a unique marketing strategy that would help? Or, is there another creative solution?

Summary

Testing a business concept for feasibility by comparing it to a model business will help you determine whether you should pursue it. If feasibility is established, the next step is to develop a business plan for that venture.

This chapter included the following key ideas:

- Entrepreneurs can test whether a business concept is feasible by examining the product/service, its potential market, and its profitability.
- The model business does not exist but serves as a benchmark against which to evaluate a concept’s product/service, market, and financial characteristics.
- Products/services that are perceived as needed or desired, that are ready to sell, and that have potential for unlimited life are generally easy to market to potential customers.
- Products/services that offer some protections, minimal interference from the government, few liability risks, and the potential for expansion are more attractive than those that do not.
- If the market is recognized and the competition has obvious weaknesses, the business concept increases its chances for success.
- A model business utilizes an established distribution system if possible.
- Customers who frequently purchase products/services are most desirable.
- Businesses that attract media interest have increased potential for exposure to the target market.
- Entrepreneurs should strive to create businesses that generate a continual flow of revenue.
- Businesses that pose potential legal entanglements should be avoided.
- The exit strategy should drive the day-to-day operating decisions.
Overview
In the product/service portion of the business plan, you will describe your product/service and how it benefits customers. Each feature should be described in terms of the benefit the customer receives or as a solution to the customer’s needs. It is important to be honest about the limitations and potential liability of the product/service. You may also provide the reader with information regarding the production aspects of the product/service development, as well as any potential spin-offs or related developments.

Protecting the intellectual property of a product/service is critical to the growth, value, and stability of an entrepreneur’s company. Entrepreneurs can protect intellectual property through patents, trademarks, service marks, or copyrights.

Entrepreneurs must also be concerned about complying with government requirements for their business. Several federal, state, and local agencies must be satisfied. Those businesses that have significant contacts with multiple states need to comply with those states and their local governments as well.

Objectives
In this chapter, you will learn to:

• Define the product/service.
• Assess ways to protect the product/service.
• Comply with governmental regulations.
• Write the product/service section of the business plan.
5.1 Defining the Product/Service

5.1.1 Description of Product/Service

An important building block of the business plan is the description of the product/service, including both its functional and operational attributes. Entrepreneurs must be able to clearly and concisely communicate key aspects of the product/service. Readers of the business plan need to understand the exact nature of the product/service being offered to comprehend the entire plan.

from real entrepreneurs

Entrepreneurs succeed when they redefine what they are selling to their customers in terms of the benefits customers are purchasing. A carpet company does not simply sell material that covers the floor. It sells an attractively decorated interior. A garment maker doesn’t sell clothes. It sells self-esteem, image, social acceptance, and career advancement. Domino’s Pizza is not in the pizza business, it’s in the home-delivery business. Drive-by Grooming is not in the mobile dog grooming business, it’s in the convenience business.

This section of the plan starts out with a description of the product/service, one of the most important aspects of this section. It is best to describe the product/service in terms of the problems it will solve from the customer’s standpoint. Then the description should focus on the benefits or value the product/service creates. The product/service description is not the place to detail technical specifications; they belong in the appendix.

Tip

Before going any further with your business concept, you must know if the product/service is feasible. Will it work? Has the product/service been tested? You must either own a workable product/service or be able to license it.

The product/service section should be written after any problems associated with the product/service have been worked out. If a product/service is not workable, the business concept is not feasible.

from real entrepreneurs

In 1995 Sergey Brin and Larry Page, two Stanford University computer science doctoral students, began focusing on the problem of which web pages linked to a given page (backlinks). They nicknamed their project “BackRub.” The rest is history, as the saying goes. Their brainchild, Google, now dominates the Internet search industry with over 70% market share.

Reality

Investors will be wary of any venture in which all possible problems have not been solved or solutions to possible future problems have not been devised.
5.1.2 Features and Benefits

Features are what the product/service does or has. Benefits are the reasons customers buy the product/service.

Unique features of a product/service are what set it apart from the competition. Unique features highly valued by customers result in increased marketability. And marketability leads to profitability.

Each feature should be described in terms of the benefit the customer receives or as a solution to the customer’s needs. For instance, the only dry cleaning business in the area offering home pick-up and delivery would describe its service in terms of the benefit to the customer: convenience.

---

**Tip**

Features tell. Benefits sell!
Remember, the features of a product/service tell what it does or has. The benefits are the motivating factors that sell the product/service.

---

**Reality**

Successful businesses differ in meaningful ways from their competitors. Entrepreneurs will not succeed just by copying the competitors’ products/services. Some significant differentiation must exist to create built-in motivation for customers to buy.

---

**More Info**

Marketing Features Vs. Benefits, Benefits Are Results—When selling features of a product/service, the customer has to do all the work. It benefits the seller to draw the connection to the benefits, or results, the customer can expect. Laura Clampitt Douglas, Entrepreneur Magazine.  [entrepreneur.com/article/34942-2](http://entrepreneur.com/article/34942-2)

Features and Benefits—One of the basic rules of selling to sell on benefits that customers will gain from using the product rather than the list of features that it has.  [changingminds.org/disciplines/sales/articles/features_benefits.htm](http://changingminds.org/disciplines/sales/articles/features_benefits.htm)

Exercise 5.1.2
Understanding Features and Benefits

Learning Objective
• List the features and benefits of a given product/service.

Overview
Features tell and benefits sell! Remember, Features tell what a product or service does or has. Benefits are the motivating factors that sell the product or service... the “what’s in it for me”.

Step 1
The exhibit shown below is based on an automotive repair shop called J & B’s Automotive. The majority of the description focuses on Features rather than Benefits. Identify the features mentioned and write each in the Feature column in the chart on the next page. Then for each Feature, ask yourself “So what...why is this important to the customer?” Write the corresponding Benefit in the column labeled Benefits.

J & B’s Automotive is a full-service automotive center offering repair and maintenance as well as auto body repair. The center services all makes and models of domestic and foreign automobiles as well as light trucks. J & B’s houses fifteen bays equipped with the latest diagnostic equipment and staffed by ASE-certified technicians. This enables the center to provide a guarantee that all vehicles are repaired to the customer’s satisfaction in a timely manner. In addition, certified maintenance protects the factory warranty.

Located in Worcester, Massachusetts, J & B’s has been independently owned and operated by the Baker family since 1968. Seamless customer service is achieved through their on-site management staff and an electronic shop management system which is used to document each vehicle’s service history. The auto center is open Monday through Friday from 7 am – 6 pm and Saturday from 7 am – 3 pm. J & B’s also offers towing services, loaner vehicles and 24/7 after-hours drop off.

Identify features and benefits.

<table>
<thead>
<tr>
<th>Features</th>
<th>Benefits</th>
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<td>1.</td>
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<td>5.</td>
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<tr>
<td>6.</td>
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</tbody>
</table>
Step 2
Create a list of Features for your business. Use a web page from a similar business to stimulate ideas – like the example J&B’s Automotive. Then identify the Benefit(s) that corresponds with each feature in the column on the right. To help identify benefits, look at each feature and ask “so what?” “why is this important to the customer?” (Remember, the benefit(s) identified should be benefits to the customer, not the business).

<table>
<thead>
<tr>
<th>Features</th>
<th>Benefits</th>
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</tbody>
</table>

Step 3
Transfer the Features/Benefits identified to your Product/Service plan in the business plan template. Use the following format for each feature identified. Repeat format for each significant feature.

<table>
<thead>
<tr>
<th>Features</th>
<th>Benefits</th>
</tr>
</thead>
<tbody>
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</tbody>
</table>

See the Product/Service Section in the Run KC Business Plan for an example of this section of the plan.
5.1.3 Stage of Development

Just as businesses go through stages, so do products/services and industries. Entrepreneurs should be able to identify the stage of development of their business as well as the industry and/or their specific product/service. The product/service life cycle is determined by how long the product/service is marketable. The common stages that a product/service may go through during its life are introduction, growth, maturity, and decline:

- **Introduction stage**—Profits are low in this stage because research and development, production, and marketing costs are high. Prices on products/services are typically set high during this stage to recoup some of the development and introduction costs.

- **Growth stage**—Increased customer demand results in greater sales. Cash flow improves and profits are at their peak. The Iphone is an example of a growth industry.

- **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 in this stage. The fast food industry is an example of a mature industry.

- **Decline stage**—Sales drop rapidly even though prices continue to fall. Profits are extremely low at this stage. It is time for the company to redevelop, remarket, or discontinue the product/service. If efforts to redevelop or remarket the product/service are successful, a new stage—rebirth—may emerge. 35 mm cameras and film are examples of products in the decline stage as digital cameras become more sophisticated. Landline telephones are also declining in numbers.

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from real entrepreneurs

A bonding agent that performed well in extreme temperatures was the basis for founding a manufacturer’s supply company. When first released, the company priced the commercial grade glue at premium prices. Initially, the glue was demonstrated and sold by knowledgeable sales representatives. After recouping the costs of developing the bonding agent, the company lowered prices to be more competitive. Then the glue was sold through more traditional marketing strategies.
This section of the product/service plan should include a history of the product/service development for the industry as a whole, as well as the status of your specific product/service within that industry. It should also identify the current stage of development of the business, projected dates for achieving the next stage of development, and how the product/service can be regularly improved to remain competitive.

### 5.1.4 Product/Service Limitations

If limitations of a product/service cannot be overcome, they must be openly discussed in the business plan. Factors such as rapidly changing consumer-driven trends, new innovations, and technological advances limit the amount of time the product/service is marketable. The ideal product/service will not suffer these limitations. Its demand will go on and on. High-tech ventures often face the difficulty of having a short marketable life. The economic life of the product/service is sometimes so short the company cannot make enough money on the product/service to be profitable. A product with a long shelf life can be stored until a profitable market can be found for it.

Some product/services have limitations that affect their current marketability. Maybe the product’s functions are limited or a service may be limited by

### Tip

The following businesses have considerable product/service limitations:

- Fashionable products—Cars, clothes, music
- Technical products—Software applications, computer hardware
- Perishable products—Food, flowers
- Products that need to be assembled or installed—Satellite TV, water purifiers
- Products/services that have legal restrictions—Prescription drugs, building contractors
the expertise available. For example, floral shops must carefully plan their inventory based on historical sales to assure that excess inventory doesn’t wilt and die, taking profits with them. Staffing agencies in the medical field are limited in the number of jobs they can fill due to shortages of available workers with specific skills. The business plan must address product/service limitations by explaining the appropriate actions that will be taken to combat them.

Reality
In many start-up service businesses, a major limitation is the entrepreneur’s time. If the entrepreneur has 30 hours available each week for billable work—work attributed to meeting clients’ needs as compared to work related to marketing activities and running the business—that limits the amount of income that can be generated. When the entrepreneur’s time is used up, additional customers cannot be served.

5.1.5 Product/Service Liability

It is important to clearly define any product/service liability and plans to address this liability. Liability is not limited to just product-centered companies. Any company, whether it is a service provider, manufacturer, wholesaler, distributor, or retailer can be liable for 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. Every product/service should be carefully evaluated as to its potential liabilities.

Equally as important as identifying the liability is to outline the plans necessary to protect the business and personal assets of the entrepreneur from a potential lawsuit. Trade associations can be a good source of liability exposure and protection information. Entrepreneurs seeking to lower their liability risk should consult an experienced attorney and fully understand the warranties both expressed and implied in product/service liability. In addition, every business should have, at a minimum, a general business liability policy. Entrepreneurs should consult a good independent insurance agent or risk consultant to determine their particular needs. All protective actions taken should be openly discussed in this section of the plan.

In addition to insurance, entrepreneurs take proactive steps to reduce or avoid liability risks through product labeling and instilling high quality control measures such as contracts, policies and signage.
Exercise 5.1.5
Product/Service Liabilities

Learning Objective

- To recognize potential liabilities associated with doing business and to identify ways to address these potential liabilities.

Overview

Legal liability refers to “an individual’s or company’s obligation to act responsibly or face compensatory penalties.” It is important to clearly define any potential liability and identify plans to address these liabilities. Liability issues are not limited to just product-centered companies. Any company, whether it is a service provider, manufacturer, wholesaler, distributor, or retailer has liabilities.

Outlining plans to protect the business and personal assets of the entrepreneur is equally as important as identifying the potential liabilities. In addition to insurance, entrepreneurs should take proactive steps to reduce or avoid liability risks through contracts, polices and rules, legal structure, product labeling and instilling high quality control measures.

Step 1

Read through the information on the Insurance Information Institute website at iii.org to determine how to protect your business and yourself from liabilities.

From the home page for iii.org, click on Insurance Topics or go directly to Insurance Topics at: iii.org/insurance_topics/

Review the information under the heading – Business. Be sure to visit the sub-heading “Insurance for Specific Businesses.” In that sub-heading, click on the business that most closely resembles the type of business you plan to open. There you will find information on more specific risks and types of insurance.

There is also valuable general insurance information at: iii.org/business-insurance-general/ and a very informative video that you are encouraged to view at: iii.org/video/business-owners-policy-quiz.html, “Test Your Business IQ, Business Owners’ Policies.”

Be aware that in addition to insurance, you can minimize the likelihood of things going wrong in your business by taking proactive steps to prevent adverse events. These steps might include identifying ways to avoid or reduce risks such as contracts, policies, product label warnings, safety precautions, and employee training.
### Step 2

Use information gathered from the Insurance Information Institute’s website and Chapter 5 to complete the following Product/Services Liabilities Chart for your own business.

**Product/Services Liability Chart**

<table>
<thead>
<tr>
<th>Identify Business</th>
<th>Checkmark the measures you will take to address the potential liability identified.</th>
<th>Describe the steps you will take in more detail.</th>
</tr>
</thead>
<tbody>
<tr>
<td>List potential liabilities within your business.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>___ insurance (identify type)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>___ contracts</td>
<td></td>
</tr>
<tr>
<td></td>
<td>___ policies/rules</td>
<td></td>
</tr>
<tr>
<td></td>
<td>___ legal structure</td>
<td></td>
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<tr>
<td></td>
<td>___ other (specify here)</td>
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<tr>
<td>2.</td>
<td>___ insurance (identify type)</td>
<td></td>
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<tr>
<td></td>
<td>___ contracts</td>
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<td>___ policies/rules</td>
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<td></td>
<td>___ legal structure</td>
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<td></td>
<td>___ other (specify here)</td>
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<td>3.</td>
<td>___ insurance (identify type)</td>
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<tr>
<td></td>
<td>___ contracts</td>
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<td>___ policies/rules</td>
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<td>___ legal structure</td>
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<td>___ other (specify here)</td>
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<tr>
<td>4.</td>
<td>___ insurance (identify type)</td>
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<td></td>
<td>___ contracts</td>
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<td>___ policies/rules</td>
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<td>___ legal structure</td>
<td></td>
</tr>
<tr>
<td></td>
<td>___ other (specify here)</td>
<td></td>
</tr>
</tbody>
</table>

* Note: In Chapter 6, Management and Organization Planning, legal structures for a business will be covered in detail. Some legal forms provide protection for the owners personal assets.

### Step 3

Use the information from the Product/Services Liability Chart to complete the liabilities section of your Product/Service Plan. In this section, be sure to identify potential liabilities AND indicate how you will control them.
Scenario 5.1.5

Run KC—Identifying Liabilities

Learning Objective

- To recognize potential liabilities associated with doing business and to identify ways to address these potential liabilities.

Overview

Legal liability refers to “an individual’s or company’s obligation to act responsibly or face compensatory penalties.” It is important to clearly define any product/service liabilities associated with a business and to develop plans to address these liabilities. One proactive step is to act responsibly by putting measures in place to avoid problems. This might include identifying ways to avoid or reduce risks such as the use of warning labels or signage, policies, contracts and employee training. But, not every adverse event can be avoided and therefore, measures such as insurance and legal structure which can help protect both business and personal assets should also be considered.

Step 1

Following is a description of the products and services offered by Run KC:

Run KC is a retail running shoe store offering footwear, apparel and accessories to serious and aspiring runners. The product line offered by Run KC has been carefully screened to ensure that customers find satisfaction on the first try. Products are of a high quality in the mid to high price range.

Run KC differentiates itself from other running shoes stores by the level of service provided during and after the sale. During the sale, Run KC provides gait analysis, individual fit assistance and well-trained staff to help runners select the best shoes and accessories from a carefully selected inventory to enhance their running experience. In addition, a customer file is kept on customers. The atmosphere of Run KC is welcoming and offers runners a place to hang out with one another and connect even after the sale. The store offers training programs, boot camps and a running club. Involvement in local running events by staff and sponsorship of these events also strengthens relationships with runners.

Step 2

1. Based on the products and services offered by Run KC and the activities in which the business participates, what liability issues could the business face?
2. What measures could be put into place to avoid problems, minimize liability and protect the assets of the business and the owner?

Step 3
Review the following brief articles found on the Insurance Information Institute’s website. After reading these articles, are there any additional measures you would suggest to Tim Clark, owner of Run KC?

iii.org/articles/what-does-a-businessowners-policy-cover.html
iii.org/small-business-guide/insurance-for-specific-businesses/small-retail-stores.html

More Info
Risky Business — Before a defective product becomes your downfall, learn how to protect yourself. Mark Henricks, Entrepreneur Magazine. entrepreneur.com/magazine/entrepreneur/2005/march/76232.html

Insurance Information Institute — Types of insurance and what they do. iii.org/business-insurance-general/

Insurance Information Institute — Specialty Business Insurance. iii.org/business/keypersonlifeinsurance/


Business Insurance Planning Worksheet - A list of types of insurance business owners should consider. Go to entrepreneur.com/formnet/form44 and search for business Insurance Planning Worksheet.

from real entrepreneurs
Everyone has heard the story of the McDonald’s customer who spilled hot coffee in her lap. Since suffering that huge liability judgment, McDonald’s and most stores selling coffee place warnings on their cups as well as post signs cautioning that contents may be hot.
5.1.6 Production and Facilities

When writing the production and facilities portion of the product/service plan, the writer should describe the production process, the need for facilities, as well as how much of the product/service will be produced internally and how much will be subcontracted out. Production capacity and the need for future capital to build facilities should be projected.

Many entrepreneurs select a competitor with superior performance as a benchmark when designing their production processes. The entrepreneurs look at the competitors’ production processes to identify areas where they can match or surpass superior performance. These processes are outlined in the business plan.

Production performance can be rated on the basis of:

- Production capacity.
- Absence of errors or reworks.
- On-time processes and delivery.
- Inventory reduction.
- Cost reduction.
- Other criteria relevant to the product/service.

from real entrepreneurs

In his business plan, Charles wanted to identify his production process in detail. It seemed logical to begin his research within the industry, as others in the industry regularly shared information through articles in trade journals and at trade shows. His industry association also provided literature to new members that included basic information about the industry. Through his industry research, Charles was able to identify key suppliers for the materials he needed as well as the names of vendors to which he could outsource the production of some components used in the production process. Based on this information, Charles identified the core manufacturing processes his business would retain and those that he could subcontract out. He incorporated this information into the production process described in the Product/Service section of his business plan.

Reality

Too often, entrepreneurs of service companies skip this portion of the product/service plan. They don’t realize that the production and facilities portion of the product/service plan applies to them also. Service companies must produce or administer their services as well. It is just as important to clearly define the process and people involved in providing a service. For example, the careful planning of processes to recruit, screen, train and place nannies, in-home child-care workers, in clients’ homes insured that Mary Poppins Nannies had both the supply and quality of workers needed.
5.1.7 Suppliers

This portion of the product/service section of the business plan describes the function of suppliers in the business. Entrepreneurs spend a lot of time planning their businesses and working toward success. Therefore, they should not be willing to risk their success on the performance of unknown or unproven suppliers. Sometimes business owners do not put much effort into checking out their suppliers, which can be a costly mistake. Before signing on a supplier, entrepreneurs need to know if the supplier operates with the same basic values as they do, if the supplier makes good on its promises, and if the supplier will be available when needed.

One way entrepreneurs improve their chances of finding good suppliers is to plan a supplier selection process. Successful entrepreneurs ask and answer the following questions before they set up any long-term relationship with a supplier:

- Who else does this supplier do business with?
- What is the strategic plan of the supplier?
- How is the company doing financially?

Suppliers may provide business services as well as products. More and more companies are contracting non-core functions, such as payroll, bookkeeping, and customer service, to outside organizations—outsourcing. On the flip side, many entrepreneurs have launched successful companies supplying these services to businesses.

In this portion of the plan, entrepreneurs should list major raw materials, inventory, and service suppliers. For suppliers, it is helpful to describe the expected relationship. How often will they supply goods and services? What is the contractual agreement with them? Every business plan also needs to build in contingencies. Who are the backup suppliers and how will they be used?

Tip

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 for your business.

More Info

Build a Good Relationship With Suppliers—They’re your hidden growth assets. Follow these four tips to become a valued customer. Bob Reiss. entrepreneur.com/growyourbusiness/businessstrategies/article206530.html

Dun and Bradstreet Million Dollar Directory—Subscription database with information on over one million U.S. public and private companies with sales greater than $1 million. Even though it is subscription based, many local libraries subscribe to this database. Resource is usually available in business libraries. dnb.com/

Vendor Management Tips: Building Relationships—Highly informative and practical, this article provides tips from IT managers on managing vendor relationships but can be useful to any manager. computerworld.com/managementtopics/management/story/0,10801,99816,00.html
5.1.8 Related Products/Services and Spin-Offs

This portion of the product/service section outlines the potential for related products/services that can be added in the future. Rarely is one product/service, or even one product/service line, sufficient to keep a company profitable over time. The products/services of a company must be continually reevaluated for possible enhancement or elimination. In addition, the company must constantly look for ways to expand the product/service line and bring in new products/services. For example, industry giants such as the Coca Cola Company maintain and grow market share through their continual product expansion, including Coke, Diet Coke, Coke Zero, Sprite, and its more recent array of energy and sports drinks.

Another aspect to consider is whether a spin-off enterprise may result from a successful venture. A spin-off is an enterprise started from an existing company. Spin-offs are common in high-technology industries. If potential spin-offs can meet market needs in the industry, they should be clearly defined in the business plan.

from real entrepreneurs

Paul had worked diligently in various productive capacities for a urethane-foam manufacturer in Los Angeles, but he harbored desires to have his own operation. Insightful management at the company provided him with just such an opportunity. The firm asked Paul if he was interested in beginning a separate company in Denver. The Los Angeles manufacturer would furnish the know-how and initial capital for beginning operations in exchange for a "piece of the action." The company was initiating a form of internal venturing. It had done this previously for another employee, and the venture had worked well. It was a good deal for everyone. Why would a manufacturer cooperate in a spin-off operation? The simple answer is money. Management was realistic enough to know that it would have eventually lost Paul to his own enterprise. Since he knew the urethane-foam manufacturing business, it was likely that sooner or later he would start his own operation. Entry requirements were modest. The only question was whether or not the parent organization would participate in the new spin-off. Management wisely decided to keep some control over the situation. It protected its Los Angeles markets by encouraging the new spin-off to locate elsewhere.
5.2 Protecting the Product/Service

5.2.1 Importance of Protecting Intellectual Property

Protecting intellectual property is critical to the growth, value, and stability of a company. Intellectual property gives a company a competitive edge in the marketplace and builds value. Intellectual property takes three forms:

- **Legal**—Patents, trademarks, copyrights, and trade secrets
- **People**—The knowledge and skills of employees
- **Relationships**—Customers, suppliers, independent contractors, and consultants

Entrepreneurs must explain their plans to protect these proprietary assets in the business plan.

Once intellectual property is properly protected, a company must guard and maintain its rights zealously. If a company does not defend its rights, they will be lost. If a company allows others to use its trademarks or copyrights 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 Kleenex, Xerox, and Ketchup, although brand names, have become synonymous with a type of product rather than differentiating one brand from another.

**Reality**

The biggest mistake entrepreneurs make is not recognizing their intellectual property. The business name, logo, brochures, product, service procedures and much more are proprietary and can be legally protected from competitors. Every entrepreneur should strive to build proprietary assets for the future success of the company.

Unfortunately, protecting intellectual property rights takes time and money, but defending those rights is what maintains their value for the company.

**More Info**

Intellectual Property: The Practical and Legal Fundamentals, Thomas Field—
This site also contains an impressive listing of related online resources. piercelaw.edu/tfield/plfip.htm

Intellectual Property Checklist—This tool guides entrepreneurs through a simple checklist to help identify intellectual property and to develop action steps to begin protecting it. View this resource using the More Info link in the online course.

United States Patent and Trademark Office, an agency of the Department of Commerce. uspto.gov
from real entrepreneurs

Coca-Cola is an excellent example of a company that has protected its intellectual property.

- The artwork on the can/bottle is copyrighted.
- The brand name and logo are trademarked.
- The formula for Coca-Cola is a trade secret.
- The shape of the bottle is trade dress.

The formula for Coca-Cola could have been patented, but that would make it a matter of public record and without protection after the patent expired. Keeping it a trade secret has helped Coca-Cola preserve its domination of the market.

5.2.2 Patents

A patent is a grant of a legal right to certain property by the United States for a term of 20 years. What is granted is the right to exclude others from making, using, selling, or importing the product. 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 the knowledge that was once protected. All of the patent holder’s rights are gone.

Patent law is an exceedingly complex field that requires the assistance of a patent lawyer. Not all patent lawyers have the same expertise. They specialize in various fields. Most patent attorneys have very specific product/service experience, which is reflected in their fields of specialization.

Getting a patent is a very long and expensive process. The process includes a search of existing patents, the application, probably at least one rejection, and defending it even after it is issued. It is not unusual for a patent to cost $10,000 to $20,000 and take 18 months to obtain, and then, the entrepreneur only has the right to defend it 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.

Reality

Avoid the patent trap. Spending money to obtain a patent for an unmarketable product is foolish. The patent itself is worth nothing unless it protects a product/service that people want. Consider a patent as an investment that should pay off over time.

from real entrepreneurs

An inventor worked for two years in his basement developing a 3-D television. He was afraid that someone might steal his invention, so he would not discuss his product idea with anyone. When he decided that his working drawings and prototype were perfected, he contacted a patent attorney to start the patent search. During the patent search, the inventor found out the concept had been developed and tried four years previously and would not work. He wasted his time and money because he did not seek advice from the appropriate people early in the process.
Spending the money to acquire patent protection for a product/service is not always appropriate. An entrepreneur should retain the services of a patent attorney to determine if an idea should be patented. Before hiring an expensive patent attorney, entrepreneurs should be aware of these patent realities. The product/service may not be patented if:

- Another party already has patented the product/service. Preliminary patent searches can help to identify similar patents that have already been issued.
- The product/service is not useful. Patent law says that the patent will only be granted for a useful product/service.
- The product/service was in the public use or offered to the public before the application.
- The product/service is just an idea without a workable device or process.
- 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 in fact applied for a patent.

Tip

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, VA 22202-3513. An attorney can make this search on your behalf for a fee.

More Info

Understanding the Patent Process from Soup to Nuts—This article provides an expert explanation of the various kinds of patents, including utility patents and design patents, along with a practical description of the complete patenting process. entrepreneurship.org/en/resource-center/understanding-the-patent-process-from-soup-to-nuts.aspx

U.S. Patent and Trademark website—Searchable database of U.S. patents and trademarks, some patent images available for free online. uspto.gov

Delphion—Searchable database of U.S. patents and trademarks. delphion.com

Patent It Yourself, David Pressman (Book)—Includes information on intellectual property, why you should have it and how you can get it, patent laws and legislation, etc.

5.2.3 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 those used by a business to identify its products and distinguish the products from those offered by others. Brand names are one form of trademark. Distinctive packaging, unique color schemes, unique designs, and slogans can also be trademarked.
Service marks are often slogans or phrases used in the sale or advertising of services as opposed to products. A service mark is used in advertising while trademarks appear on packaging.

Trademarks and service marks are an affordable way to obtain protection for intellectual property. They 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.

With the widespread use of the Internet in business today, trademark issues related to domain names have become increasingly common. A company’s domain name is its address on the Internet, and as such, has considerable value to the company. Congress passed the Anticybersquatting Consumer Protection Act in 1999 to strengthen trademarks laws as they relate to bad-faith registering of domain names. A cybersquatter registers a domain name without the intention of creating a website, rather they intend to later sell the name for profit to its rightful owners.

An entrepreneur may choose to protect intellectual property with trademarks and service marks in a specific state or at the federal level. It is much more advantageous to register federally as it gives nationwide protection and permits greater damage recovery. A search can be done to identify marks which are already registered. Until the mark has in fact been registered, one cannot legally use the ® symbol.

More Info
U.S. Patent and Trademark website—Searchable database of U.S. patents and trademarks. uspto.gov

from real entrepreneurs

Registering your trademark with the U. S. Patent and Trademark office provides some protections against trademark infringement. Such was the case for Red Bull, a registered trademark of UAE, which won a lawsuit to prevent a large importer from selling Bullfighter—which was found guilty of trademark infringement. In this case, it was argued that Bullfighter was purposely misleading customers into thinking its product was a Red Bull product or endorsed by Red Bull.

5.2.4 Copyrights

Copyrights protect the property of the author who created the work. Copyrights protect original works of authorship from unauthorized copying or use. Copyright protection is automatic but should be registered with the Register of Copyrights at the Library of Congress in order to prove when the material was created and its contents. Protection is good for the life of the creator plus 70 years. Literary, musical, dramatic, choreographic, pictorial, graphic, sculptural, audiovisual and architectural works can all be protected through copyrights. Many music enthusiasts may recall February 12, 2001, as “the day the music died.” It was the day that the federal court of appeals found that Napster, a software program that facilitated exchanging music files over the Internet, encouraged and assisted its users in the infringement of copyrighted music. The ruling in this landmark intellectual property case, A&M Records, Inc. v. Napster, Inc., resulted in Napster shutting down its file swapping service.
Copyrights do allow limited use of the material by others for criticism, comment, news reporting, teaching, scholarship, and research.

**Reality**

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. Entrepreneurs must develop clearly written agreements with employees and sub-contractors concerning who owns the copyright on the materials produced.

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 “Corp.”
- The first year of publication
- The name of the owner or company

For example: © 2011 John Doe

**Tip**

It should be standard procedure to have the copyright symbol with the date and company name printed on all materials distributed on behalf of the company. Most word processing programs will allow this copyright information to be printed as a default on all documents created.

**More Info**

10 Big Myths about Copyright Explained—This article, while not legal advice, is an excellent, readable guide to today’s changing copyright laws.

[templetons.com/brad/copymyths.html](http://templetons.com/brad/copymyths.html)

### 5.2.5 Licenses and Royalties

Another strategy some businesses use is to license their intellectual property to other companies. It might limit the licensed usage to a particular category of product/service or geographic area or permit its use without such limits. When intellectual property is licensed, ownership is retained but another may use it in accordance with the contract. Generally a license fee is paid up front or over time, and royalties are the periodic payments based on use or sales. A license may be issued for a specific period of time or keyed to performance quotas. Many times the licensor, or the owner, will insist upon minimum royalties regardless of sales or use. A license can be exclusive for the intellectual property, or exclusive or non-exclusive for a particular market or territory. The variations are limited only by the imaginations of those involved.

Entrepreneurs can profit from licensing products/services to others (licensor) or from licensing the rights to use or sell other companies’ products/services (licensee).
Whether the licensee or licensor, entrepreneurs must carefully consider the contents of the license agreement.

- Will any money be paid up front for the license?
- What royalty will be paid? Will it be based on 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 does 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?

### Tip

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.

### Reality

License agreements are complex and, as with all legal documents, should only be entered into with the advice of an experienced attorney.

---

**from real entrepreneurs**

Colleges and universities frequently license the rights to use the their name or identifying mark—logo or mascot—to individuals, companies or organizations wishing to use it on products or in advertising. Frequently along with this right comes the obligation to use manufacturers officially licensed by the college to use its trademark. Proceeds generated by licensing programs go back to the college typically for special programs or sports scholarships.

**More Info**

The Licensing Business Handbook Seventh Edition, Karen Raugust—All the tools needed to create and implement a successful and profitable licensing program.

---

**from real entrepreneurs**

Licensing provided an effective way to saturate the market for Teva founder Mark Thatcher. After a layoff from Citgo, Thatcher combined his love of river rafting and technical ingenuity to create an "amphibious utility sandal." Without the resources to manufacture and market the Teva sandal himself, he entered into a verbal licensing agreement with a sporting goods company. When sales began to climb, the partner tried to squeeze him out. Fortunately, Thatcher found another licensee and a good lawyer and managed to regain his rights. Today, Teva is a leader in the sports sandal market.
5.2.6 Trade Secrets

A trade secret is something that an entrepreneur or firm knows that others do not know. Trade secrets include techniques, designs, materials, processes and formulas that are not known by the public and can be licensed in the same way as a patent. Trade secrets can also be a supplier or customer list, manufacturing process or technique, or merchandising or promotional system. Such trade secrets can be very valuable.

Entrepreneurs must be particularly careful that their 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 the business leaves the information lying around, 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 thing.

Employees at all levels of a business may have specific skills or knowledge that are immensely valuable to that business. Perhaps it's a salesperson who knows the customers, whom to meet with, when and where to call on them, and their internal procedures. Suppose one day this same salesperson decides to start a business? What about the plant manager who knows every detail of how to produce the product? These are both examples of intellectual property that needs to be protected. The employees in these examples cannot be forced to continue to work for a business unless an employment contract requires it, and even then, when the contract expires, they are gone. Non-compete clauses in their employment contracts, with reasonable duration and scope, can provide the company protection for a period of time.

More Info

Martindale-Hubbell Law Directory—Comprehensive listing of individual lawyers and law firms by specialty and geographic location. martindale.com
Exercise 5.2.6
Identify Intellectual Property

Learning Objective

- Identify various types of intellectual property a business may possess and the means to protect it.

Overview

Many people think that the only intellectual property a business might have is a patent or trademark. Every business has some form of intellectual property. It is a great way to build value in a business. You have something more to sell than simply the hard assets. Sometimes the most valuable asset a business possesses is its customer list. That’s a form of intellectual property. In other cases, a key employee may be a form of intellectual property. Obviously, an employee cannot be possessed but the business may be protected against the loss of that employee, especially a loss to a direct competitor.

The most common types of intellectual property are below. For more information, refer to Chapter 5.

A **patent** is issued to new and useful inventions, discoveries and designs. To be entitled to a patent, a work must be completely new, useful and not obvious.

A **copyright** is given to “original works of authorship” such as written works, musical works, visual works or performance works.

A **trademark/service mark** protects a name or symbol, which is used to distinguish one person’s goods or services from those of others.

A **trade secret** is some information or process that provides a commercial advantage, which is protected by keeping it secret.
Step 1
Brainstorm intellectual property. Think of a non-franchised but themed restaurant, maybe Mexican or Thai, which has unique menus, décor and recipes. Brainstorming with another, make a list of all the potential intellectual property that a restaurant might have and indicate in which category each would properly be classified.

### Intellectual Property Item | Type
--- | ---
EXAMPLE Recipe for certain food | Trade secret
1. | 
2. | 
3. | 
4. | 
5. | 
6. | 
7. | 
8. | 
9. | 
10. | 

Step 2
List three proprietary aspects about your own products/services you may want to protect.
1. 
2. 
3. 

Step 3
List the ways your business’ intellectual property can be protected.
1. 
2. 
3. 

Step 4
List three questions you need to ask an attorney about protecting intellectual property.
1. 
2. 
3. 
5.2.7 Using Intellectual Property Attorneys

Intellectual property issues can quickly become expensive and time-consuming. It is important to find an attorney who specializes in the type of intellectual property law applicable to the entrepreneur’s business.

Entrepreneurs can have valuable rights stolen from them and yet be unable to do much about it for a number of reasons:

- The cost of correcting the problem is prohibitive.
- Proof of theft is lacking.
- 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 $15,000 or more. Defending a patent against infringement is even more expensive.

An intellectual property attorney can do much, however, to prevent problems. First, attorneys can spot intellectual property in a business perhaps more readily than entrepreneurs and devise ways to protect it. Certainly attorneys can prepare the appropriate documents, but they can also advise on protective measures in matters such as hiring, firing, administration and operations. Prevention is cheaper than cure.

Tip

For assistance, ask your general business lawyer to recommend an intellectual property attorney and then interview prospective candidates. In screening candidates, answer the following questions:

- Can you and the attorney effectively communicate with each other?
- Does the attorney explain advice in terms you understand?
- Does she adequately explain her fee and billing procedures?
- Is she accessible by phone?
- Does he return phone calls within 24 hours or have a procedure in place that someone from the office will call you and see if they can help?
- When you speak with the attorney, does he appear knowledgeable about your industry, type of business, and the matter he will be handling for you?

If the answers to any of these questions are negative, seriously question retaining the attorney’s services.

from real entrepreneurs

One way for entrepreneurs to manage their legal expenses is to hire an attorney that will work on a contingency basis. This arrangement worked well for Staar Surgical during a critical patent infringement case. Management agreed to pay an attorney a share of the settlement if Staar prevailed in court, which they did. It was a win-win situation that culminated in a payment of over one million dollars to the attorney.
5.3 Complying with Governmental Regulations

5.3.1 Federal Government Property

Entrepreneurs must comply with all federal, state, and local governmental regulations and obtain all licenses and other permissions before beginning operations. Most of these requirements were created for the purpose of putting people on the various tax rolls, such as income, sales, Social Security, workers’ compensation, unemployment, and personal property owned. Other requirements were established to prevent a person from doing things considered dangerous or undesirable.

At the federal level, unless an enterprise plans to make or sell alcohol, firearms, explosives, pharmaceutical drugs, nuclear devices, or other controlled substances, its main concern is with the Internal Revenue Service (IRS). The IRS wants to know where a business is and what the business does. Thus, most entrepreneurs must obtain a EIN by filing a form SS-4 with the IRS to register the business.

Upon filing the SS-4 form, the owner will receive an EIN (sole proprietors without employees use their Social Security number) as well as 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. All communications with all governmental agencies must include this EIN. The EIN is also needed to open business bank accounts and brokerage accounts and in dealing with others who must report the business 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.

Additional considerations at the federal level include:

- Occupational Safety and Health Administration (OSHA) which has very specific requirements concerning health and safety.
- The Americans with Disabilities Act (ADA) affects many businesses both in hiring practices and customer accommodations.
More Info

Government Agencies for Small Business—Detailed list including 16 federal government agencies with hot links to their websites for entrepreneurs. A copy follows this section.

U.S. Department of Labor — Small Business Resource Center, a guide to the departments, rules, and regulations. dol.gov/oasam/programs/osdbu/sbrefa/

Internal Revenue Service—Award-winning website designed to help entrepreneurs comply with federal tax and wage reporting regulations. Forms and helpful information are available. irs.gov/businesses/small/index.html

The Licensing Business Handbook Seventh Edition, Karen Raugust—All the tools needed to create and implement a successful and profitable licensing program.

Registering a business sba.gov/content/5-steps-registering-your-business

Licenses and permits-information on federal and state licenses and permits. sba.gov/licenses-and-permits

Licenses-Licensing rules. sba.gov/content/obtaining-business-licenses-permits

### More Info

<table>
<thead>
<tr>
<th>Government Agencies for Small Businesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Information Center</td>
</tr>
<tr>
<td>sjww.org/info/fed.info.center.html</td>
</tr>
<tr>
<td>Internal Revenue Service</td>
</tr>
<tr>
<td>irs.gov</td>
</tr>
<tr>
<td>Small Business Administration</td>
</tr>
<tr>
<td>sba.gov</td>
</tr>
<tr>
<td>Department of Labor</td>
</tr>
<tr>
<td>dol.gov</td>
</tr>
<tr>
<td>Social Security Administration</td>
</tr>
<tr>
<td>ssa.gov</td>
</tr>
<tr>
<td>Department of Justice/Immigration and Naturalization Service</td>
</tr>
<tr>
<td>immigration.gov/graphics/index.html</td>
</tr>
<tr>
<td>U.S. Department of Commerce</td>
</tr>
<tr>
<td>commerce.gov</td>
</tr>
<tr>
<td>Patent &amp; Trademark Office</td>
</tr>
<tr>
<td>Copyright Office</td>
</tr>
<tr>
<td>Bureau of Census</td>
</tr>
<tr>
<td>Minority Business Development</td>
</tr>
<tr>
<td>International Trade Association</td>
</tr>
<tr>
<td>Federal Trade Commission</td>
</tr>
<tr>
<td>ftc.gov</td>
</tr>
<tr>
<td>Environment Protection Agency</td>
</tr>
<tr>
<td>epa.gov</td>
</tr>
<tr>
<td>Food &amp; Drug Administration</td>
</tr>
<tr>
<td>fda.gov</td>
</tr>
<tr>
<td>U.S. Customs</td>
</tr>
<tr>
<td>customs.gov/xp/cgov/home.xml</td>
</tr>
</tbody>
</table>
5.3.2 State Governments

While federal regulations are the same for everyone in the United States, each state has different regulations, and may require different licenses and sales tax collection procedures.

The selection of the state in which to locate a business is not a minor matter. Where an entrepreneur chooses to do business can greatly affect the cost of operations, markets, and profits. Granted, circumstances are often beyond the entrepreneur's control and may force a person to do business in a certain state. Still, the successful entrepreneur is keenly aware of all regulations required by the states.

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. Sales tax rates vary and some states tax certain products and services differently. Entrepreneurs can find out about state sales tax on the Internet, from local chambers of commerce, or by contacting their state Department of Revenue. If business is conducted in several states, the venture may have to be authorized to do business in all of them.

### Reality

Sales taxes should not cost the entrepreneur 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. Still, some entrepreneurs get caught in the trap of spending the collected sales tax money before it is due. Then they must scramble to come up with additional funds to pay the sales tax division. All state government agencies frown upon this practice.

If a business purchases goods for resell, they will need to obtain a state sales tax identification number. In this way, they do not pay sales tax on their purchases. Rather sales taxes are collected when the product/service is sold to the final user.

Many state governments require a business to register with the secretary of state.

Corporations will file their articles of incorporation while sole proprietors may be required to file a fictitious name registration. A quick call to the secretary of state's office will reveal the regulations for companies doing business in that state. Also, many states have established websites with answers to frequently asked questions about starting a business and links to the appropriate agencies.

from real entrepreneurs

The complexity of collecting sales tax and filing tax reports with multiple states caused one small book publisher to opt for selling strictly wholesale, to bookstores that would resell her books. In that way, she didn’t have to collect sales tax from her customers. These bookstores collected sales tax when they sold her books.
5.3.3 Local Governments

Local governments in each county and city regulate licenses, permits, and zoning. When applying for a local license, a new business is often subjected to inspection by the fire department, building officials, and zoning authorities. The fire department wants to know if the business is doing anything that could be a potential fire or chemical hazard. 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 and up to code and the zoning department will determine if the intended use is permitted in the zoning classification.

When necessary, local governments can impose changes to existing and new buildings. For example, a plant was forced to cut a large hole in the middle of its floor for another stairway from the basement. The stairway costs $9,500. Although the plant met local building-code specifications when it was built, local authorities still had the ability to order compliance to new code regulations.

Some zoning regulations may not apply to small home-based businesses. Rural areas or small towns often have fewer requirements than larger cities. A call to city hall or the county government will reveal the requirements in that region.

from real entrepreneurs

Public officials in one large city discouraged some businesses from entering town yet gave favors to other businesses. When IBM wanted to come to the area to build a huge complex, local officials bent over backwards to accommodate it. A small electronics manufacturer had no problem at all because the person who wanted to sell the land and build its plant was politically well-connected. The terms of the deal indicated that the seller was to provide all clearances, or the deal was off. Yet, another large manufacturer was not given such favors. Fed up with the bureaucracy, this manufacturer located the factory in a nearby town.

from real entrepreneurs

Getting permitted for complex local development can depend on who you are and who you know. IBM might find officials bending over backwards to accommodate it, while another firm in a different industry might run into opposition. Whoever you happen to be, having strong knowledge of the local community and local representation is generally the safest path to take; even so, no one bats 1.000.
Exercise 5.3.3
Government Approvals

Learning Objective
• To determine the federal, state, and local government regulations needed to legally operate a specific business.

Overview
Unfortunately, there is no straight forward answer to the question “What legal requirements are required to establish a small business?” Not only do requirements vary by the type of business but every state, county and city also has different requirements. Look at your city’s webpage or that of your local chamber of commerce for sources of business start up information. To make it easier for entrepreneurs to locate the information they need, some metropolitan areas consolidate information pertinent to small business at one convenient web location. Members of the small business support community, such as your local chamber or SBA office, will be able to point you to this resource. For example, in the Kansas City metro area, kcsourcelink.com is a website that provides an integrated system of resources for entrepreneurs. Visit US Sourcelink at ussourcelink.com. Under About Us, click on US Sourcelink Across the County for information on partners that provide similar resources in other locations.

Step 1
Access information through the websites of local resources for small business in your area, including that of the Secretary of State, or contact the city, county, and state where the business will be located to determine their requirements. Sometimes this can be determined through a Google search but often it requires phone calls to get specifics.
Exercise 5.3.3
Government Approvals

Step 2
Complete the following chart:

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>List license/registration/approval needed</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>City: ___________</td>
<td>Look on your city’s website for business licensing information or call city hall.</td>
<td></td>
</tr>
<tr>
<td>County: __________</td>
<td>Call the county—generally the county appraiser or assessor’s office.</td>
<td></td>
</tr>
<tr>
<td>State: ___________</td>
<td>Look at the Secretary of State’s website or call the office.</td>
<td></td>
</tr>
<tr>
<td>Federal</td>
<td>Most common federal regulation will be FEIN number at irs.gov.</td>
<td></td>
</tr>
</tbody>
</table>

Use the information from the chart above to complete the Governmental Approvals section of your plan.
Assignment 5a: Product/Service Plan

At this point in the course, you are ready to begin writing your business plan using the electronic business plan template. The product/service plan is the first section that you will write. This assignment, combined with the rest of the assignments in this course, will make up your business plan. Throughout the process of writing a business plan, it is common to continually update previous completed sections. Therefore, you will probably need to update the product/service plan later in the course as additional information becomes available.

In this section of the business plan, you will briefly describe the product/service, concisely communicate its purpose, and define unique features that will attract paying customers. It is often difficult to limit the amount of product/service information included in the business plan. After all, some readers may be more interested in the technical aspects of the product/service than others. Describe the product just enough to demonstrate that you have sufficiently considered its details, worked out the bugs, and addressed potential problems. Clearly communicate the fact the product/service works and is ready to go. Include technical information in an appendix for readers who want more information and technical specifications.

In the product/service plan, highlight proprietary aspects, product/service limitations, product/service liability, and other operational aspects. These issues help the reader understand your planned process for making your products/services available to potential customers.

from real entrepreneurs

John was an engineer who developed a new method of processing grains into pellets for certain pet foods. He believed his method to be superior in efficiency and cost. He concentrated so heavily on defining the benefits to his process that readers of the plan didn’t understand what the actual product/service was. The questions posed to him made it obvious that readers did not understand that he was offering an engineering consulting service to existing manufacturers of pet foods. They thought he wanted to start a pet food company. His business plan concentrated on the wrong aspect of his product/service.

In preparation for completing Assignment 5A which follows, review the Product/Service Plan in the business plan for Run KC.
Assignment 5a: Product/Service Plan

Directions: Now is the time to research your answers to the following questions.
Then record your answers in the Product/Service Plan section of the Business Plan Template.

<table>
<thead>
<tr>
<th>Business Plan Questions</th>
<th>Section Content Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description of Product/Service</strong></td>
<td>5.1.1</td>
</tr>
<tr>
<td>What is the product or 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? Include a clear description of product/service.</td>
<td></td>
</tr>
<tr>
<td><strong>Features and Benefits</strong></td>
<td>5.1.2</td>
</tr>
<tr>
<td>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? Using the format suggested in Exercise 5.1.2 makes this section easier for the reader to follow.</td>
<td></td>
</tr>
<tr>
<td><strong>Stage of Development</strong></td>
<td>5.1.3</td>
</tr>
<tr>
<td>What is the stage of development of the industry? At what stage of development is the product/service (model stage, working prototype, small production runs, full manufacturing/production, or other) for the business? When do you plan to achieve other stages of development? At what life cycle stage is the product/service (introduction, growth, maturity, or decline)?</td>
<td></td>
</tr>
<tr>
<td><strong>Product/Service Limitations</strong></td>
<td>5.1.4</td>
</tr>
<tr>
<td>What are the inherent product/service limitations, if any? Include perishability, limited shelf life, installation needs, legal restrictions, staff availability, etc.</td>
<td></td>
</tr>
<tr>
<td><strong>Product/Service Liability</strong></td>
<td>5.1.5</td>
</tr>
<tr>
<td>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?</td>
<td></td>
</tr>
<tr>
<td><strong>Production</strong></td>
<td>5.1.6</td>
</tr>
<tr>
<td>What is the production process? 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. Service business—how will services be provided to customers? For service businesses, clearly define the process and people involved in providing the service.</td>
<td></td>
</tr>
<tr>
<td><strong>Facilities</strong></td>
<td>5.1.6</td>
</tr>
<tr>
<td>What are the plans for facilities (manufacturing, office, retail)? Include manufacturing facilities, production capacity, and future capital required to build facilities.</td>
<td></td>
</tr>
<tr>
<td><strong>Suppliers</strong></td>
<td>5.1.7</td>
</tr>
<tr>
<td>Who are the major raw material/service suppliers, and what are the significant purchasing contracts with them? Are there backup suppliers?</td>
<td></td>
</tr>
<tr>
<td><strong>Related Products/Services and Spin-Offs</strong></td>
<td>5.1.8</td>
</tr>
<tr>
<td>What is the potential for related products/services that could be added in the future? How might 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?</td>
<td></td>
</tr>
<tr>
<td><strong>Trademarks, Patents, Copyrights, Licenses, Royalties</strong></td>
<td>5.2</td>
</tr>
<tr>
<td>How will you protect intellectual property? What patents, trademarks, or copyrights have been obtained or which ones will be pursued? What license or royalty agreements are associated with the product/service, and what plans are there for future agreements? What distribution rights have been obtained or given away?</td>
<td></td>
</tr>
<tr>
<td><strong>Governmental Regulations and Approvals</strong></td>
<td>5.3</td>
</tr>
<tr>
<td>What government agencies regulate businesses in your industry? What governmental approvals are necessary at the federal, state, and local levels and what is the status of such approvals? Some 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, planning and zoning commissions. Organize this section based on the levels of government: city, county, state and federal requirements.</td>
<td></td>
</tr>
</tbody>
</table>
Assignment 5b: Product/Service Plan Feasibility Checklist

Now that you have worked through your product/service plan, you can check it against the product/service criteria for the model business. This assignment will help you further understand the strengths and weaknesses of the product/service.

Don’t be surprised if some of your answers have changed from when you used this tool previously. Also at this point, you should be able to answer all questions related to product/service feasibility, including those that you weren’t able to answer earlier.

By repeating the process of evaluating each section of the business plan immediately after its completion with the model business feasibility checklist, you will be aware of any potential problems before going further in the planning process. In addition, you can improve your chances of success. For each criterion in which the business scores less than 3, examine it and determine if you can improve these aspects.

Assignment 5b: Model Business Feasibility Checklist—Product/Service

Learning Objective

- Identify strengths and weaknesses in your product/service as compared to the model business product/service.

Overview

The Model Business Feasibility Checklist identifies the major criteria that can make or break the success of a business. This checklist has already been used to evaluate the overall feasibility of the business concept. Now, you will use the product/service criteria to reevaluate the feasibility of the product/service you are offering. By doing this, you can develop benchmarks for improvement.

Tools

Model Business Feasibility Checklist—Product/Service
Step 1
Review the product/service criteria. The model, or perfect, business has all these things. If you need help understanding one of the criteria, refer to the criteria explanation page.

Step 2
Rate your product/service. Using a scale from 1 to 5 (1 meaning that your concept absolutely does not meet these criteria and 5 meaning that your concept entirely meets these criteria), rate your product/service against the model business product/service criteria by typing the number in the box that corresponds to the number you choose. If you do not know some of the answers right now, do not rate those criteria. As you go through this course and learn more, you will continue to rate your product/service against these criteria. The criteria explanations, a more detailed explanation of each item on the Model Business Feasibility Checklist, follows the checklist grid.

Step 3
Evaluate your product/service. Generally, for a product/service to be feasible it must achieve at least one-half of the possible points overall and at least one-half of the possible points in the section. A score less than 3 for any individual criterion indicates a weakness in the product/service, which requires further consideration.

Step 4
Identify one or two criteria that you rated low. Consider ways you can improve these scores as you go through the course. Do you need more information, a unique marketing strategy, or creative solutions? Most scores can be improved over time. List several options that could raise the scores of the low criteria you identified.

<table>
<thead>
<tr>
<th>PRODUCT OR SERVICE FEASIBILITY</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>LOW</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HIGH</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customers perceive a need for product/service.</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Product/Service is ready to sell.</td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Product/Service has unlimited life.</td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Product/Service is unique and protectable.</td>
<td></td>
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</tr>
<tr>
<td>Product/Service is not regulated by the government.</td>
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<tr>
<td>Product/Service line has expansion potential.</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Product/Service has no liability risk.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total: /35
### Assignment 5b: Model Business Feasibility Checklist—Product/Service

#### Model Business Feasibility Checklist—Criteria Explanations

If you need help rating your business using the Model Business Feasibility Checklist, check out the following questions. Look closely at the options for each model business factor. Then, choose the one that most closely represents your situation. Be honest!

#### PRODUCT OR SERVICE FEASIBILITY

| Customers perceive a need for product/service. | 1. Customers are totally clueless about my products/services.  
2. Customers must be educated about my products/services before they see a need for it.  
3. Customers must be convinced to buy from me instead of my competitors.  
4. Customers need my products/services and will often select them over competitors’.  
5. My customers need my products/services and want to buy from me. |
|---|---|
| Product/Service is ready to sell. | 1. I have not started developing my product/service.  
2. I could have problems; I'm still developing my products/services.  
3. I have sold some products/services, but they are not completely tested or trouble free.  
4. I have thoroughly tested my products/services and am fixing the problems.  
5. My products/services work well with minimal problems. |
| Product/Service has unlimited life. | 1. My products/services must be sold quickly so they don’t perish or become obsolete.  
2. My products/services have a relatively short life cycle which makes profits minimal.  
3. I can make a profit before the life cycle ends for my products/services.  
4. My products/services have a fairly long life cycle which will allow for ample profits.  
5. The life cycle of my products/services is unlimited. |
| Product/Service is unique and protectable. | 1. I don't have anything proprietary; all that I offer is similar to the competition.  
2. My product/service is not proprietary, but it stands out from the competition.  
3. I'm going to do my best to create proprietary rights for my products/services.  
4. My product is somewhat unique in function or style and can be legally protected.  
5. My products are unique in function and style and can be legally protected. |
| Product/Service is not regulated by the government. | 1. Complying with regulations is going to require lots of time and money.  
2. The regulations are undergoing change, possibly requiring more time and expense.  
3. It's okay. The regulations are reasonable, but I'll have to watch them closely.  
4. It's easy to comply with regulations for my specific products/services.  
5. Regulations are limited to those imposed on all businesses. |
| Product/Service line has expansion potential. | 1. My product/service has no expansion potential.  
2. Right now, I only have one product/service to sell.  
3. Definite expansion potential. Will require hard work to make it happen.  
4. I have the beginnings of a product/service line with several things to sell.  
5. My products/services complement each other, and I can easily add more to sell. |
| Product/Service has no liability risk. | 1. I’m worried; I may encounter a large legal risk selling my products/services.  
2. I’m not sure what the risks are in selling my products/services.  
3. I can afford to protect myself for the risk involved in selling my products/services.  
4. I will have minimal risk selling my products/services; I can afford to protect myself.  
5. I’ll have no liability risk selling my products/services. |
Assignment 5c: Financial Assumptions

How much will it cost to start this business? Will it be profitable? As you research your business, document the financial data you uncover on the Financial Assumptions worksheets that follow. These assumptions will help you develop the financial projections that are necessary to determine financial feasibility. You will begin the financial projection process when you reach Chapter 11. However, it is critical to begin collecting data to use in those projections as you work through the plan. If you wait until you are ready to start your financial plan, the task will be overwhelming.

Print out the Financial Assumption Worksheet. As you advance through the plan, keep it handy and make notes regarding the costs you encounter—these become your assumptions. The last column on the worksheet provides space for an explanation of each expenditure or cost.

Be sure to cite the sources for the facts that are the basis for your assumptions. For example, after researching his telephone and insurance costs for his business, Run KC, Tim will include the following assumptions: Monthly charge for local, long distance, and cell coverage is $200 (estimate for AT&T). Insurance expenses for a Business Owner’s Policy and Worker’s Compensation will run $1,600 a year, paid every 6 months (quote from Diane Ford, independent broker). Most assumptions can be explained in a sentence or two which indicate how the figures for the projection were calculated. It helps the reader understand the basis for your projections and builds a strong case for your ability to manage your company. The explanation should be simple and straightforward. Some of the costs you document will be start-up costs, some will be monthly, some will be annual and some might fall into several categories.

This is a working document. Add to the document as you progress through the various sections of the business plan. When you complete the marketing plan, your financial assumptions worksheet should be complete and ready to provide the information you will need to build your financial projections.

Tip
Depending on the size and complexity of the business, you may not need to answer every question. For example, a home-based business would not have operating expenses for rent.

Reality
Be realistic. You want the projections to reflect the realities of your business. It may be better to be a little pessimistic with your projections, even though you want the plan to reflect your enthusiasm for the business.
Financial Assumptions

As you describe the costs and sources of these costs, remember this information will be used to build your financial plan.

**OPERATING EXPENSE PROJECTIONS**

This will be used to complete Operating Expenses on the Financial Template.

<table>
<thead>
<tr>
<th>Describe the way you estimated the cost figure and the source of any information you used.</th>
<th>Check One</th>
<th>Estimate</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bank Charges:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Bank Charges:</strong> Many banks charge businesses for a commercial checking account. What fees will you have for writing checks or depositing money?</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>Dues &amp; Subscriptions:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Dues &amp; Subscriptions:</strong> If you plan to purchase any trade magazines or periodicals, the cost of these publications will go here. Dues to Chambers/Organizations/Associations.</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>Inventory/raw materials:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Inventory:</strong> This section is for the cost of purchasing inventory and/or raw materials. Research the Cost of Goods Sold for your particular industry. If you are manufacturing your own product, use the separate Financial Assumption worksheet - Product/Service Production.</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>Insurance:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Insurance:</strong> This section is for the cost of purchasing general liability or other insurance. Be sure to specify what kind of insurance it is and the agency in the notes section.</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>License &amp; Fees:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>License &amp; Fees:</strong> What costs do you expect for licensing fees? This should include registering the legal form of business, local permits etc.</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>Meals &amp; Entertainment:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Meals &amp; Entertainment:</strong> Think about the costs that you may have for networking and meetings with advisors and clients. This does not include your lunch on a daily basis. Just if you are at meetings or with clients.</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
<td></td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>Marketing and Advertising:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Marketing:</strong> How will you market your business? Include separate notations for trade shows, marketing materials, web and advertising.</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
<td></td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>Office Expense (postage):</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Office Expense (postage):</strong> In this category, put the expenses it takes to run your office, but not office supplies.</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>Office Supplies:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Office Supplies:</strong> You will need some office supplies to run your business. This category is not for products that will be resold to customers.</td>
</tr>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td><strong>Outside Services:</strong></td>
<td>Start-up</td>
<td>$ -</td>
<td><strong>Outside Services:</strong> Record the services that are provided to you from outside vendors, such as window cleaning, janitorial, computer services, etc.</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
<td></td>
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<tr>
<td></td>
<td>Annual</td>
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<td></td>
</tr>
</tbody>
</table>
### OPERATING EXPENSE PROJECTIONS (continued)

This will be used to complete Operating Expenses on the Financial Template

<table>
<thead>
<tr>
<th>Describe the way you estimated the cost figure and the source of any information you used.</th>
<th>Check One</th>
<th>Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Payroll--Salaries, Taxes &amp; Benefits:</strong></td>
<td>Start-up</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Professional Fees:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Property Tax:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
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</tr>
<tr>
<td><strong>Rent:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Repairs &amp; Maintenance:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Telephone:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Training &amp; Development:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
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<tr>
<td><strong>Travel:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Utilities:</strong></td>
<td>Start-up</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Vehicle Expenses:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
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<tr>
<td><strong>Other Operating Expense:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
</tbody>
</table>

**Other Information:**

**Payroll--Salaries, Taxes & Benefits:** Your salary and the salary of all employees should go here. If you are a Corp, your salary goes here. For any other legal form, owner’s salary goes in owner’s draw below. Also, record any benefits that your business provides for management employees and the taxes associated with their salary.

**Professional Fees:** From time to time, you may hire a professional to help with different areas of your business. Put your fees for management consultants, lawyers, accountants and other professionals here.

**Property Tax:** What taxes do you expect to pay on the property owned by the business? Do not put your income taxes in this category.

**Rent:** Use Loopnet.com to get an estimate. This may or may not include Common Area Maintenance and Taxes. If it does not, add at least $5/sq foot. To do so, multiply square footage by $5 and divide by 12 for the added monthly cost. Add this to the monthly rent.

**Repairs & Maintenance:** Record all repairs and maintenance to computers, equipment, and other capital purchases. Consider repairs and maintenance to the property as well.

**Telephone:** Put the amount you expect for local, long distance, and mobile phone coverage here. Fax lines and internet service should also go here.

**Training & Development:** Record the costs for management training and development. This might include conferences and other training workshops.

**Travel:** You may have some costs for traveling to training sessions, or out-of-town association meetings.

**Utilities:** Call the utility company to get an estimate for the utilities for the space you plan to rent. Consider the needs of your type of business vs businesses previously in that space.

**Vehicle Expenses:** Consider mileage to clients or to meetings, if applicable. If the vehicle is company-owned, what additional expenses will you have?

**Other Operating Expense:** Do you have additional costs that relate to managing your business?
### Financial Assumptions

**CAPITAL BUDGET PROJECTIONS**

This will be used to complete the Capital Budget Worksheet on the Financial Template.

<table>
<thead>
<tr>
<th>Describe the way you estimated the cost figure and the source of any information you used.</th>
<th>Check One</th>
<th>Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner’s Draw:</td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
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<tr>
<td>Investor’s Draw:</td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Dividend’s Paid:</td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Security Deposits:</td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Computer Equipment:</td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Equipment/Machinery:</td>
<td>Start-up</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Furniture:</td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Leasehold Improvements:</td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Vehicle:</td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
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<tr>
<td>Building:</td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
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<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Land:</td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td>Other Capital Purchase:</td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
</tbody>
</table>

**Other Information:**
## Financial Assumptions

### INVENTORY PRODUCTION PROJECTIONS

If you purchase inventory, document your assumptions on page one of this worksheet under the category of Inventory/Raw Materials. If your business manufacturers a product(s), document the assumptions for inventory you produce in the section that follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Check One</th>
<th>Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchases of Inventory/Materials with Cash</strong></td>
<td>Start-up</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Purchases of Inventory on Credit/Payment Terms</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Production Freight-in &amp; Trucking:</strong></td>
<td>Start-up</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
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<tr>
<td><strong>Production Insurance:</strong></td>
<td>Start-up</td>
<td>$ -</td>
</tr>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
</tr>
<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Production Payroll—Salaries, Taxes &amp; Benefits:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
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<tr>
<td><strong>Production Rent:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Production Repairs and Maintenance:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
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</tr>
<tr>
<td><strong>Production Rework:</strong></td>
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<td>$ -</td>
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<td>Mthly</td>
<td>$ -</td>
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<tr>
<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Production Subcontracting:</strong></td>
<td>Start-up</td>
<td>$ -</td>
</tr>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Production Utilities:</strong></td>
<td>Start-up</td>
<td>$ -</td>
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<td></td>
<td>Mthly</td>
<td>$ -</td>
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<td></td>
<td>Annual</td>
<td>$ -</td>
</tr>
</tbody>
</table>

**Other Production Expenses:** Include additional costs that relate to producing your product/service that are not previously recorded.

### Other Information:

**Financial Assumptions**

**INVENTORY PRODUCTION PROJECTIONS**

If you purchase inventory, document your assumptions on page one of this worksheet under the category of Inventory/Raw Materials. If your business manufacturers a product(s), document the assumptions for inventory you produce in the section that follows.
You will begin your work on the Financial Assumptions worksheet with items related to the Product/Service Plan. In the process of researching and writing the Product/Service section of your plan, you encountered various expenses. Document what you found on the Financial Assumptions worksheet. Not every business will have expenses in every category. Expenses related to the product/service plan for which you may now have estimates include but are not limited to:

Operating Expense Projections section in Financial Assumptions Worksheet
- Insurance
- Facilities (rent or purchase)
- Licenses and Fees

Inventory Expense Projections section in Financial Assumptions Worksheet
- Inventory/Raw Materials
- Expenses related to production

Summary
This chapter outlined the basics of product/service planning. Defining and protecting the new product/service and complying with all governmental regulations is extremely important.

This chapter included the following key ideas:
- When describing a product/service, an entrepreneur should describe its purpose in terms of the problem it will solve.
- Each feature can be described in terms of a benefit the customer receives or as a solution to the customer’s needs.
- Entrepreneurs should briefly explain the history of the product/service development and also identify its current stage of development.
- The product/service limitations and potential liability of the product/service should be considered.
- Entrepreneurs should provide information regarding the production aspects of product/service development, as well as any potential spin-offs or related developments.
- Protecting the intellectual property of a business is critical to the growth and stability of the company.
- Entrepreneurs can protect the intellectual property of their business in the form of patents, trademarks, service marks, copyrights, licenses, trade secrets, non-disclosure, non-compete and employment contracts.
- Entrepreneurs must satisfy the necessary governmental requirements in order for their business to proceed.
- As you research the business, financial information should be documented. If you wait until you are ready to start the financial plan, the task will be overwhelming.

Tip
Later when you complete the financial assumptions for the marketing section, you will come back to your product/service financial assumptions to make sure the projections are consistent. If you plan to sell 10,000 widgets, make sure you have planned production accordingly.
Overview

In the management and organization section of the plan you will describe the structure of your business both legally and organizationally. This chapter will help you accomplish the following:

- Describe your legal structure.
- Develop your management team.
- Determine your plans for recruiting employees and hiring outside services.

Your business can be structured in many different ways. In this chapter, you will learn to distinguish among the various types of legal structures that are available. Then, you will begin to assess which structure is best for your business.

Another important topic discussed in this chapter is planning a strong management team. A strong team is essential to the success of your business. Even though many challenges and potential problems can arise with the creation of a management team, most can be solved through careful planning.

This chapter will also help you plan for recruiting and retaining good employees. Furthermore, you will evaluate plans to outsource work by using other companies, contractors, or professionals to supplement your management team and employees. The right people will be a key predictor of your business’ eventual success or failure.

Objectives

In this chapter, you will learn to:

- Evaluate different legal structures.
- Define the roles of the management team.
- Build an entrepreneurial management team.
- Develop a plan to recruit and retain employees.
- Identify when outsourcing infrastructure is the best course of action.
6.1 Selecting a Legal Form of Organization

6.1.1 Introduction to Legal structures

Business must be done within some kind of legal framework. Entrepreneurs must make decisions and take legal action to structure the business. If they do not, the law will make those decisions for them. If an individual entrepreneur fails to choose, the law will assume the business is a sole proprietorship, meaning the entrepreneur and the business are legally one and the same. If more than one person is an owner and the business is not a corporation or limited liability company, the law will assume the business is a general partnership.

While an entrepreneur should consider many factors in choosing the legal structure of the business, not all factors will apply to every business. Several key issues, however, apply to most:

- **Number of Owners**—While entities such as Corporations might have many owners, most entities, including Corporations, can have as few as one owner.

- **Control**—Those in control may get to make all the decisions but they are solely responsible for financial losses as well.

- **Liability**—Unless entrepreneurs are willing to be personally liable for the debts of the business, liability protection should be sought. Choice of legal entity can contribute to this protection.

- **Ease of Set-up**—Some entities require an investment of time and money to fulfill legal requirements.

### Tip
Take an active role in choosing your legal structure. Don’t let someone else decide for you. Many businesses put off making a decision as to which legal structure is best until it is too complex or expensive to change. Select the legal structure that is best for your business after consulting with your attorney and accountant.

### Reality
In an ideal world, entrepreneurs would select a legal form of business understanding every legal and tax implication. The reality is that most entrepreneurs must rely on the advice of their attorneys and accountants to make this decision. Attorneys and accountants can anticipate many situations based on their experience and on information provided by the entrepreneur. Still, the legal structure of the business is the entrepreneur’s decision to make and live with.

### Tip
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.

- **Taxation**—Tax liability is a major concern for business owners. The various legal entities treat income and losses differently and they tax profits differently.
Entrepreneurs are usually concerned with all of these factors. The key is to identify the legal structure that best meets the entrepreneur’s needs and the needs of the business. An experienced attorney should help the entrepreneur make this decision.

from real entrepreneurs

James and Tyrone owned a highly profitable repair shop for firefighting equipment. The business had never adopted any form of doing business, but the two owners had always split the profits 50/50 even though Tyrone had contributed nearly all of the assets to the business including the land and building. One day, James’ teenage son was returning to the shop with parts he had picked up in another town as a favor to his father. On the way, he was involved in an automobile accident that killed two people. The boy was not an employee of the business and was not to receive any compensation for the favor. In a law suit against the boy and the two owners of the business, the business was declared to be a partnership, and they were all found liable. In order to pay the judgment after the insurance limits were exhausted, all of the assets of the business were sold. Tyrone, who had contributed nearly all of the assets, was left with nothing.

Once investors, lenders, or stockholders get involved, entrepreneurs need to protect their own interests from those who might seek to take control, ownership, or profits. Even though entrepreneurs start corporations, nothing guarantees they can continue as directors, officers, employees, stockholders, or even recipients of dividends. Nothing guarantees they will continue to be included in the inner workings of the business. An entrepreneur can be squeezed out in many ways, some direct and others very subtle. To understand the various squeeze-out methods and how to protect against them, entrepreneurs rely on experienced business attorneys. These professionals make sure the entrepreneur’s interests are protected before that entrepreneur commits to take on other owners or investors. Successful entrepreneurs continue to consult an attorney as time passes and the venture changes; especially if it becomes more valuable.

Tip

While the professional advice you need may be costly, do not select your attorney or accountant based upon costs alone. You should also consider the attorney’s experience, area of expertise, work ethic, and compatibility with your company.

More Info

Martindale-Hubbell Law Directory—Free online listing of individual lawyers and law firms by specialty and geographic location. martindale.com

Business Entity Comparison Table—Chart of the different legal organizational forms. bizfilings.com/Libraries/pdfs/business-type-comparison-table.sflb.ashx

Most Common Way to Structure a Business—Outlines the common legal entities and links to tax forms needed for each. sba.gov/content/incorporating-your-business

Choosing a Form of Organization—Covers the advantages and disadvantages of different legal structures. toolkit.cch.com/text/P01_4710.asp
6.1.2 Sole Proprietorship

A sole proprietorship is a business owned and controlled by one person and operated for the owner’s profit. It is the easiest entity to form and maintain, requiring no paperwork or approvals.

In a sole proprietorship, the owner alone controls the entire business. The owner can either manage it or hire managers. All the profits and losses belong to the owner.

Taxes for a sole proprietorship are relatively easy to file using Schedule C of the 1040 form. The sole proprietor does not worry about double taxation, excessive compensation or excessive retained earnings. On the other hand, the proprietor is not allowed to take a tax deduction for many items a corporation may deduct, such as defined-benefit pension plans, insurance expenses, and health benefits.

In a sole proprietorship, the owner is liable for any debts of the business. In essence, the business and the business owner are the same. In other words, the personal assets of the owner can be used to pay the debts of the business and business assets can be used for personal obligations.

A sole proprietorship can be sold as a business or it can close its doors and sell its assets. Fractional sales to allow new owners or investors are not allowed.

The business ends upon the death of the owner and may end upon the owner’s permanent disability or prolonged absence.

The ability of a sole proprietorship to raise capital is limited. Shares of the business cannot be sold. To borrow money, sole proprietors are usually asked to pledge collateral and to personally guarantee that the loans will be repaid before a bank will even consider the loan.

from real entrepreneurs

After learning the disadvantages of doing business as a sole proprietorship, a very successful business consultant made the decision to do business in that form. She knew that the nature of her business created only a very small risk of liability, which was covered through an insurance policy. She worked alone or with others, all as independent contractors on specific projects, and she had no employees. She enjoyed the absolute freedom to control every aspect of her business.

More Info

Sole Proprietorships - Information to help determine the IRS forms that a sole proprietorship may be required to file.

irs.gov/businesses/small/article/0,,id=98202,00.html
6.1.3 Partnership

A partnership forms when two or more entities join together for a common business purpose. Two or more people, a person and a corporation, two corporations or even two partnerships may form a partnership. A partnership can be general or limited. Although no written document is required to form a partnership, a partnership agreement should be developed for the sake of all partners. This document should spell out such matters as division of profits or dissolution of the partnership.

The partners control a partnership according to their agreement. A great deal of flexibility is available. If those involved in a general partnership have no agreement, the law assumes that partners share control equally. In a limited partnership, the general partner controls the operations and the limited partner is simply an investor.

Tip

Never split the ownership of a business 50-50. If the owners are not in agreement, nothing will be accomplished. Instead, choose a third party in whom the owners have complete trust. Give that person a very small percentage of ownership or have a written agreement that the third person resolves tie votes.

The partnership has a fairly simple tax structure. The income and loss earned by the partnership is passed through to the partners and reported on their respective tax returns. The partners then pay the tax on their share of the profits. The partnership itself does not pay any tax on profits.

Most authorities strongly advise against using the general partnership form of organization because liabilities are personal and unlimited. Moreover, each partner is fully personally liable for the actions of any other partner. In a limited partnership, only the general partner is personally liable. The limited partner’s liability is limited to the amount invested in the business.

Since a partnership is a voluntary association, it can be ended at any time by any partner. Partners can simply say that they no longer wish to be a partner. The death of a partner also automatically ends a partnership. Therefore, a partnership agreement should include provisions for matters such as dissolution, the payment or performance of partnership obligations, division of assets, continued use of the name, and ownership of intellectual property.

Reality

A creditor will usually seek to collect from the partner with the most easily reached assets. Seeking reimbursement from the partners who did not pay can be a long and sometimes futile process for the partner who paid the debt.
from real entrepreneurs

Three partners purchased land near a proposed horse breeding, training, and racing facility. The partners planned to develop buildings on the land and sell the development to a hotel management company. The investment was primed to reap huge profits for the partners. When costs exceeded the initial estimates, however, only one partner had the funds necessary to meet the terms of the contract. This partner purchased the interests of the other two partners for far less than their initial investment and made all the profit himself when the land was eventually sold.

Technically, ownership in a partnership cannot be transferred since the addition of a different owner constitutes a new partnership. Provisions can be made in the partnership agreement, however, for the addition of new partners, the retirement or resignation of old partners, and the continuation of the old partnership, at least in name.

A partnership is primarily dependent upon the individual assets of the partners to raise additional capital. The addition of investors would require the conversion from a general to a limited partnership. It would be a new entity. Lenders will look for a fully collateralized loan to be personally guaranteed by the partners. Since limited partners generally are simply investors whose liability is limited to their investment, it is unlikely that they would be willing to personally guarantee a loan.

from real entrepreneurs

In the partnership agreement, in addition to including how partners can exit the partnership, also include a method for determining the value of a partner’s share. The lack of such a method resulted in considerable confusion when one of five partners in a small manufacturing business decided to exit and sell her share of the business to the remaining partners. Her share was worth more money than her initial investment, but how much more? Luckily the team was amiable and a satisfactory solution was finally reached, but it could have turned ugly.

More Info

Partnerships—Information to help determine the IRS forms that a partnership may be required to file.  
irs.gov/businesses/small/article/0,,id=98214,00.html

Husband Wife Partnerships—Discussion regarding employment of a spouse compared to a husband/wife partnership.  
irs.gov/businesses/small/article/0,,id=97732,00.html

Partnership Agreements—Questions for business partners to answer before entering into a partnership.  
sbdc.umb.edu/pdfs/Partnership%20agreements.pdf

Avoid These 7 Partnership Killers—Setting up guidelines for a partnership.  
entrepreneur.com/startingabusiness/startupbasics/startupbasicscolumnistbradsugars/article196912.html

6.1.4 Corporation and S Corporation

A corporation is a legal entity created under state law. A corporation can manage its own affairs, hold property, borrow money, and legally do nearly anything an individual can do. Stockholders may be, but don’t necessarily need to be, employees, officers, and or directors of the corporation.
An advantage of corporations is the insulation of liability afforded its owners and operators. If the corporation is operated in accordance with laws and regulations, only the corporate assets may be reached by creditors for business debts. The owners’ personal assets are not at risk. The law requires corporations to operate separate from the owner, to file all governmentally required reports and to pay taxes. All too often, a one- or two-person corporation keeps inadequate records and the owners fail to strictly separate corporate and personal assets and liabilities. The consequence of failing to operate the business as a corporation is the loss of insulation from liability. In other words, if a creditor can show that the business has not been properly operated as a corporation, the creditor can then reach both corporate and personal assets of those responsible for operations.

**from real entrepreneurs**

An S corporation was sued because of one employee’s involvement in an automobile accident while driving the corporate minivan. Upon investigation, the plaintiff’s attorney was able to prove that the minivan, although owned by the corporation, was used frequently by the owner’s wife to transport their children to little league and soccer games. In addition, this attorney proved that no vehicle log was maintained as is required. The court ruled that the corporate veil, or liability shield, had been pierced and that the owner’s assets were available to satisfy any judgment.

The insulation from liability afforded by a corporation does not shield the individual from liability for harming others through their own negligence. That person may be liable along with the corporation. Nor does it prevent the corporate owners and officers from being sued. Even if they are ultimately determined not to be individually legally liable, defending the action filed against them can cost them thousands of dollars. For these reasons, many corporate owners and officers obtain individual liability insurance coverage.

All states permit corporations, but their laws and regulations differ somewhat. Some states permit corporations in which one person fills the roles of stockholder, director, and officer. Others permit one owner corporations but require two officers as a minimum. All states’ requirements are based on the concept that the corporation is a separate legal entity from those individuals who own and operate it.

Corporations have a three-tiered control system. Stockholders elect the directors of the corporation. In turn, directors elect the officers. Other than electing directors and expecting dividends, stockholders generally have no other function. The directors make primary decisions for the corporation, and the officers direct the day-to-day operations.

All corporations start the same. They obtain a charter from the state, generally the state in which they intend to do the most business. Unless the corporation elects to be treated as a partnership for tax purposes (the subchapter S election), it files a corporate tax return. After paying taxes, most corporations distribute money to their stockholders in the form of dividends. The stockholders must pay taxes on the income received. This practice results in double taxation.

**Tip**

Double taxation refers to a situation that occurs when the earnings of a corporation are taxed twice, both as the net income of the corporation and again as the dividends distributed to the stockholders. Your accountant can advise you on ways to avoid double taxation.
To avoid double taxation, a special tax election can be made called a ‘subchapter S election’. Such businesses are called an S Corp or S Corporation. To qualify for this status the business must make the election and meet the following requirements:

- Be a domestic corporation
- The number of stockholders cannot exceed 100.
- Have one class of stock.
- Have only allowable shareholders (may not include partnerships, corporations or non-resident alien shareholders)
- Not be an ineligible corporation i.e. certain financial institutions, insurance companies, and domestic international sales corporations.

If these requirements are met, the corporation is treated as a partnership for tax purposes. In this case, the corporation pays no tax and the profits pass through to the stockholders who pay income tax on their share of the profits.

Shares of a corporation represent ownership of the corporation. While shares may be restricted through the by-laws of the corporation, transfer of ownership of all or part of the corporation is relatively easy. Transfer of ownership, if necessary for any reason (raising capital, exit strategy, investors, etc.), can be done. When entrepreneurs want to sell their businesses, the corporation provides a much more salable package than a sole proprietorship or partnership. The corporation may exist forever as evidenced by its charter, granted by a state.

The corporation is the only entity that can deduct as business expenses many benefits such as health care and retirement plans. These expenses reduce the taxable profits of the corporation and give employees valuable benefits which are not taxed as income.

**Reality**

Persons who buy a company’s stock have the right to receive dividends, (assuming there are profits), vote for directors, sell the stock to other people, and, under some circumstances, sue the officers or directors for any misuse of corporate assets or malfeasance.

**from real entrepreneurs**

Software Solutions, Inc. began as an S corporation. Within five years of starting the business, founders Alexei and Nina Vladimir wanted to go public—that is, issue and sell shares of stock to the general public. To do this they had to give up their S status and become a C corporation. They will have far more than the 100 stockholders permitted by S regulations.

**Tip**

Not all companies are eligible to be every type of corporation. Specific businesses such as banks, railroads, public utilities, health care, law and others are required by states to be specific types of corporations. S corporations also have a number of regulations to consider. Consult an attorney and accountant before making a decision as to which type of corporation is permitted and right for your business.
Incorporating a business carries many advantages. One of the most significant advantages is tremendous financial flexibility in raising capital. A corporation has the ability to provide its creators with the capital structure they need to accomplish their goals.

More Info

C Corporations Versus S Corporations—This article describes the primary similarities and differences between these two legal structures. [bizfilings.com/products/articles/c_corps_vs_s_corps.asp](bizfilings.com/products/articles/c_corps_vs_s_corps.asp)

C Corporations—Information to help determine the IRS forms that a Corporation may be required to file. [irs.gov/businesses/small/article/0,,id=98240,00.html](irs.gov/businesses/small/article/0,,id=98240,00.html)

S Corporations—Information to help determine the IRS forms that an S Corporation may be required to file. [irs.gov/businesses/small/article/0,,id=98263,00.html](irs.gov/businesses/small/article/0,,id=98263,00.html)

6.1.5 Limited Liability Company (LLC)

The LLC is neither a corporation nor a partnership. This type of business entity, when properly structured, is designed to combine the benefits of liability protection afforded a corporation with the “pass through” tax treatment and management flexibility of a partnership.

The LLC is the newest form of doing business and laws concerning LLCs differ from state to state. It is particularly important that an entrepreneur seek the guidance of an attorney before adopting this form of business.

To form an LLC, articles of organization must be filed with the secretary of state. In addition, an operating agreement must detail how the business will operate, how the profits and losses will be shared, how new members may be added, and how retiring and resigning members will be treated.

Reality

While all states have adopted statutes permitting LLCs, they are not uniform. Until a sufficient number of cases have been tried, each state may deal differently with laws concerning LLCs.

Tip

The LLC’s operating agreement, a critical document, should be written by an attorney. Its terms have a profound long-term effect and need to be carefully thought out.

The control of an LLC is in the hands of the owners, called members, and in accordance with their operating agreement. Managers are elected by members either from among their own membership or from outside their membership. The operating
agreement will determine how management is selected as well as the extent of the manager’s authority. It could be that only day-to-day operations are within the control of the manager and that the members as a whole make all other decisions. Initially, not all states recognized single member LLCs. Today, every state recognizes the single member LLC, however, treatment varies from state to state.

One principal advantage of an LLC occurs at tax time. The LLC may elect to be treated as a partnership. Like a partnership, the income and loss earned by the LLC are passed through to the members and reported on their respective tax returns. If no election is made, the LLC is taxed like a corporation.

The advantage of an LLC when compared with a partnership is that the members’ liability for the debts of the LLC is limited to the extent of their investment in the business.

Transfer of ownership in an LLC requires the unanimous consent of all members unless the operating agreement provides otherwise. Thus, the founders may provide for maximum flexibility regarding the acceptance of new members and the withdrawal or retirement of existing members if they write the operating agreement that way.

LLCs do not exist perpetually. Unless the operating agreement provides for its continued existence, an LLC ends upon the death of a member. Most states require that they have a stated period of existence.

Since it is a collection of individuals, an LLC suffers from the same limitations on raising capital as do partnerships. However an LLC does have a method to raise modest amounts of capital by requiring initial contributions or buy-ins by new members. The operating agreement may provide this option.

from real entrepreneurs

An entrepreneur established his business as an LLC. After several years of operating the business, he overheard another business owner talking about filing an annual report for his LLC. The owner didn’t realize that he needed to file this report. Upon checking, he discovered that his status as an LLC had been forfeited and therefore, he had been operating for several years as a sole proprietorship.

More Info

Limited Liability Company—Information to help determine the IRS forms that the LLC may be required to file. [irs.gov/businesses/small/article/0,,id=98277,00.html](http://irs.gov/businesses/small/article/0,,id=98277,00.html)

Protecting Personal Finances From Business Creditors—A primer to protect personal assets. [entrepreneur.com/money/personalfinance/article207610.html](http://entrepreneur.com/money/personalfinance/article207610.html)
6.1.6 Nonprofit

Some of the most profitable corporations in this country are nonprofits. The classification as a nonprofit does not mean that the business does not make a profit nor does it mean that it tried but failed to make a profit. It simply means that the Internal Revenue Service has determined that it has filed for and meets the requirements as an organization that provides a service to the community for certain purposes. These purposes may be religious, charitable, scientific, testing for public safety, literacy, educational, fostering a national or international amateur sports competition, or the prevention of cruelty to children or animals. Nonprofits are prohibited from distributing net income to owners, members, directors or officers but they may pay fair compensation to their employees. Contributions to nonprofits are tax deductible by the donor, which is a great advantage in raising funds.

Nonprofits are formed in compliance with appropriate state laws, and then they seek IRS classification.

Nonprofits are controlled just as other corporations by a board of directors, but they have no stockholders. A nonprofit does not pay income tax, but it does file informational returns. Just as with for-profit corporations, the nonprofit offers insulation from liability to its board, officers and employees. Recently, many law suits have been filed against corporate directors of both for-profit and nonprofit corporations claiming they have not acted in the best interests of their corporations. Because defense costs can be enormous and the potential for liability, which would not be insulated, is a reality, almost all boards of directors obtain liability insurance coverage.

More Info
FirstGov Federal Government — Links to government-sponsored programs and information for nonprofits. [usa.gov/Business/Nonprofit.shtml](http://usa.gov/Business/Nonprofit.shtml) and [sba.gov/content/nonprofit-organizations](http://sba.gov/content/nonprofit-organizations)
Exercise 6.1.6
Choose a Legal Structure

Learning Objective
- Evaluate the advantages and disadvantages of the available legal structures and begin to make an informed decision about the legal structure of your business.

Overview
Business must be done within some kind of legal framework. Entrepreneurs must make decisions and take legal actions to structure the business. If they do not, the law will make those decisions for them.

Introduction
Every business must exist in some legal form such as a sole proprietorship, partnership, corporation or limited liability company. Each form has its advantages and disadvantages. This exercise will assist you in understanding each form. The final decision should be made only after consulting a lawyer and accountant.

The formation and operation of business entities are matters of state law. The state in which you will have your principal place of business will have the greatest impact upon your business. While states may differ, generally the following types of entities are available:

1. Sole Proprietorship
2. General Partnership
3. Limited Partnership
4. Corporation
5. S Corporation
6. Limited Liability Company
7. Nonprofit Corporation

Generally, every business owner will be concerned about certain basic consequences and considerations when selecting a legal structure. Some of these issues are:
- The number of owners
- The degree of control retained by the founder
- The liability of the business and the founder
- The ease of set up
- The ease of raising additional capital
- How the business will be taxed
Step 1

**Identify your initial choice of legal form.** Misconceptions and misinformation about legal structures abound. Many people rely on what others say when deciding which structure to chose. Without referring to the charts in this exercise, make an initial choice of business entity for your business and give two reasons why you chose it over any other form. After you have done so, share your selection and reasons with another.

Type of entity chosen:

Reasons: 1. 

2. 

Step 2

**Evaluate your initial choice against other legal forms.** The next step will help you decide whether your reasons identified in Step 1 were valid. The following chart provides a summary of the issues mentioned earlier for each legal entity. Review the attributes of each legal entity for the issues listed on the left. At the bottom of the page, rank the entities from first choice (#1) to last choice (#5) based on suitability for your business. At the bottom, indicate why you chose the form you chose as #1.

Now, when you go to see your attorney and accountant, you know some of the factors affecting the choice of entity that are important to you and your business. Undoubtedly, you may think of other considerations which should also be discussed.
### Selecting Your Legal Form

The chart below outlines the attributes of each legal entity for the issues listed at the left. At the bottom of the page, rank the entities from first choice (#1) to last choice (#5) based on suitability for your business. Then, indicate why you chose the form you chose as #1.

<table>
<thead>
<tr>
<th>Issue</th>
<th>Sole Proprietorship</th>
<th>Partnership</th>
<th>Corporation</th>
<th>LLC</th>
<th>Non-Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of owners</td>
<td>One</td>
<td>At least two, and may be thousands, but normally limited to a small number.</td>
<td>As few as one, but may be millions.</td>
<td>As few as one but may be many. Normally a small group actively engaged in the business.</td>
<td>There are no owners of a non-profit corporation. An individual may found and control a non-profit, but no one owns it.</td>
</tr>
<tr>
<td>Management Control</td>
<td>Sole Proprietor has full control.</td>
<td>Control shared by partners based on partnership agreement.</td>
<td>In a closely held corporation, control normally comes from ownership of more than 50% of the shares.</td>
<td>A membership interest of more than 50% normally results in control of the LLC.</td>
<td>Controlled by the officers as directed by the board of directors.</td>
</tr>
<tr>
<td>Owner’s liability</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Limited to investment</td>
<td>Limited to investment</td>
<td>Liability is generally limited to corporate assets. However, under some circumstances officers can be held personally liable.</td>
</tr>
<tr>
<td>Ease of Set-up</td>
<td>Minimal requirements, if any.</td>
<td>Minimal requirements. A partnership agreement between the partners should be prepared by an attorney.</td>
<td>Must comply with requirements including filing articles of incorporation, obtaining an EIN, maintaining stock and minute books, and holding shareholder and board meetings. Requires investment of time and money to fulfill legal obligations.</td>
<td>Must comply with requirements including filing articles of organization with the state. Should have a written operating agreement. Requires investment of time and money to fulfill legal obligations.</td>
<td>The federal government offers numerous classifications for non-profits. Each has its own specific requirements. The IRS approval process is complex.</td>
</tr>
<tr>
<td>Raising capital</td>
<td>Limited to owner’s capital and ability to borrow.</td>
<td>Limited to partners’ capital and ability to borrow.</td>
<td>Capital may be raised through borrowing or by selling shares. Allows for passive investors.</td>
<td>Limited to the capital contributions of the members and ability of members to borrow.</td>
<td>If approved, non-profits can receive tax deductible donations. They also may be eligible for public and private grants.</td>
</tr>
<tr>
<td>Taxation</td>
<td>Profits and losses of business flow through to the sole proprietor’s taxes. Taxed at individual level.</td>
<td>Profits and losses of business flow through to the partners’ taxes based on partnership agreement. Taxed at individual level.</td>
<td>Corporation pays taxes on earnings and deducts losses. Shareholders pay taxes on all dividends. Double taxation.</td>
<td>LLC members may elect to be treated for tax purposes as a partnership or a corporation.</td>
<td>There are no taxes but an informational return must be filed.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Limited Partnership</th>
<th>Limited Partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partnership in which the limited partner invests funds but is not active in the management of the business. Limited partner’s liability is limited to their investment.</td>
<td>Same as above except an S status is filed with the IRS resulting in no taxation at corporate level – earnings passed to shareholders as dividends which are taxed. Requirements: no more than 100 stockholders; one class of stock; only allowable shareholders. See IRS.com for details.</td>
</tr>
</tbody>
</table>

**Rank (1-5)**

Indicate why you chose the form ranked #1:
6.2 Defining the Management Team
6.2.1 Introduction

Early in the planning process, entrepreneurs should give thought to the management team they will need for their enterprise and the roles those individuals will play. Having the right management team is key. Professional investors in new ventures consider the management team to be one of the most important factors in determining the attractiveness of the investment. The management team directs the company by making decisions about how to sell products/services, improve profitability, and expand into new markets.

### Reality

Venture capitalists would prefer to back a second-rate concept headed by a first-rate management team than a first-rate concept with a second-rate team. The three things they evaluate when financing a new venture are management team, management team, management team.

Not everyone wants to be the leader of a management team. Many choose solo-entrepreneurship. For varied reasons, these entrepreneurs choose to build a company that can be managed by the entrepreneur alone. This decision is fine unless the entrepreneur is seeking to build a sizable business. Then a management team will be needed.

**from real entrepreneurs**

Sandy was researching and planning her catering business when she began to think about the management team. At first, she had intended to manage the company herself. After a close look at her business strategy—to expand the company into several additional markets including new geographic regions within the fourth year of business—she knew she needed to work toward building a management team. Her specialty was in food preparation, not in sales, marketing, or administrative duties. In her business plan, she included the need to recruit individuals to fill the management roles. She hired team members during the third year, and her strategy was carried out as planned.

**More Info**

ABI/Inform—Subscription database of articles on business and management topics from thousands of business periodicals and magazines. Usually available at business libraries.

Institute of Management Consultants—Free online referrals for consulting professionals who have pledged to abide by IMC USA's code of ethics. imcusa.org/
6.2.2 Understanding Management Team Roles

The management team includes a combination of critical roles. Often played by a single entrepreneur at start-up, these roles become the basis for establishing an on-going management team as the business grows. Depending on the nature of the business, common roles essential to most ventures include the Research and Development Director, Chief Executive Officer, Marketing Director, Sales Manager, Production Manager, Chief Financial Officer and Chief Operating Officer.

- **Research and Development (R&D) Director**—Someone must create the product/service sold to the customer. Inventors, researchers, and often times production engineers are the creators. Creators should be allowed to do precisely what they do best, which is to create.
- **Chief Executive Officer (CEO)**—The CEO is the driving force that makes everything happen. This person puts together the resources to support the product/service and takes it to market.
- **Marketing Director**—The marketing director uses knowledge of the industry and marketing to develop the right plan to reach the right people.
- **Sales Manager**—The sales manager organizes the sales team or manufacturer’s representatives so they can sell to the target market.
- **Production Manager**—The role of the production manager is to oversee manufacturing of the product/service.
- **Chief Financial Officer (CFO)**—The CFO is in charge of financial planning and recordkeeping.
- **Chief Operating Officer (COO)**—The COO is the organizer who makes operations flow smoothly and economically.

### More Info

**Build Your Management Team**—A guide to help you figure out who you need on your management team. [entrepreneur.com/article/83618-1](http://entrepreneur.com/article/83618-1)

### Reality

Experience has shown that most successful entrepreneurs are driving forces, not creators. Which one are you?

### Tip

Someone with the necessary skill must make certain that the financial records accurately reflect what is happening in the business and meet IRS requirements. Someone will also need to prepare reports that assist the management team in planning.

---

**from real entrepreneurs**

Steve Jobs, cofounder of Apple Computer, attributes the company’s initial success to his fortunate hiring of an experienced organizer or chief operating officer—Mike Markula. Mike was one of the early employees of Intel and was heavily involved in building Intel into a large computer company. His understanding of the computer chip was important to enhance the technology that led to the development of Apple’s personal computer.
Exercise 6.2.2
Identifying Management's Strengths

Learning Objective

- To identify the strengths of the management team and their responsibilities within the business.

Overview

Having the right management team is key. The management team directs the company by making decisions about how to sell products/services, improve profitability, and expand into new markets. For many start-up businesses, the entrepreneur is the management. For others, a team of individuals is brought together to provide direction for the company. In either situation, it is important to look at the skills and experience each member of the management team brings to the business and determine if they have what it takes, individually and collectively, to lead the company.

Step 1

In the space below, describe the duties YOU will be assuming within the business. Identify the position(s) you will fill within the organization and responsibilities associated with the position(s).

**Position(s):**

**Responsibilities:**

Step 2

Complete the Entrepreneurial Start-up Employment Application. Answer all questions thoroughly – especially the sections which ask you to describe responsibilities and skills used/gained.

Step 3

Exchange applications with another person. Each person should review the application they have received and then relate back to the “applicant” what they see as that person’s strengths related to the business they want to start and the industry in which it falls.

Step 4

Based on the information on the application, the person conducting the application review should now relate back to the applicant what they see as that person’s transferable skills. Transferable skills are “the skills and abilities you have acquired during any activity in your life that are applicable to what you want to do in your next job.” For example, an individual who has worked in a clothing boutique would have customer service skills. These skills transfer to many different job situations. Now have each person who will be part of the Management Team for your business complete the application and use it to identify their skills.

Step 5

This activity has prepared you to write the Management Team section within the Management and Organization section of the plan. In this section, describe who will manage the business, their specific responsibilities and their qualifications. Use the strengths and transferable skills you have identified in this exercise. Also include plans for adding key management positions in the future.
Entrepreneurial Start-up
Employment Application

**APPLICANT INFORMATION**

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<th>Position Applied for</th>
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**EDUCATION**

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### HOBBIES/VOLUNTEER ACTIVITIES

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Scenario 6.2.2

**Run KC—Identifying Management’s Strengths**

**Learning Objective**
- To identify the strengths of the management team and their responsibilities within the business.

**Overview**
Having the right management team is key. The management team directs the company by making decisions about how to sell products/services, improve profitability, and expand into new markets. For many start-up businesses, the entrepreneur is the management. For others, a team of individuals is brought together to provide direction for the company. In either situation, it is important to look at the skills and experience each member of the management team brings to the business and determine if they have what it takes, individually or collectively (in the case of a management team), to lead the company.

**Scenario**
In the business Run KC, Tim Clark will be the entire management “team” during the early years of the business. Think about what the management responsibilities would be for a specialty running shoe store. List those responsibilities below.

**Position(s):** Store owner/manager – specialty running shoe store

**Responsibilities:**

Reference the Entrepreneurs’ Application completed by Tim. Which aspects of his background and experience qualify Tim to manage this business?

What experience and qualifications should he look for in future management candidates?
ENTREPRENEUR
Employment Application

APPLICANT INFORMATION

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<th>Last Name</th>
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<tbody>
<tr>
<td>Clark</td>
<td>Tim</td>
<td>W</td>
<td>9/20/xx</td>
</tr>
</tbody>
</table>

City: Leawood

State: KS

ZIP: 66224

Phone: 913-321-4567

E-mail Address: timothyclark@runkc.com

Position Applied for: Entrepreneur/Business Owner

Type of Business: Specialty Running Shoe Store

EDUCATION

High School:

South High School

City: Podunk, Missouri

From: 1992

To: 1996

Did you graduate?: YES

College:

Beantown College

City: Boston, MA

From: 1996

To: 2000

Did you graduate?: YES

Other:

PREVIOUS EMPLOYMENT

Company:

RUNNER’S RESOURCE RUNNING STORE

Address: Boston MA

From: January 2005

To: Present

Job Title:

Shoe/Inventory Manager

Responsibilities:

Track sales and inventory; order merchandise; plan product mix; analyze sales

Skills used/gained:

Goal setting; tracking; analysis; communication; event management

Accomplishments:

Designed and implemented new inventory tracking system; streamlined process for special order merchandising resulting in decreased shipping costs; decreased clearance inventory; developed increasingly profitable product mix by analyzing sales
## PREVIOUS EMPLOYMENT

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<th>Company</th>
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<tr>
<td>TBJ GROUP, LTD</td>
<td>Boston, MA</td>
<td>January 2000</td>
<td>January 2005</td>
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**Job Title**

Auditor

**Responsibilities**

- Responsible for compilations, review and audits for governmental units, not-for-profits and commercial clients; prepared financial statements

**Skills used/gained**

- Recordkeeping; preparation of financial statements; analysis; supervision; client relations

**Accomplishments**

- Progressed to in-charge level within 18 months; supervised 2 employees

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<th>Company</th>
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<tr>
<td>BEANTOWN COLLEGE</td>
<td>Boston, MA</td>
<td>Sept 1996</td>
<td>Jan 2000</td>
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**Job Title**

Bookstore – cashier (2 years)/inventory management (2 years)

**Responsibilities**

- Checked customers out; received payment; handled cash and credit sales/placed special orders; managed inventory; dealt with vendors

**Skills used/gained**

- Customer service; vendor relations; money handling; ordering; inventory tracking

**Accomplishments**

- Progressed to head cashier; managed staff; implemented customer feedback system

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## MILITARY SERVICE

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**Rank at Discharge**

**Responsibilities**

**Accomplishments**

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## HOBBIES/VOLUNTEER ACTIVITIES

- Running/Biking/Triathlon/Marathons
- Half Ironman
- Camping
- Travel
- Volunteer race coordinator
- Big Brother volunteer
6.2.3 Evaluating Management Team Needs

In each stage of a business, the management needs of the business change. Different roles are critical during the different stages of a business. Review the various stages most businesses go through and the types of management team members needed:

- **Initial conception stage**—During this stage, the entrepreneur identifies multiple business opportunities and then determines which one to pursue. The entrepreneur often plays all roles of the management team to get the business up and running.

- **Start-up stage**—The business is launched and cash is usually tight in this stage. Entrepreneurs struggle to survive, modify the products/services, and experiment with market-penetration tactics. Every venture must have a creator (R&D) and a driving force (CEO) at this stage. These roles are often played by the same person, usually the entrepreneur.

- **Early stage**—In the early stage, the company has attracted customers but struggles to increase sales. The entrepreneur begins to rely on other management members and key personnel. This stage is a smart time to hire a marketing director to implement a strong marketing plan for the company.

- **Growth stage**—During the growth stage, an organizer must begin to take over the operations of the company. The markets are established but the company experiences continual cash flow crises in this stage. New investors, customers, and staff are added quickly. The entrepreneur must also rely on a sales manager to lead the sales efforts of the marketing plan. Manufacturing companies need to hire a production manager.

- **Rapid growth stage**—When the business outpaces industry growth rates and has established itself as a viable enterprise, it is in rapid growth. A professional management team should now be in place, including a financial watchdog or CFO.
• **Maturity stage**—In the maturity stage, the company has well-established markets with multiple products/services. It experiences increased competition and saturation of the market. The entrepreneur focuses on how to preserve the business so it will continue to be healthy and increase in value. The management team works together to fulfill the strategic plan of the company.

• **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.

**More Info**

Google’s Greatest Innovation May Be Its Management Practice—How Google builds management strength. [fastcompany.com/1720052/the-b-y-leadership-model-google-s-greatest-contribution-to-innovation-may-be-it-s-management](http://fastcompany.com/1720052/the-b-y-leadership-model-google-s-greatest-contribution-to-innovation-may-be-it-s-management)

America’s Best—Video of growth tips and tidbits from America’s best known brands. [sba.gov/content/americas-best-preview](http://sba.gov/content/americas-best-preview)

### 6.2.4 Creating a Board of Directors or Advisory Board

At every stage of a business, the entrepreneur will need input from inside and outside the company. If a company is organized as a corporation, it must have a board of directors. The board is the managing agent for the 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, has the advantage of generating ideas from many minds. The board of directors usually includes key members of the management team, including the CEO, investors, and independent outside advisors.

**Tip**

After you have established a board of directors, concentrate on using that board to its fullest potential. Have regular board meetings that have agendas and specific desired outcomes. Talk with the directors between board meetings to get their ideas on management issues. Above all, do not be afraid to discuss difficult issues with the board. It exists specifically to offer guidance and direction.

**Reality**

Some prospective board members may be reluctant to serve since the trend by creditors or disgruntled stockholders is to sue them for their decisions or lack of oversight. Insurance is available and perhaps necessary to persuade members to serve on a formal board of directors. Others might be persuaded to serve on an informal advisory board if they are reluctant to take a more formal position.
Entities other than corporations are not required to have a board of directors. Another excellent way to receive invaluable advice is to recruit an advisory board. An advisory board is usually a group of business experts that 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.

Advisory board members may be bankers, marketing consultants, industry experts, financial consultants, customers, or other successful entrepreneurs. They may meet monthly, quarterly or as needed by the entrepreneur. They are usually compensated in some way, although compensation is small. Examples of compensation include a meal during the meeting or a small payment per meeting. Few advisors do it for the money. Many successful entrepreneurs attribute their success to the help that they received from mentors and advisors. Now, they feel it is their turn to give back and help someone else by joining an advisory board.

from real entrepreneurs

Marcus organized an advisory board for his sporting goods store because he heard that he should. He wasn’t sure how to use them. He asked a successful entrepreneur, a financial whiz, a marketing expert and an industry expert to be a part of the team. To his surprise, they all heartily agreed to the proposal. Marcus would provide breakfast for the board once each month in exchange for their ideas and advice concerning his business. He came to the first meeting a little unprepared, but after seeing their enthusiasm he began to see the worth in having these experts to call on. Now, Marcus feels accountable to the advisory board for the suggestions they make. He follows through or provides reasons for not implementing each idea. Within the first six months, his business increased 30 percent over the previous year. He claims the growth came from some of the ideas generated by the advisory board meetings. Now, Marcus plans to have a yearly retreat with his advisory board to go over his business plan.
Exercise 6.2.4
Developing Your Team

Learning Objective

• Determine your management team’s gaps and begin the process of filling in the gaps to develop your team.

Overview

For a business to be successful, it must have competent management and leadership. Most new ventures cannot afford to hire all of the talented people needed to fill essential roles. The founder must perform many of the roles. Gaps can be filled by outside advisors, paid or unpaid and/or independent contractors. Many of these gaps will be filled by a Board of Directors, an Advisory Board and the company Infrastructure.

A company will have a Board of Directors if it is a Corporation. The Board of Directors is made up of individuals elected by the stockholders of a corporation. They are responsible for selecting officers and overseeing the overall direction of the company. It is possible to have a single individual as the sole owner of a corporation and as the sole director. A corporation may also have an advisory board.

An Advisory Board is usually a group of business experts who do not work directly for the company...they give advice, ideas, and direction. All companies – no matter what size – should consider having an advisory board. Think about who you will add to your advisory board. These people should complement your skills and fill in the gaps.

The Infrastructure is made up of individuals or businesses that carry out work for the business but are not employed by the business. They are often independent contractors. Sometimes they work for other companies and provide a service – i.e. bankers, insurance agents. The infrastructure can include specialists such as attorneys, certified public accountants (CPAs), bankers, insurance brokers, consultants, and others who provide services necessary to support the entrepreneur.

Step 1

Below, list five skill or knowledge areas relating to your business which you would consider to be your weakest. These might include: marketing, financial, pricing, computer, human resources, industry knowledge, industry experience, sales, management, layout and design, merchandising, etc. You can also list traits such as organization, discipline, persuasiveness and self-confidence. Don’t limit yourself to those listed here. Think about your own business needs and your skills.

1. 

2. 

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5. 
More Info

Advisory Boards – How to structure and build an advisory board. entrepreneur.com/encyclopedia/term/82088.html

Selecting an Advisory Board – Tips for finding the best advisors. entrepreneur.com/startingabusiness/startupbasics/startupbasicscolumnistpaigearnoffenn/article71684.html

6.2.5 Avoiding Potential Problems

When establishing a team, entrepreneurs must anticipate potential problems that could occur. Entrepreneurs should work with an advisor and attorney to address potential problems such as squeeze outs by partners or employees, harmful actions by inept or dishonest employees, personality conflicts, and policy disagreements. Planning for these problems in advance can help prevent them altogether or at least provide specific steps to deal with them once they arise.

The entrepreneur should work closely with legal counsel to guard the ownership of the company. In a closely held corporation, the entrepreneur should maintain majority ownership to sustain control. If a company has several stockholders, each with a similar percentage of shares, an entrepreneur can be fired from the corporation by a majority vote from other stockholders.

from real entrepreneurs

In one enterprise, an entrepreneur became associated with a vendor who bragged that he had cheated the government and other business associates. The entrepreneur did not heed the warning signs that the vendor lacked principles and had taken advantage of others. The entrepreneur should have recognized that the vendor would also cheat him.

A strong system of communication must be established by the entrepreneurs. It is important to communicate with others on the management team on a regular basis. If disagreements arise, those involved should talk them out in a calm manner. Most disagreements can be solved when everyone stays calm, behaves rationally, and keeps the good of the company in mind.

Reality

If the parties simply cannot agree, a buyout agreement might be necessary. It is best to anticipate the possibility of potential problems ahead of time and develop a buyout agreement before it is needed.

Despite potential problems inherent in working with groups of people, entrepreneurs need the skills of others to grow their business. By hiring the right people, the chances for success are enhanced. The benefits of working with others may far exceed the benefits of working alone.
6.3 Planning the Entrepreneurial Organization

6.3.1 Introduction

Careful attention to recruiting and hiring good people is critical to a successful business.

Planning the entrepreneurial organization is not difficult when the goals of the business are clearly defined. When the business plan is clear, an effective organization of productive team members can be built by using the following tactics:

1. Recruiting and hiring self-motivated people.
2. Helping others be successful.
3. Creating clarity throughout the workforce.
4. Communicating the entrepreneur's values.
5. Providing appropriate reward systems.
6. Creating a learning environment.
7. Celebrating the victories.

A key to the success of most entrepreneurial ventures is forming a team of highly qualified people who are committed to the goals and objectives of the firm. This does not mean that the market demands, product/service uniqueness, or profitability goals are unimportant. It does mean that successful entrepreneurs are able to expand their vision through the actions of various teams of motivated people, who share the same goals and objectives.

More Info

Hire Great Employees—Advice on what to look for when hiring employees.
entrepreneur.com/money/columnistbillbartmann/article205826.html

Ten Steps to Hiring Your First Employee—10 steps to ensure compliance with key federal and state regulations when hiring. sba.gov/content/10-steps-hiring-your-first-employee

Writing Effective Job Descriptions—Job descriptions are essential in hiring and managing employees. sba.gov/content/writing-effective-job-descriptions

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 that at all levels there is ability you should be drawing on.”

—Ewing Marion Kauffman

Reality

Success is reached through a combination of factors including a marketable product/service that can be sold at a profit. Still, if the entrepreneur is not able to build an entrepreneurial organization of productive people, the business will not grow beyond the abilities of the entrepreneur.
6.3.2 Recruiting and Hiring Self-Motivated People

Entrepreneurs need to plan a method for recruiting and hiring the very best people they can find. People should have not only great technical skills but also the motivation to work with the entrepreneur to make the business a success. When starting a business, entrepreneurs need people who are willing to build things from scratch, work hard, deal with uncertainty, and be flexible. These may not be the same skills and abilities needed from employees as the business approaches a more stable operating stage.

Legendary entrepreneur Ewing Marion Kauffman offered his own 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.” Mr. 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.” Successful entrepreneurs resist the urge to hire people just because they share the same personality traits and backgrounds. Businesses benefit from having different points of view to challenge and develop the company into the future. If the business must rely on a productive team of individuals in addition to the entrepreneur, hiring self-motivated people must be part of the overall business plan. Finding qualified candidates today is difficult because of global competition, changing work force demographics, and workers’ values. Employers are learning to be open-minded and more flexible regarding employment policies and working hours. New strategies include providing for job sharing, working at home, using temporary help and contract labor, and hiring the disabled and retired seniors.

Tip

One way to evaluate the motivation of individuals is to ask these questions during the interview: “What was a major setback in your life, and how did you deal with it?” This requires candidates to speak from experience, and it gives you some past behavior to evaluate. You can then ask the follow-up question, “Why did you choose that course of action?” Evaluate their thought process, which is just as important as the course of action they chose.

Tip

One way to find qualified employees is by networking with professional and technical people in the industry about potential applicants they know. Talk to larger companies that are downsizing and trying to find employment for their laid-off workers. Ask other entrepreneurs for referrals of people they know and would recommend. Also elicit referrals from vendors, consultants, current employees and alumni associations. Other recruiting sources and methods include tele-recruiting, direct mail, electronic bulletin boards, websites, point-of-purchase displays, retiree job banks, and college and university placement offices.

Reality

Hire motivated workers. Entrepreneurs do not have the time or skills to create motivation in others if it does not already exist.

from real entrepreneurs

In a medium-sized consulting firm, the managers place making money fifth on their list of priorities. Unsurpassed customer service and employee satisfaction are among their primary goals. They consider everyone who works for the firm a professional. No time clocks here! They turned their management chart upside down; the management serves its employees. They hire self-motivated employees and deliberately foster innovation among them. The results are increasing profits year after year, outpacing industry averages.
Interviewing and Hiring Guidelines

Interviewing and hiring employees can be difficult and time consuming. Entrepreneurs can gain confidence in their final decisions by following some of the hiring guidelines below.

- **Applications**—Have applicants 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. Many companies now have prospective employees submit applications online through the company website.

- **Screening**—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 provide clues about the applicant.

- **References**—Always check all references. Studies show that about 30 percent of resumes contain some false information. People who overstate or falsify their job qualifications may cause future harm to an organization or may be poor employees. A criminal background check can provide critical information about a prospective employee. A number of firms provide background checks on employment applicants.

**Reality**

Resumes are not legal documents. Applications are. Many resumes contain false information that cannot be verified when checking the application.

**Reality**

Experts claim that 90 percent of all hiring mistakes can be prevented through proper background checks.

**Tip**

The law prohibits businesses from asking potential employees certain questions verbally or on applications. Check with your attorney 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.

**More Info**

Performing Pre-Employment Background Checks - What is permitted when following up on a potential employee’s background and work history. [sba.gov/content/performing-pre-employment-background-checks](sba.gov/content/performing-pre-employment-background-checks)


Recruiting and Hiring Top-Quality Employees - Tips to ensure you’ll bring the right people into your company. [entrepreneur.com/humanresources/hiring/article76182.html](entrepreneur.com/humanresources/hiring/article76182.html)
6.3.3 Helping Others Be Successful

Ewing Marion Kauffman’s philosophies that “others should be treated as you would like to be treated” and “those who produce should share in the results” established a healthy working climate at Marion Laboratories. To create a successful work environment, entrepreneurs must understand the goals, dreams and aspirations of the people working within the business.

Many people will be motivated by money, at least for a period of time. Successful entrepreneurs have found that many people are motivated more by the work they do and the environment in which they work than by the money they earn. The ability to learn new skills or advance in the company may attract quality employees.

from real entrepreneurs

An entrepreneur who owned a biotechnology firm set the first Friday of each month as a special day for the company. A potluck lunch was held at which all workers, managers and directors ate together. Management made a point of mixing with workers. The entrepreneur gave out awards each month recognizing both great performances and efforts to remove barriers to performance. The entrepreneur then described the month’s accomplishments and thanked the people individually for their particular achievements.

Many businesses have capitalized upon the desire of some people to work in an informal organization. A relaxed dress code and flexible hours, while not practical for all businesses can create a culture which leads to a dedicated workforce. Other employees look for recognition, achievement, growth, freedom, and autonomy. Whatever the personnel needs, the entrepreneur should remember that motivations vary from person to person and hire accordingly.

from real entrepreneurs

Ewing Marion Kauffman founded a pharmaceutical company, Marion Laboratories Inc., by operating out of the basement of his modest home. By 1989, when Marion Laboratories was sold to Merrell Dow, it had become a globally diversified pharmaceutical giant with annual sales of nearly $1 billion. Mr. Kauffman followed his philosophy of “treating others as you would like to be treated” in his leadership, hiring and communication practices, which had an enormous impact upon the success of the company. Another guiding philosophy of Mr. Kauffman was that “those who produce should share in the rewards.” Mr. Kauffman’s commitment to this principle can be seen in the 300 or so millionaires who were created when Marion Laboratories merged with Merrell Dow. Many senior managers, plant and clerical workers who had been with the company for many years received great wealth from their stock ownership.

In order to respond to the interests and dreams of the people involved in the business, entrepreneurs must 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 the entrepreneur’s.
6.3.4 Creating Clarity in the Organization

In his analysis of the successful growth of Marion Laboratories, Gerald W. Holder attributed much of the strength of the organization to an entrepreneurial leadership team that focused significant energy on creating clarity throughout the work force. This focus enabled people to operate with a common understanding and purpose. It required leaders to establish clarity for themselves first, and then implement a major communications and reinforcement effort to create it for the organization. Holder identified the following four clarities as critical to the success of Marion Laboratories:

- **Clarity of purpose**—It is important that people know why the organization exists. People need a reason to give their enthusiastic support. People 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.

- **Clarity of direction**—With careful thought and communication, people know where they are headed with the business. They know the kinds of skills and talent they need to bring to the company.

- **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 interdependence of the employee team.

- **Clarity of measurement**—Knowing how to measure the results in a business is essential. The entrepreneur should 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.

### Reality

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.”

### Tip

In a rapidly growing new venture, the opportunities for promotion are 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. The entrepreneur should 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.
6.3.5 Communicating the Entrepreneur’s Values

Core values in a business provide an important basis for making decisions. These values are a set of ideas or beliefs that the entrepreneur has about how the business will operate, its role in the community, and employee support. It is important to communicate honest values.

An entrepreneur’s values are communicated in the personal vision. The vision outlines the lifestyle, professional, and financial goals of the entrepreneur. Building upon this framework, the entrepreneur can establish the particular criteria that can form values for the entire company. When an entrepreneur presents these values in a clear way, the people in the business will know how and why the leadership makes decisions.

Tip

You probably have a clear understanding of your own values. But have you ever tried to communicate them to others? Take time to write down your values—the things that are important to you about how the company will operate. Incorporate those values into your vision. Now, share your vision with someone who will offer you candid feedback. Does your written vision reflect your values? How can you make your vision more clear? More obtainable? More purposeful?

An entrepreneur must communicate values clearly and consistently act according to them in order to have a positive impact on the business. Ewing Marion Kauffman’s philosophies of “treat others as you would be treated” and “those who produce should share in the results” would have had little impact on his business had he not constantly expressed them in both word and deed.

from real entrepreneurs

Cranium was founded in 1998 by two ex-Microsoft employees determined to apply the software giant’s product development strategies to game products. Cranium, the product, is the fastest selling independent board game in U.S. history. Entrepreneurs Richard Tait and Whit Alexander communicate their core values to Cranium employees every day. One core value concerns the quality of their products. This core value is reinforced through a quality test called CHIFF. To ensure product quality, employees of Cranium evaluate their game innovations against the CHIFF test. All products must be clever, high quality, innovative, friendly, and fun.

More Info

Inside the Smartest Little Company in America, Julie Bick—Whit Alexander and Richard Tait, founders of Cranium Inc., created the fastest-selling independent board game in history. inc.com/magazine/20020101/23798.html

SBA Delivering Success: Entrepreneurial Spirit – Video interview with Warren Brown who talks about his passion and vision for CakeLove. sba.gov/content/sba-delivering-success-entrepreneurial-spirit
6.3.6 Providing Appropriate Reward Systems

Most people think that rewards are only monetary. In fact, effective reward systems include all forms of monetary compensation plus a wide variety of other things that are important to people in a work setting. Other forms of compensation include the following:

- job assignment
- recognition
- growth and learning
- additional responsibility
- trust
- authority
- autonomy

from real entrepreneurs

A high-tech computer manufacturing company had many hourly employees who received low- to mid-level salaries working on the assembly line. It was hard to give any substantial wage increases to staff because higher labor costs made the product too expensive. The owner was always coming up with different ways to make employees happy without continually giving wage hikes. One of his most successful incentives was changing to a four-day work-week, which gave employees a three-day weekend. These employees were very happy and treated it as a luxury, since a four-day workweek was a benefit their friends in other companies didn’t have.

The effectiveness of any reward system requires two primary factors. First, whether or not the recipient perceives the reward as a positive, and second, whether the reward actually encourages the desired behavior.

Reality

If rewards are given randomly or without a clear understanding of the positive performance or behavior, the rewards quickly lose their value. Rewards serve two purposes. First, to recognize employees for performance that meet or exceed certain goals. Second, to encourage employees to repeat their actions or behaviors again and again.

Rewards are essential to performance, but the entrepreneur should clearly understand what employees perceive as a reward. Offering an ineffective incentive can have disastrous results.

In order for the reward to be effective, it must not only be regarded as a positive by the employee, but it must also encourage the desired behavior. That desired behavior must be consistent with the business plan, which is based on the entrepreneur's vision. It is the responsibility of the leader to make sure the reward system is set up to support this plan.
from real entrepreneurs

For Secretary’s Day, a law firm had traditionally taken all the secretaries to lunch with the partners. When that policy was changed to giving each secretary a gift certificate for a dinner for two, the recognition was much more appreciated. The leaders recognized that the secretaries perceived a night out with a companion of their choice more valuable than a required lunch with “the bosses.”

More Info

Providing Employee Benefits—Outlines the two types of employee benefits: (1) those the employer must provide by law; and (2) those the employer offers as an option. [sba.gov/content/providing-employee-benefits](sba.gov/content/providing-employee-benefits)

Employee Ownership & Incentives—From The Entrepreneurial Revolution with Jack Stack, CEO of Springfield Remanufacturing. View this resource using the More Info link in the online course. (Video)

SalaryExpert.com—Provides salary, bonus, cost-of-living, and benefits data. Offers information on over 31,000 jobs in over 45,000 U.S. and Canadian cities, as well as some international coverage. [salaryexpert.com](salaryexpert.com)

25 Ways to Reward Employees (without spending a dime)—Ways to compensate employees for doing good work without breaking the budget. [hrworld.com/features/25-employee-rewards/](hrworld.com/features/25-employee-rewards/)

1001 Ways to Reward Employees (Book), Bob Nelson—Low cost rewards for every conceivable type of situation.

6.3.7 Creating a Learning Environment

Any given outcome can be achieved a number of ways. The wise entrepreneur will encourage associates to look for and experiment with different ways to improve a task or solve a difficulty.

When entrepreneurs acknowledge that they do not have all of the answers, the team is encouraged to help find solutions. This presents an opportunity for employees to contribute their know-how to the business. This type of attitude also sets the stage for change, when it is needed.

Howard Stevenson and D. E. Gumpert, in their article “The Heart of Entrepreneurship” (Harvard Business Review 63, no. 2 (1985): 85-94), said, “The best entrepreneurs are the ones who fail quickly and get on with learning how to do it better.” 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 product/service.

Reality

Rather than spending great energy trying to prove that they are right, successful entrepreneurs say, “That way is not working, we should try something else.”

Tip

Successful companies look at failures as learning opportunities on the road to success.
from real entrepreneurs

Market-driven companies often thrive in a learning environment. NoteTime Solutions, a software development company for home-care patient records, succeeds with their “can do” attitude. Neither of the founders had a working knowledge of computer technology when starting the business, however, both knew exactly what the software should do. Creating this learning environment helped pave the way for bringing in a third partner, a computer engineer. This computer-savvy individual knew that the goal of the company was to find a way to get the technology to do what the market needed it to.

More Info
Hiring and Developing Employees – video interviews with successful entrepreneurs who share lessons learned about hiring and developing employees.
sba.gov/content/sba-delivering-success-hiring-and-developing-employees

6.3.8 Celebrating the Victories

Most people want to be associated with a winner, yet employees are rarely given an opportunity to celebrate the victories of the business as a whole. When a company makes a big sale, secures a new account, or gets a new project from an important customer, everyone should celebrate. A wise entrepreneur celebrates not only individual achievements but also corporate successes. Simple joy can be great motivational fuel for the next challenge.

from real entrepreneurs

Johnsonville Engineers regularly celebrates its victories—large and small. Victory parties are scheduled monthly to review the successes reached during that period by teams and individuals. One of the keys to success in celebrating the victories has been to make each event different in size and style. “We don’t want anyone to begin expecting a certain kind of victory party,” says entrepreneur Kim Lee. “So, we change the theme monthly. Sometimes we hand out cash gifts, sometimes gag gifts. Either way, we always celebrate and have fun.”
Exercise 6.3.8
Employees—Recruitment, Screening, Rewards and Communications

Learning Objective
- To identify techniques to recruit, screen, reward, and communicate with employees.

Overview
If the business must rely on a productive team of individuals in addition to the entrepreneur, hiring and retaining self-motivated people must be part of the overall business plan. An effective organization of productive team members can be built using the following tactics:

1. Recruiting and hiring self-motivated people.
2. Helping others be successful.
3. Creating clarity throughout the workforce.
4. Communicating the entrepreneur’s values.
5. Providing appropriate reward systems.
6. Creating a learning environment.
7. Celebrating the victories.

Step 1
Break into groups of 3-5 people. Using the following worksheet Employees – Recruitment, Screening, Rewards and Communication, brainstorm methods you might use to recruit, screen, reward, and communicate with employees. Think back to methods you have experienced in past employment situations.

Step 2
In a large group, report back creating a master list of methods for each category. Discuss applications and examples of each.

Step 3
Certain methods are more appropriate for some businesses than for others. On your own worksheet, circle those methods that you might use in your business. Use this list to complete the Recruitment and Selection of Employees, Employee Reward and Incentive, and Communication sections of the Management and Organization plan. Consider these methods for independent contractors and your infrastructure as well.
Employees – Recruitment, Screening, Rewards and Communications

In groups, brainstorm:

1. Methods to recruit employees:

2. Methods to screen employees:

3. Methods to reward employees:

4. Ways that you might establish a good communication system with employees.

Certain methods are more appropriate for some businesses more than others. Circle those methods that you might use in your business.
6.4 Outsourcing
6.4.1 Using Outside Resources

While a large corporation normally employs a multitude of professionals on its staff, an entrepreneur cannot afford such luxuries. Yet highly specialized and technical advice is needed. Successful entrepreneurs rely on outside resources for their infrastructure – “the basic services needed for the functioning of the organization”. This practice can be less expensive and time consuming than hiring a large staff to do all the work. For example, most entrepreneurs hire an advertising firm rather than employ their own team. That way, they only pay for what they need, when they need it.

from real entrepreneurs

An interior designer charged $100 per hour for her consultation services. By outsourcing her administrative tasks to a secretarial service at $20 per hour, she was able to bill more hours at $100.

Entrepreneurs should learn to use their 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. The entrepreneur may need to spend additional time securing resources. Note the common types of outsourcing in the chart below.

Tip

Before hiring an outside resource, take time to thoroughly investigate the person or firm. An inept professional could be costly. Once you have hired the resource, establish a good relationship from the start and maintain that relationship through regular communication.

<table>
<thead>
<tr>
<th>COMMON TYPES OF OUTSOURCING</th>
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<tbody>
<tr>
<td>Professional Services</td>
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<tr>
<td>Legal Professionals</td>
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<tr>
<td>Financial Professionals</td>
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<tr>
<td>Business Consultants</td>
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<tr>
<td>Marketing Consultants</td>
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<tr>
<td>Engineering/Design Professionals</td>
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<tr>
<td>Operational Services</td>
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<tr>
<td>Manufacturing Subcontractors</td>
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<tr>
<td>Human Resource Services</td>
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<tr>
<td>Computer Services</td>
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<tr>
<td>Building Maintenance &amp; Security</td>
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<tr>
<td>Distribution Services</td>
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<tr>
<td>Distributors</td>
</tr>
<tr>
<td>Manufacturing Reps</td>
</tr>
<tr>
<td>Import/Export Brokers</td>
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<tr>
<td>Trucking &amp; Warehousing</td>
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</tbody>
</table>
6.4.2 Legal Professionals

In this highly complex legal society, entrepreneurs need competent legal advice in a variety of areas. A wise entrepreneur starts with a good business lawyer who can provide advice when help is needed.

The process of selecting a business lawyer requires time and effort. To find an attorney, new business owners should ask friends, other entrepreneurs and business contacts for recommendations. The lawyer should have considerable practical experience in small-business law. Some entrepreneurs prefer to deal with large law firms because they employ a variety of lawyers from tax experts to securities experts to litigation attorneys. Many of these firms have substantial power and many contacts. On the other hand, a smaller firm could give the entrepreneur more personalized attention at a substantially lower cost. For example, a large firm might charge $1,000 to $3,000 to incorporate a business, while a smaller firm may only charge $500 to $1,500. In addition, a large firm may not be interested in a small business account, or it may not be available when the entrepreneur needs help. For these reasons, many entrepreneurs use smaller firms more eager for business.

from real entrepreneurs

To save money, Roger and Marie had a friend prepare the incorporation papers for their new dental practice. After fifteen years in business, they prepared to sell their practice for a handsome price. The purchaser’s attorney discovered, however, that the business was registered as a general business corporation in violation of state law. The contract to sell the existing practice had to be renegotiated. The sellers had little or no bargaining power and had to agree to a sale as a loss of half million dollars. Their legal fees amounted to about $20,000.
After establishing a list of several potential business lawyers, the entrepreneur should make appointments and interview them. The entrepreneur needs adequate information from an attorney to assess whether the relationship is a fit. In other words, the entrepreneur interviews attorneys to see if they will be hired. Entrepreneurs should seek the following information during an interview with a potential legal advisor.

- Does the attorney have a specialty?
- What is the primary size and nature of businesses for which the attorney has provided services?
- How many years of experience does the attorney have working with entrepreneurial companies?
- Does the attorney have small business expertise?
- Based on the attorney’s workload, how quickly are they able to respond to the needs of a business owner?
- What is the attorney’s fee structure?
- How easy is it to communicate with the lawyer being interviewed? It is paramount that the entrepreneur and the business attorney are compatible.
- Have the attorney describe a routine legal matter in order to explain how they would handle it.

**Tip**

Once you have selected a lawyer, prepare in advance any assignment you will give him or her. Write down the questions you have. If, for instance, you are going to discuss a contract you are negotiating, determine what you want in the contract with the other party before going to the lawyer. Then the lawyer can draw up a formal contract based on the agreed terms, as well as suggest aspects that you had not considered. Generally you will pay for legal services based upon time. The less time you take with the lawyer, the lower the fee.

**More Info**

Martindale-Hubbell Law Directory — Free online listing of individual lawyers and law firms by specialty and geographic location. [martindale.com](http://martindale.com)


### 6.4.3 Financial Professionals

**Accountants**

Fortunately, entrepreneurs usually can get excellent professional help from certified public accountants (CPAs). Most entrepreneurs use small accounting firms since they are usually more affordable than larger ones. Excellent, one-on-one service can be obtained from small, local CPA firms.
from real entrepreneurs

An entrepreneur who had an office in her home consulted with her accountant about taking a tax deduction for her home office. The accountant explained there are rules regarding the use of that office to qualify for the deduction and upon the sale of the home, computations must be made to properly apportion any appreciation or depreciation and possibly amended returns filed. Since the entrepreneur planned to sell her home within two years, she decided not to claim the home office deduction. By the time she gathered all the records necessary to support the deduction and paid the accountant for all the work, her tax savings would be minimal.

Because of the number of CPAs employed, large accounting firms can provide the entrepreneur with a variety of accounting and financial experts in one convenient location. If entrepreneurs plan on taking their company public or using bank money to any significant extent, they should make sure to use an accounting firm that will audit the books right from the beginning of the venture to limit any questions that might arise by the Securities and Exchange Commission (SEC). Much time and money will be saved if things are done correctly from the start.

from real entrepreneurs

A small multi-media publisher chose to work with a small accounting firm during its start-up stage. The company also had its financials audited by a large accounting firm because the founders had established an exit strategy of selling the business once it had gained $13 million in annual sales. After many years of hard work, and many state contracts, they were able to exit the business because they had met their financial goals and had audited financial statements to provide to potential buyers.

Whether they work for a small or large firm, accountants can offer many financial functions to the entrepreneur, including the following:

- Setting up an accounting system.
- Preparing financial statements.
- Completing tax forms.
- Advising entrepreneurs on purchasing, financing, and other decisions.
- Analyzing financial information against industry standards.
- Setting financial achievement goals.
- Auditing financial statements for accuracy.

Reality

Many entrepreneurs think if they own 51 percent of the company, they control the company. This is not completely true. The person who controls the money controls the business.

More Info

American Institute of CPAs—News and services, conferences, links and features.
aicpa.org

Bankers

Most entrepreneurs want to establish a relationship with a banker. A banking relationship should be established early, as soon as entrepreneurs begin to build their new ventures. Many times, start-up businesses do not qualify for a bank loan because they have no assets or collateral to pledge. However, the bank can assist in setting up checking accounts, merchant accounts and depositing employee payroll checks.
They can also help entrepreneurs become bankable in order to qualify for a commercial loan. Banks provide capital in debt form, in other words loans, to companies that have an established track record such as a company history, historical financial statements, and a good collateral base.

Some start-up businesses can receive loans from banks that participate in various Small Business Administration programs. The SBA does not make loans; it simply has programs that guarantee portions of loans made by banks to qualified customers.

### 6.4.4 Business Consultants

Entrepreneurs use consultants 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. Consultants are paid hourly or charge a fixed fee for a project.

The important decision to hire a consultant should be made only after carefully researching and interviewing potential consultants. Many skilled consultants can provide invaluable services. The best way to find consultants is through referrals from lawyers, accountants, other entrepreneurs, business consultants, the Small Business Administration, and Small Business Development Centers. Successful entrepreneurs avoid unsatisfactory consulting relationships by considering the following characteristics of consultants when seeking outside services:

- **Expertise**—Consider whether a generalist or a specialist is needed. You may need several consultants for different aspects of the project.

- **Experience**—Consider the consultants’ prior track records. Who else have they worked for and what services did they render? Obtain the names of other entrepreneurs they have worked for and call to verify the results of their performance.

- **Proposals**—Ask for a written proposal. Evaluate proposals by looking for the outcomes and objectives the consultants say they will accomplish.

- **Attitude**—Interview the consultants to determine if you would be comfortable working with them.

Once the entrepreneur decides on a consultant, a written agreement should be created that specifies the consultant’s responsibilities and objectives, including the timeline and compensation. The agreement should address in writing what will happen if either party wishes to end the relationship before the work is finished. It should also specify who owns the completed work product.

**More Info**

Institute of Management Consultants—Free online referrals for consulting professionals who have pledged to abide by IMC USA’s code of ethics. [imcusa.org](http://imcusa.org)
6.4.5 Marketing Consultants

Marketing consultants are particularly useful to entrepreneurs because many entrepreneurs do not have marketing experience. Advertising and public relations are two specialized fields in which the entrepreneur often needs help. Determining the competency of advertising and public relations consultants can be a challenge. The entrepreneur must look at their track records as well as their costs.

Some areas of marketing require specialized knowledge and skills that those outside of the area typically do not possess. This is especially true in the field of direct-response marketing, in which professional consultants and operational firms can execute an entire direct-marketing program probably cheaper and more effectively than a business could do for itself. Some firms will help business owners with total marketing plans while others specialize in certain fields such as direct mail, research, regional studies, and product/service positioning.

More Info

Direct Marketing Association (DMA)—Monthly newsletter covering government activities regarding direct mail and the association’s lobbying efforts. the-dma.org

MANA Online—MANA is the association of interdependent manufacturers and representatives dedicated to educating, protecting and promoting the multi-line, outsourced sales function. manaonline.org

6.4.6 Others

Many types of consultants abound in the world of business. Hiring a consultant to advise on specific issues can be a valuable use of resources. In addition to the outside infrastructure already discussed, the following may also provide valuable insights for the entrepreneur.

- **Risk-management advisors**—The many risks inherent in business operations include loss from fire, flood, embezzlement, or theft, as well as other types of legal liabilities. The two major risks that owners need to cover are property loss and liability for injuries. A business owner must find and work with a good independent business-insurance broker to protect the company against risk.

- **Governmental agencies**—The government can provide businesses with much help and information, and the costs for this assistance are usually quite low, sometimes.
even free. Some agencies frequented by entrepreneurs include the National Institute of Standards and Technology (NIST), the Manufacturing Extension Partnership (MEP), the Small Business Administration (SBA), and the Patent Office. Governmental data banks and research exchanges also contain large deposits of information.

- **Manufacturer representatives**—A sales force can be expensive for a new business so many entrepreneurs hire representatives. The Manufacturing Extension Partnership can help entrepreneurs find a sales representative that can promote specific product/service lines both nationally and internationally.

### from real entrepreneurs

It costs Blue Sky Distribution $100,000 a year to keep a salesperson in the field. So, when a salesperson couldn’t sell at least $1,000,000 worth of goods in a year, selling costs soared to more than 10 percent of sales—a cost that Blue Sky couldn’t afford. After supporting an internal sales force for three years, Blue Sky restructured its sales department and started using manufacturers’ reps with very positive results.

- **Manufacturing subcontractors**—Thousands of firms exist solely to produce goods for others. Entrepreneurs can concentrate on marketing and sales when an outside company is hired to manufacture the goods.

- **Engineering or design firms**—Engineers can be hired to solve a technical problem. Graphic designers can be hired to improve the packaging or look of a product. Interior design firms can be hired to plan the décor to strengthen the business image.

- **Distributors**—A distributor is an existing firm that will buy the product of a business venture and resell it to the intended market. It can save the entrepreneur time, money, and anguish.

- **Human resource consultants**—Many entrepreneurs use employment agencies or executive-search firms to find and recruit qualified candidates, write job descriptions, and provide other consulting services.

- **Industry specific consultants**—Consultants with industry expertise might be hired to provide insight and guidance. For example, a consultant in the coffee shop industry might provide assistance with anything from workspace design to menu development.

- **Lobbyists**—Entrepreneurs with a product/service that needs governmental approval or restrictions lifted may need to contact a lobbyist to represent them on critical issues.

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**Reality**

When needing services outside the scope of the core business, successful entrepreneurs believe in hiring professionals to do a job rather than trying to do it themselves. They feel they get a better result at a lower cost in the long run.

- **Import/export brokers**—To bring goods into the United States, entrepreneurs must comply with customs regulations. Import/export brokers, or customs brokers, take the responsibility for such goods to clear customs. They charge a commission based on shipment price. An entrepreneur should hire a customs broker who has expertise in importing and exporting in the country with which the venture is dealing.
Assignment 6a: Management and Organization Plan

In this section of the business plan, you will ensure that your business will have the management expertise needed to be a success. When starting a business, entrepreneurs wear many hats. At one moment the entrepreneur may be responsible for marketing and sales. The next moment the entrepreneur needs to order supplies, answer phones, or clean the showroom. This rarely lasts in the successful business. The demands of the successful business force the entrepreneur to add employees or a management team to the operations of the business.

As you answer questions for the management and organization plan, highlight both the current and future management needs of the business. Current needs identify those responsibilities carried out by you and others as you start the business. Future needs identify those responsibilities that will require additional management team members.

If any members of your management team lack the needed credentials or experience, explain how these deficiencies will be overcome with assistance from the board of directors, an advisory council, consultants, attorneys, accountants, and other resources.

Tip

Too often, entrepreneurs with a technical skill or know how believe that is all they need to operate a business. Knowing how to bake wonderful bread does not equate to knowing how to succeed in the bakery business.

In preparation for completing Assignment 6a which follows, review the Management and Organization Plan in the business plan for Run KC.

Tip

It is best to show each management position even if you are the one performing all these functions. This practice will give you a healthy perspective about the different roles that you will be required to fill and provide you with an understanding of the key team members that you must recruit in the future.
## Assignment 6a: Management and Organization Plan

<table>
<thead>
<tr>
<th>Business Plan Questions</th>
<th>Section Content Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Legal Form of Business</strong></td>
<td>6.1</td>
</tr>
<tr>
<td>What legal form has been selected? What are the major reasons for this selection? What is the state of incorporation (corporations) or organization (LLCs)? In which states will it be necessary to be authorized to do business? Some legal forms allow for special elections for tax purposes. What, if any, tax treatment elections will you request?</td>
<td></td>
</tr>
<tr>
<td><strong>Management Team</strong></td>
<td>6.2</td>
</tr>
<tr>
<td>What is the contribution of the entrepreneur? Who are the key management team members, and what are their job descriptions and qualifications? What offices or titles, such as President, Chief Financial Officer, etc., will each hold? What experience and qualifications are desired for future management positions? When and how will these be filled?</td>
<td></td>
</tr>
<tr>
<td><strong>Board of Directors/Advisory Board</strong></td>
<td>6.2.4</td>
</tr>
<tr>
<td>Who are the board of directors and advisory council members? Include names, compensation and any ownership in the company. What are their qualifications related to the business?</td>
<td></td>
</tr>
<tr>
<td><strong>Recruitment and Selection of Employees</strong></td>
<td>6.3</td>
</tr>
<tr>
<td>What is your plan to find and hire self-motivated people for your business? What are the required qualifications, the duties to be performed, and the interview and hiring guidelines to be followed?</td>
<td></td>
</tr>
<tr>
<td><strong>Compensation and Ownership</strong></td>
<td>6.3</td>
</tr>
<tr>
<td>What is the compensation package for the entrepreneur and other key management team members? What are their salaries, benefits and bonuses? What portion of the business is owned by the entrepreneur and management team?</td>
<td></td>
</tr>
<tr>
<td><strong>Employee Reward and Incentive Plan</strong></td>
<td>6.3.6</td>
</tr>
<tr>
<td>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, team work and flexible hours.</td>
<td></td>
</tr>
<tr>
<td><strong>Communication</strong></td>
<td>6.3.4 and 6.3.5</td>
</tr>
<tr>
<td>How will you communicate your business values and expectations? What system will you use to assure clarity of communication throughout your business?</td>
<td></td>
</tr>
<tr>
<td><strong>Infrastructure</strong></td>
<td>6.4</td>
</tr>
<tr>
<td>Who are the key resources? Include names and compensation of accountants, lawyers, bankers, and consultants. What expertise will they provide? Include strategic alliances, computer technology, management, marketing, and specialists in product or service issues. Remember that members of the advisory board should not be part of the infrastructure. Remember that members of the advisory board should not be part of the infrastructure. Organize this section based on the levels of government: city, county, state and federal requirements.</td>
<td></td>
</tr>
</tbody>
</table>
Assignment 6b: Financial Assumptions

In the Product/Service Section of the plan, you began to work on the Financial Assumptions worksheet. This is a working document. You should add to this document as you progress through the various sections of the business plan. In the process of researching and writing the Management and Organization section of your plan, you encountered various expenses. Document what you found on the Financial Assumptions worksheet. Some of the expenses for which you should now have estimates include but are not limited to:

- Legal form of organization
- Professional fees
- Payroll
- Benefits
- Owner’s compensation
- Outside services

Summary

This chapter identified the factors which must be addressed in planning the legal structure and management team.

This chapter included the following key ideas:

- Businesses can take the legal form of a sole proprietorship, partnership, corporation, S corporation, limited liability company (LLC) or nonprofit.
- Selecting a legal form of business will depend on the goals of the business, the demands of investors, control issues, tax considerations and the amount of liability the owner is willing to bear.
- The key to the success of most growing organizations is a team of highly qualified people committed to the goals and objectives of the firm.
- A comprehensive plan can help build an entrepreneurial organization and achieve successful results.
- An excellent way to receive invaluable advice is to recruit an advisory board.
- Interviewing, hiring, and retaining only the best workers is crucial to building a management team.
- Although compensation is a primary motivator for some people, others are equally motivated by their work environment and the potential for developing their skills or advancing within the company.
- Much of the work of a business venture can be done by outside organizations or consultants hired by the company. This is referred to as the infrastructure.
- Legal, financial, business and marketing professionals and other specialists can be obtained from outside the company.
Market Planning: Industry & Competition

Overview
The marketing plan and the marketing skills of the management team play a significant role in the success of the business. The marketing plan describes the entrepreneur’s strategies to bring products/services to customers. Successful marketing strategies are planned after thorough research and analysis.

This chapter will guide you through the process of creating an industry profile and identifying and analyzing your competition. These are two critical first steps in the marketing process. Understanding opportunities within the industry enhances product/service development, marketing strategies, and pricing. Evaluating your competition can help you strategically position your company.

Objectives
In this chapter, you will learn to:

• Develop and write the marketing plan – industry and competition sections.
• Create an industry profile.
• Identify types of competition.
• Analyze the competition.
7.1 Developing the Marketing Plan

7.1.1. Purpose of the Marketing Plan

The purpose of the marketing plan is to describe the marketing strategies the company will use to bring together products/services and customers. To develop these strategies, entrepreneurs must begin with a broad view of the industry and competition.

The marketing plan starts with an analysis of the industry in which the company will be doing business. Researching the industry reveals the status of the industry, its growth potential, and trends that may be opportunities for the business. After analyzing the competition, the entrepreneur determines the company’s strategic position in the market. The marketing plan also answers the following questions:

- Who is the target market?
- What is the profile of the customer?
- What is the timeline for getting to market?
- What promotional efforts will be used?
- What distribution channels will be accessed?
- What will the marketing strategies cost?

from real entrepreneurs

Only after spending time and hard work researching her market, did Julia decide to open her bridal shop. She talked to potential customers, suppliers, and industry officials. She also located, read, and analyzed information from libraries, trade associations, and Internet searches.

Reality

The market will not simply come to you because you have a great product/service. In reality, you must reach out to the market.

7.1.2 Components of the Marketing Plan

A marketing plan has five sections. Each section is a separate assignment and should be worked on individually. As each section is complete, it will be combined with other sections to form the marketing plan. The five sections of a marketing plan are as follows:

- **Industry**—Defines current size, future growth, current trends, profit characteristics, existing distribution channels, and any geographic limitations.
- **Competitive analysis**—Identifies who the competition is, what the basis for industry competition will be (i.e. price, quality, promotion, service) and how the business will compete.

Tip

A primary purpose of the marketing plan is to make sure you have the budget and resources to get your product/service to the customers.

Reality

When writing your marketing plan, cite your sources of information. Citations add credibility to your plan.
- **Market analysis**—Analyzes potential markets to determine a target market, describes the customer profile, and considers future markets.
- **Market penetration**—Details the distribution channels to be used, the sales force, advertising means and costs, packaging and labeling, and opportunities for future markets.
- **Pricing**—Explains the pricing strategy, policies and price list.

### Reality

A great market penetration plan will not succeed if it does not match the overall marketing plan. Also, all parts of the marketing plan must be aligned with the rest of the business plan.

### 7.2 Creating an Industry Profile

#### 7.2.1 Finding Industry Information

Entrepreneurs thoroughly research their industry to determine its current strength and future outlook. To access numerous sources of information, entrepreneurs use their Standard Industrial Classification (SIC) and North American Industrial Classification System (NAICS) codes. This information can be found online and through reference books in the library. The NAICS system, which is newer than the SIC system, will have more relevant classifications for technology-based and many service businesses. Some businesses operate in more than one industry requiring research and planning for each.

Sources of industry information include trade associations, trade journals, libraries, government reports, and university banks of business research. Data is available from the Census Bureau, Department of Commerce, the Small Business Administration (SBA), Standard & Poor’s, Moody’s, and the Internet.

Most libraries have the Encyclopedia of Associations to locate relevant associations for an industry. Many trade associations publish journals that include industry statistics, demographic information, and financial data for that industry. Association members, trade publications, and trade shows are additional sources for industry information.

### from real entrepreneurs

Beth Marcus started researching industries that might benefit from a glow-in-the-dark fabric called IllumiNite. When her research indicated the opportunity in the four-legged market, Marcus started Glow Dog Inc. Glow Dog leveraged the growing markets for pet supplies and services and now has 100 wholesale customers, including PETsMART®, the largest pet superstore in the country.

### More Info

**NAIC Codes**—NAIC Code key word search at U. S. Census Bureau website.

census.gov/cgi-bin/ssd/naics/naicsrch

**SIC Codes**—SIC Code key word search at U. S. Department of Labor website.
osha.gov/pls/imis/sicsearch.html

**Tip**

Conducting research for the marketing plan is a difficult task for many entrepreneurs. Ask a librarian in the business reference section for assistance.
Census Information—Economic Fact Sheets for an Industry available on the census website provide industry data regarding the number of establishments, sales, and employees. census.gov

7.2.2 Current Size, Growth Potential, Profitability

Understanding the current size of the industry and its growth potential will help entrepreneurs identify opportunities for their product/service. A comparison of the history of the industry to its current size and future growth potential will reveal a great deal about the stability and opportunities of the industry. Comparisons are particularly helpful in established industries such as finance and retail. Entrepreneurs must be wary of making assumptions about industries with relatively short or volatile histories such as information technology.

The potential for a business to succeed can be evaluated by reviewing the profit characteristics of the industry. Entrepreneurs should gather information on an industry’s historical and expected gross margin and net profit. Gross margin is a measurement of the profit retained after the direct costs of products have been deducted from sales. Net profit is the amount of money from sales available after all costs and expenses have been paid. Seasonality is another characteristic which may impact an industry. Some industries have special seasons or are affected by the weather.

from real entrepreneurs

A company specializing in preparing taxes makes most of its revenue in one quarter. It must make enough money in that one quarter to cover the quarters that generate much less revenue.

More Info

BizStats—Industry Financial Benchmarks. bizstats.com If you have access to ProQuest Entrepreneurship through a library database, you may be able to locate a more in depth BizMiner report for your industry at no charge.

Small Business Development Center Research Center—sbdcnetwork.org Be sure to click on the headings Industry Information Link and Research Report Achieve.

James A Hill Reference Library—jhill.org/business_stages/ Business Stages for Entrepreneurs is a free online information resource for entrepreneurs and small businesses at any stage of development.

Business & Company Profile ASAP™—Subscription database used to research all business, industry, and management topics. Usually available in business libraries.

Market Research.com—Subscription database containing the world’s largest collection of market research. Usually available at some university libraries.

ProQuest Entrepreneurship—Subscription database containing a wide range of information ranging from journal articles to videos. Usually available in business libraries.

Dun and Bradstreet Million Dollar Directory—Subscription database with information on over one million U.S. public and private companies with sales greater than $1 million. dnb.com Usually available in business libraries.

Tip

Do not merely seek information about the industry as if you were completing an assignment. Draw conclusions about what the information means to you and your business concept.
Standard and Poor’s Industry Survey—Surveys for major industry include reports on the current environment, the industry profile and industry trends. Usually available in business libraries.

Census Reports—The census provides Annual Surveys with estimates and historical data for the following: service businesses census.gov/services/; retail businesses census.gov/retail/index.html; wholesale businesses census.gov/wholesale/ and manufacturing census.gov/mtis/

Small Business Sourcebook—Reference book found in most business libraries. Provides sources of information for over 300 businesses including trade associations, trade shows, suppliers and articles.

### 7.2.3 Industry Trends

Researching industry trends helps an entrepreneur identify opportunities for starting and expanding a business. The marketing plan should discuss the primary trends and the opportunities they create for the business.

To identify trends entrepreneurs should get out and talk with people. Some entrepreneurs waste too much time waiting until the information is reported and written up for a research journal.

Another great way to find information on industry trends is to attend trade association meetings or trade shows for the industry. By visiting with those knowledgeable about the industry, new trends can be discovered, and the newest products and services can be found. Attending technical sessions will reveal information about future products and new technologies. Trade periodicals are often the best written sources of industry trends. All of these sources provide critical information about the industry opportunities presented now and in the future.

### from real entrepreneurs

Displaced worker Delena Stout came up with her idea for a business through her pets. “We have large dogs,” she said. “Local places to wash dogs were not clean, had bad equipment, or were inconvenient as large dogs were required to climb up a ladder for a bath.”

It was when she attended a trade show and identified natural pet foods as a coming trend that she turned her original idea into a winning one—Brookside Barkery and Bath—combining pet nutrition with self-serve pet baths. Her subsequent research on other pet health stores around the country helped her decide to focus on quality. Delena noted that “there wasn’t any place in town where we could find good quality pet food.” Customer response confirmed the need for this type of store and two additional locations were opened in her metropolitan area.

### More Info

National Retail Federation—Provides articles and data on retail trends. nrf.com

Encyclopedia of Associations—This reference book found in most business libraries provides information on more than 25,000 United States trade associations. These associations provide their members industry information and trends. Some associations provide limited information to non-members as well.

Exercise 7.2.2  
Researching the Industry

**Learning Objective**

- To understand the status and growth potential of the industry in which the company will be doing business.

**Overview**

Entrepreneurs need to thoroughly research their industry to determine its size and growth potential. To begin this process, an entrepreneur should identify the NAICS (North American Industrial Classification System) code associated with their business. Some businesses operate in more than one industry. If that is the case, the code for each industry should be noted.

Sources of industry information include trade associations, trade journals, libraries, government reports, and university banks of business research. Data is also available from the Census Bureau, Department of Commerce, the Small Business Administration (SBA), Standard & Poor's, Moody's, and the Internet. Sometimes you will be able to research data for your industry using keywords and at times, you will need to use the NAICS code mentioned earlier. The older classification system, the SIC (Standard Industrial Classification) code might also be used.

Most libraries have the Encyclopedia of Associations to locate relevant associations for an industry. Many trade associations publish journals that include industry statistics, demographic information, and financial data for that industry. Association members, trade publications, and trade shows are additional sources for industry information.

**Step 1**

Identify the NAICS or SIC code for the industry within which your business is classified.

Suggestions to find your NAICS code:

- Go to census.gov/cgi-bin/sssd/naics/naicsrch. On the left side of the page, enter a keyword for your business. From the list that appears, find the one that best matches your business.
- Go to naics.com and select Free Code Search.
- Use the NAICS book in the library or Small Business Development Center.

Or, to find your SIC code:

- Go to osha.gov/pls/imis/sicsearch.html and enter the keyword for your business.

<table>
<thead>
<tr>
<th>Industry researched:</th>
<th>NAICS/SIC Code:</th>
</tr>
</thead>
</table>

Some businesses operate in more than one industry; and if that is the case, the NAICS for each industry should be identified and researched. If applicable, note the second NAICS below.

| Industry researched: | NAICS/SIC Code: |
Step 2
Determine the size of the industry according to census data. Understanding the size of the industry in which you will be operating will help you identify the scope of the industry as well as potential opportunities.

Go to census.gov. On the left side of the page, click on American Factfinder. Again, on the left side of the page scroll over Business and Government. Select the option - Economic Fact Sheet for an Industry. Use either a keyword or NAICS code to find the information needed to complete the chart below. As the Census website changes, the steps to obtain this information may change.

<table>
<thead>
<tr>
<th>Year</th>
<th># of Establishments</th>
<th>Sales (.000)</th>
<th># of Employees</th>
</tr>
</thead>
<tbody>
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</tbody>
</table>

Step 3
Determine the growth pattern of the industry according to census data.

Using Google, enter the words Industry Statistics Sampler followed by your NAICS code. For example - Industry Statistics Sampler 448210. After finding the Sampler, click on the tab Historical Data. There you will find data for 1997 and 2002. Use that data along with the most recent data which you entered in the chart above to complete the chart which follows. A comparison of data for the industry over time will reveal a great deal about the stability and opportunities within the industry.

<table>
<thead>
<tr>
<th>Year</th>
<th># of Establishments</th>
<th>Sales (.000)</th>
<th># of Employees</th>
<th>Change (+ or -)</th>
</tr>
</thead>
<tbody>
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</tbody>
</table>

More detailed historical data is also available for some industries on the following sites: (be sure to look at the Annual Survey)

For service businesses: census.gov/services/

For retail businesses: census.gov/retail/index.html

For wholesale businesses: census.gov/wholesale/

For manufacturing businesses: census.gov/mtis/
Step 4

Find additional information related to your industry.

The numbers you found in Steps 2 and 3 give you a basic indication of the size and growth within your industry. However, you need more than census information in this section. Keep digging to find more. Industry associations, trade periodicals and library databases are a good “next step.” See Run KC as an example of the type of additional information you should be researching.

Digging Further: DIG, DIG, DIG…..and keep DIGGING

- Ask a librarian – they are amazing! In moments they can direct you to resources you could spend hours trying to google.

- Library databases - these vary by library. A few excellent databases to look for include: Business and Company Resource Center; MarketResearch.com, and ProQuest Entrepreneurship.

- Find an industry association for your business. Contact them and tell them what information you are seeking. Explain that you are a student. That might get you information that otherwise would have a fee. The Encyclopedia of Associations can help you find trade groups associated with your industry.

- See the suggested resources under More Info in the textbook and online.

- Google “your industry” and association – search their page for statistics.

- Google your NAICS code – for example put in NAICS 448210 (substitute your number).

- Google “your industry” with words like statistics, trends, growth, forecast.

While it is a good tool, don’t rely on Google...you could save hours by visiting the library.

Additional industry information: Be sure to label and provide the source of all industry information.

Current Industry Size:

________________________

________________________

________________________

Growth (compare numbers between two or more years): Is the industry growing or declining? Do not compare numbers from different sources. For example, do not compare census data from 2007 with industry data from 2010. Different sources might define what is being measured differently and therefore, comparisons would be inaccurate.

Industry Growth:

________________________

________________________

________________________
Industry Trends: What are the current trends? Are there any trends you can focus on in your business to create a competitive edge? Trade associations are a great source for trends within your industry. Also consider other trends that might impact your business. For example, might the aging baby boomer market have an impact on your business? Or, the green movement? Remember, you need facts to back up any trend you list below.

Industry Trends:

Other Characteristics: If you have not yet found information on the Cost of Goods sold for your industry, go to bizstats.com. Click on Industry Financials on the bar at the top of the page and then select Corporation, S-Corporation or Sole Proprietorships. Then continue to select the categories that fit your business until you reach the Income and Expenses Statement. Find the Cost of Sales line. Document that percentage below. This indicates the average cost of goods for your particular industry.

If you have access to ProQuest Entrepreneurship through a library database, you may be able to locate a more in-depth BizMiner report for your industry at no charge.

As you have researched your industry, you may also have identified other issues such as seasonality and geographic distribution. Make note of those which might impact your business below.

Other Characteristics:

Attach printouts/articles/etc. Highlight information related to Industry Size, Growth and Trends.
Exercise 7.2.3
Just the Facts!

Learning Objective
• Distinguish among facts, sources, and conclusions in a given section of a business plan.

Overview
It is important to use facts in a business plan. Facts help establish the foundation for decision-making. In order to provide a credible foundation, sources for your facts must be documented. In addition, conclusions about the facts must be drawn for the reader. If interpretation of the facts is left to readers, different conclusions will likely be drawn by each reader.

In the business plan:
✓ State facts throughout the plan.
✓ Support the facts by citing legitimate, respected outside sources.
✓ Draw specific, logical conclusions from the facts.

Step 1
Review the following business plan excerpts. Consider the above checklist concerning reliable statements for these examples. Are facts included? Are the facts supported by legitimate, respected outside sources? Are specific, logical conclusions drawn from the facts? What recommendations would you make?

INDUSTRY OVERVIEW

Athletic Shoes
SGMA reported $3.35 billion in running footwear sales. This is an increase of 6% over 2008. While total athletic footwear sales dropped -0.8% across the board, running shoes topped the list and reported the highest percent gain for 2009. Obviously, running must be the most popular sport. The only other athletic footwear category to report an increase was outdoor/adventure shoes which increased 4%. All other categories reported a decrease in sales. Running shoe sales are projected to increase to $3.49 billion (4%) for 2010. This suggests that running shoe sales will continue to increase in future years.

Coffee Shop
According to the Coffee Research Organization, coffee is the most popular beverage in the world. More than 400 billion cups are consumed worldwide each year. The United States leads the pack with Americans consuming more than 400 million cups of coffee per day. That number translates into four and a half thousand cups of coffee per second.

The recent economic downturn has had a minimal effect on coffee consumption. The 2009 National Coffee Drinking Trends market research survey conducted by the National Coffee Association of U.S.A. reported that daily consumption of coffee beverages among consumers remained consistent in 2009 with 54% of the overall American adult population partaking. This information tells us that even through difficult economic times; people of all ages are still consuming coffee.

Kitchen and Bathroom Remodeling
Home Remodeling Magazine projects that expenditures on home remodeling will increase by 30 percent from 2010 to the year 2011. Over the next 10 years, aging
baby boomers will result in a 50% rise in the number of people 65 to 74 years old. Baby Boomers have always spent more on home remodeling than any other group of consumers. In addition, many of these boomers live in the 11.4 million homes built in the 1980s. These homes have reached an age that requires major remodeling such as HVAC systems, roofs, kitchens and bathrooms. Baby boomers are an ideal target market for a business entering the remodeling industry.

Step 2

Analyze the above excerpts. Answer the following questions to analyze the above excerpts based on the following checklist:

In the business plan:

- ✓ State facts throughout the plan.
- ✓ Support the facts by citing legitimate, respected outside sources.
- ✓ Draw specific, logical conclusions from the facts.

A. Identify two examples of facts stated in the excerpt. What makes these facts appropriate? Inappropriate?

B. Find examples of credible sources cited in the excerpt. What makes a source credible?

C. Document any conclusions drawn by the writer concerning the facts stated. What makes these conclusions strong? Weak?

D. Discuss the improvements necessary to make one of the excerpts meet the checklist criteria.
7.2.4 Distribution Channels

A distribution channel for a product is defined as the people and processes involved in getting a product to the market.

A product’s distribution system may be short, direct to the consumer, or include middlemen such as wholesalers, distributors, and retailers. Distribution can be a major obstacle to a new business getting their products to the marketplace. The easiest way to get a product to market is to place it in an established distribution network already serving the desired market.

The means of getting a service to the market are similar to those of distributing a product. While service providers don’t typically have middlemen, referral partners or third parties might be involved in the process. For example, a nutritionist might receive referrals through a local doctor. The home supply store may have an arrangement with an independent business person to provide installation.

Both product and service companies are also finding ways to sell through the Internet. This marketing strategy is not new; the distribution channel is.

For more information about distribution models, refer to sections 3.3.3 through 3.3.5 in Chapter 3.

### Marketing Channels

#### Products B2C (Business to Consumer)
- **Producer** → **Retailer** → **Consumer**
- **Producer** → **Wholesaler** → **Retailer** → **Consumer**
- **Producer** → **Broker** → **Wholesaler** → **Retailer** → **Consumer**

#### Products B2B (Business to Business)
- **Producer** → **Consumer or Business**
- **Producer** → **Broker** → **Business**
- **Producer** → **Wholesaler** → **Business**
- **Producer** → **Broker** → **Wholesaler** → **Business**

#### Services
- **Service Provider** → **Business or Consumer**
- **Service Provider** → **Broker** → **Business or Consumer**

---

**Tip**

Before selecting distribution channels, you must predict the likely reception of your product/service by those distribution entities.
More Info

Sales and Distribution Strategies and Channels, Kauffman Foundation—Many entrepreneurs slightly adapt their distribution strategy to better meet the needs of customers. View this resource using the More Info link in the online course.

from real entrepreneurs

When asked if there is a section in a business plan that entrepreneurs usually leave deficient, one banker answered, "By and large, the marketing section—the most important section—is usually the weakest." She went on to explain the reasons for this planning error:

- Few entrepreneurs understand marketing. Marketing is a skill just like accounting. Entrepreneurs may think it should come naturally, but it doesn’t.
- Entrepreneurs must go out into the marketplace and research the industry, which requires time and effort. Sometimes they don’t know how to research. Other times they don’t want to take the time.
- Entrepreneurs must make important, difficult decisions when writing the marketing plan. They need to answer the question, "What is the right way to market the concept?" They may find many alternatives from which to choose, each with pros and cons. This uncertainty often discourages entrepreneurs from making a decision.
- Entrepreneurs wrongly assume that the market will come to them. Instead, entrepreneurs must determine how the product/service will get to customers.

Assignment 7a: Marketing Plan—Industry Section

The marketing plan is critical to the business plan because, in many cases, the marketing strategies and the marketing skills of the management team determine the success of the business. The marketing plan includes a report and analysis of the industry, competition, market, penetration, and pricing.

For this assignment, you will complete an industry profile for the business concept. The industry profile describes the industry that you will be entering by identifying growth potential, trends, and opportunities. Industry opportunities are the foundation of the marketing plan. In addition, the industry profile will describe the state of technology and innovation.

Thoroughly research the industry and document your sources so that readers will recognize that your enthusiasm for the industry is substantiated with facts. Also, use quantitative information when available. It’s much more helpful to cite a source saying that industry sales are “projected to grow at a 20 percent rate annually over the next three years” than to note that the industry is “in rapid growth.”

Tip

Since some readers of your business plan may not be familiar with your industry, in your marketing plan briefly explain how the industry is structured.
Assignment 7a: Marketing Plan—Industry Section

<table>
<thead>
<tr>
<th>Business Plan Questions</th>
<th>Section Content Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry Profile: Current Size</td>
<td>7.2.1</td>
</tr>
<tr>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>Industry Profile: Growth Potential</td>
<td>7.2.2</td>
</tr>
<tr>
<td>How much is the industry growing, stabilizing or declining? Document growth over a period of time. Cite the sources of information.</td>
<td></td>
</tr>
<tr>
<td>Industry Profile: Industry Trends</td>
<td>7.2.3</td>
</tr>
<tr>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>Industry Profile: Conclusions</td>
<td>7.2.1 - 7.2.3</td>
</tr>
<tr>
<td>What does the industry research indicate? Summarize your findings and conclusions.</td>
<td></td>
</tr>
<tr>
<td>Industry Profile: Other Characteristics</td>
<td>7.2.2</td>
</tr>
<tr>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>Industry Profile: Distribution Channels</td>
<td>7.2.4</td>
</tr>
<tr>
<td>What distribution channels currently exist to support the sale of your product/service? Cite the sources of information.</td>
<td></td>
</tr>
</tbody>
</table>

7.3 Analyzing the Competition

7.3.1 Finding Competitive Information

Learning as much as possible about the competition helps entrepreneurs define their position in the marketplace. Depending on the type of business, the Yellow Pages, Internet, local chamber of commerce, and Thomas Register of American Manufacturers can be helpful sources.

Entrepreneurs can conduct research by working for their competition before starting a business. Interviewing customers, talking with employees, and visiting the work sites of competitors are other strategies for finding information.

One of the best strategies is to interview an entrepreneur in the same type of business as you wish to start but not located in the area in which you will be operating. The industry trade association can identify and provide contact information for industry leaders or comparable businesses in other parts of the country. By talking with a “competitor at a distance,” a competitor outside one’s trade area, an entrepreneur will often be able to obtain a significant amount of information about the industry, marketplace, and operations of the business.

Tip

Suppliers and consultants may provide information about competition. Bankers, accountants, and attorneys are also frequently knowledgeable about the competition.
More Info

Dun and Bradstreet Million Dollar Directory—Subscription database with the ability to search by NAICS and geographic area to find competitors. dnb.com Usually available in business libraries.

Reference USA—Subscription database with the ability to search by NAICS and geographic area to find competitors. referenceusa.org Usually available in business libraries.

ThomasNet—Built on the 100+ year legacy of Thomas Register, this resource provides supplier information including parts, components, materials, equipment, composites and services. thomasnet.com

Superpages.com—Allows you to use the advanced search option to enter an address and search for competitors by category and distance (one – 25 miles).

7.3.2 Finding Direct Competitors

Often, entrepreneurs ignore marketplace realities and view their product/service as having no competition. In reality, all marketable products/services have some type of competition, whether direct or indirect. The entrepreneur must take responsibility to understand the venture’s competition and anticipate potential future competition.

Direct competition for a venture includes any businesses that sell similar products/services in the same target market, like Burger King and Wendy’s restaurants (fast food market) or CVS and Walgreen’s (drug store market). Direct competition also includes dissimilar businesses that sell similar products or services in the same target market. Bookstores and grocery stores carry best-selling paperback books. Consumer service businesses, such as hair salons, carpet cleaning, dry cleaners, and professional service businesses commonly have many direct competitors.

Reality

If you can really prove that your product/service has no competition, it likely has no market.

from real entrepreneurs

Robert thought his auto-parts store would have no competition until he learned his potential customers were happily buying their automotive supplies at the nearby Target and Wal-Mart.

Direct competitors may not always be located in the same geographic area. Many businesses use mail order, telephone sales, or websites to sell their products. To identify direct competitors, entrepreneurs should use the Yellow Pages and online chamber directories, do an Internet search, and conduct surveys to learn where people currently purchase the product/services of their competitor.

A successful entrepreneur must provide a product/service that can in some way be differentiated from the products/services of the competition. To do this, the entrepreneur must first understand the needs of the customer and identify the strengths and weaknesses of direct competitors. The entrepreneur can then build a product/service that meets the needs of the customer, while incorporating the strengths of the products/services offered by the competition and improving on their weaknesses.
Types of Initial Competition Faced by Start-Up Companies
Source: The Origin and Evolution of New Business by Amar Bhide.

7.3.3 Finding Indirect Competitors

Indirect competition can be an even bigger threat to a venture than direct competition since indirect competitors can be more difficult to identify. The indirect competitor is a business that sells different products/services that fill the same need as the entrepreneur’s product/service. For example, summer camps indirectly compete with child-care providers during summer vacations.

Indirect competition can also be products/services that customers provide for themselves or eliminate entirely during tough financial times, such as housecleaning or lawn-care services. Professional service businesses also can have indirect competitors. For instance, a training consultant must compete with in-house training departments.

Similar to dealing with direct competitors, the entrepreneur must have a superior or differentiated product/service to successfully compete with indirect competition. It may be necessary to create a marketing program that educates potential customers about the advantages of the product/service over the indirect competition. For example, even though health club patrons may design their own fitness workouts, a health club may wish to educate their patrons on how a personal trainer can work with them to tailor a workout to meet their personal fitness goals.

7.3.4 Anticipating Future Competition

Entrepreneurs should look to the future and think about their window of opportunity—how much time they have before another company begins competing for their existing customers and locations. Entrepreneurs may have a competitive advantage today, but others will note this and counteract with a competitive strategy. Starbucks enjoyed years as the virtually unchallenged provider of retail specialty coffee prior to the entrance of both direct and indirect competitors such as Caribou Coffee, Paneras, 7-Eleven, and McDonalds.

Tip
To find indirect competition, you have to ask yourself what products/services could be substituted for my product/service.
Knowledge of industry trends will help entrepreneurs anticipate potential competition and be ready to deploy their own competitive strategies to maintain and grow market share. Also, entrepreneurs should try to anticipate customers’ needs. As time goes by, customers’ needs will change. If the competition is more in tune with the needs of the customer, then the competition will steal the market share of a company. All the competition will need to do is to take the product/service, make minor changes to reflect customers’ preferences, and offer it again to the company’s customers.

Future competition may come from anywhere in the country or the world as more businesses incorporate Internet marketing and sales into their marketing strategies. Such was the case as many small, local bookstores found they could not compete with online retailers such as Amazon.com and Barnesandnoble.com.

More Info

The Three Windows of Opportunity, an excerpt from the book, Made in China, delivers lessons learned by Chinese entrepreneurs in the rugged and dynamic environment of that country. This excerpt zeros in on determining if your timing is right: Is the window of opportunity open? by Donald N. Sull with Yong Wang.

More Info

Reality

It can be difficult for a successful business to recognize the need to change in order to stay ahead of the competition. Successful entrepreneurs plan for change.

More Info

Magazine indexes for business periodicals, i.e. Fortune, Business Week, American Demographics, etc. Go directly to select publication’s website:

- Entrepreneur Magazine—entrepreneur.com
- Fortune Magazine—fortune.com
- American Demographics—demographics.com

ABI/Inform Dateline—Subscription database that contains complete articles from hundreds of local and regional publications that chronicle the day-to-day operations of thousands of U.S. and Canadian companies. Important business trends and events as well as regional market and economic conditions also receive considerable coverage. Usually available in business libraries. Publisher’s website:

- proquestdirect.com/products_pq/descriptions/abi_inform_dateline.shtml
- Bizjournals.com—Regional business journals from across the country.
Exercise 7.3.4
Identify Potential Competitors: Direct and Indirect

Learning Objective
• Identify direct and indirect competition for your product/service.

Overview
Competition can be defined as any business or situation that takes sales away from your business. Competition can be direct or indirect. Understanding your competition is essential for entrepreneurial success. Before you can understand it, you must identify it. Through this exercise, you will identify direct and indirect competition.

Tools
Yellow Pages, local newspaper, Internet

Step 1
Identify direct competitors. Direct competitors are businesses that sell similar products or services in the same market. Consider companies located in the same geographic region as well as companies such as mail order or Internet-based, who can reach your potential customers. Also consider direct competitors that may sell similar products or services as a sideline to their normal business. You may want to look in directories and on the Internet to find other competitors.

<table>
<thead>
<tr>
<th>Examples of direct competition include:</th>
<th>Direct Competition for my business:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Burger King and Wendy’s</td>
<td></td>
</tr>
<tr>
<td>• CVS and Walgreen’s</td>
<td></td>
</tr>
<tr>
<td>• Reebok and Nike</td>
<td></td>
</tr>
<tr>
<td>• United and American Airlines</td>
<td></td>
</tr>
<tr>
<td>• A grocery store selling cards and a card shop</td>
<td></td>
</tr>
</tbody>
</table>
Step 2

Discover indirect competitors. Indirect competitors are businesses who sell products or services that fill the same need as your business. They could be substituted for your product/service. List businesses that are your indirect competitors. This list may be much longer than direct competitors. While your direct competitors list will mostly likely name specific businesses, your list of indirect competitors may be types or categories of businesses.

<table>
<thead>
<tr>
<th>Examples of indirect competition include:</th>
<th>Indirect Competition for my business:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Subway or Taco Bell and McDonald’s</td>
<td></td>
</tr>
<tr>
<td>• A major league football game and a movie</td>
<td></td>
</tr>
<tr>
<td>• A fudge shop and a nearby ice cream shop.</td>
<td></td>
</tr>
<tr>
<td>• Handyman services and do-it yourself stores.</td>
<td></td>
</tr>
</tbody>
</table>

Step 3

Recognize other forms of indirect competition. Sometimes customers will provide the product or perform the service themselves. Other times, customers eliminate the purchase entirely when times are tough financially. This action is a form of indirect competition.

<table>
<thead>
<tr>
<th>Examples of other indirect competition include:</th>
<th>Other indirect competition for my business</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Homeowners cleaning their own houses rather than hiring a housecleaning service.</td>
<td></td>
</tr>
<tr>
<td>• Homeowners taking care of their own yards rather than hiring a lawn-care service.</td>
<td></td>
</tr>
<tr>
<td>• Businesses choosing to use training videos instead of hiring a training consultant.</td>
<td></td>
</tr>
</tbody>
</table>

Could this type of competition apply to your product or service?  
Yes ☐  No ☐

Explain:
7.3.5 Identify Strengths and Weaknesses

Business owners should know key information for every significant competitor, including their personalities, thought processes, and reactions. Some of the competition may react very aggressively to any challenge to their market position. Other businesses may take a more tolerant view of newcomers in the industry. Entrepreneurs should identify which firms will provide the most significant competition and anticipate what they will likely do if a newcomer enters the market.

Once entrepreneurs have made a list of the competition, they need to identify their strengths and weaknesses by answering the following questions:

- How do the firms in the industry compete for business? Do they compete by price, products, services, convenience, location, or promotion?
- Which tactics do firms use to attract customers? Do they offer low prices, convenience, outstanding customer service, or a higher quality of product/service?
- Do the competitors meet price competition?

Recording the strengths and weaknesses of competitors in a matrix, or chart, can be helpful in keeping track of information and making comparisons.

from real entrepreneurs

One Fortune 500 company spent much time and money writing a multi-million dollar bid that eventually resulted in a written proposal with an existing client. The president admits that the competitive advantage they had in sealing the deal was not the elegant, written proposal, but the firm’s relationship with the company that solicited bids. This strength continues to result in the many on-going contracts since the company treats each client with the highest regard.
Exercise 7.3.5

Run KC—Competitive Analysis Matrix

Learning Objective

- To analyze a competitive matrix based on research about the competition and the market.

Overview

Learning as much as possible about the competition helps entrepreneurs distinguish their business from the competition and define their position in the marketplace. The competitive matrix is your opportunity to identify the competition, understand their key attributes, and know how your product/service compares with theirs. The competitive matrix can help you answer the important question “What is your competitive advantage?” It will help you understand the terms on which your product/service will compete and help you clearly explain your competitive advantage from the customers’ point of view in the marketing plan.

Step 1

Scenario

Tim Clark, owner of Run KC, has completed a competitive matrix for the competition in his area. Help him analyze the competition by reviewing the information on the chart. Then complete the chart by filling in unique features, marketing/advertising and strengths for Run KC. Don’t limit yourself to the information provided for Run KC…be creative.

Step 2

Will the items you identified help Run KC stand out from the competition? How can he use these to make Run KC stand out?
## COMPETITOR ANALYSIS MATRIX—Running Shoe Store

<table>
<thead>
<tr>
<th>Competitor A: Greater KC Athletic Company</th>
<th>Price</th>
<th>Quality</th>
<th>Unique features</th>
<th>Distribution system</th>
<th>Marketing/ advertising</th>
<th>Location(s)</th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitor B: Leawood Running Emporium</td>
<td>Average Shoe $90-$140</td>
<td>Top Brands: Brooks, Adidas, Saucony, Asics</td>
<td>Gait Analysis. Carries extensive product lines. Wide variety of shoe sizes and widths.</td>
<td>Retail</td>
<td>Race sponsorships. Website. T-shirts/items. Ads — local magazines.</td>
<td>One location – North Overland Park.</td>
<td>Has been in business since 1990. Strong presence at races and in community.</td>
<td>Growth has led them to hiring staff that don’t have any interest in running; they train staff but enthusiasm and experience is weak.</td>
</tr>
<tr>
<td>Competitor C: BROS Sports</td>
<td>Average Shoe $60-$150</td>
<td>One brand: New Balance.</td>
<td>Focus on one brand — staff very knowledgeable on that brand. Shoes for a variety of sports — lacrosse, baseball etc.</td>
<td>Retail</td>
<td>Banners at sporting events. Sponsorship of local sports teams. Ads — local magazines. Websites.</td>
<td>Two locations — Northern boundary of Overland Park and 30 miles north in Kansas City, Missouri.</td>
<td>Shoes for a variety of sports. Staff product knowledge is extremely high.</td>
<td>Inventory limited to one brand. Staff product knowledge is high but since they have shoes for many sports, their experience level is limited.</td>
</tr>
</tbody>
</table>

Identify how you will stand out from the competition:  

---
Exercise 7.3.5
Create a Competitive Analysis Matrix

Learning Objective
- Complete a competitive analysis matrix based on research about your competition and market.

Overview
In this exercise, you will prepare a competitive analysis chart and summarize key aspects of competitive products/services. You will compare how your product/service competes with others in the areas of price, quality, unique features, distribution system, marketing/advertising, geographic location, and strengths/weaknesses.

Tools
Internet, business reference materials, competitors’ marketing materials, site visits, customer interviews.

Step 1
Start matrix with information about your business. Before you begin, consider “customizing” the chart if you feel that there are different criteria which should be studied for your particular industry. For example, if your business is a beauty salon, perhaps one of the criteria should be number of stations. Customizing the matrix to your industry will enable you to research those criteria that are important in your industry. When you are satisfied with the criteria, write the name of your business under the heading Your Business on the left-hand side of the matrix. Then, on the first line of the matrix, fill in your own business’s information related to the criteria listed – price, production/quality, unique features, etc.

Step 2
Conduct research on your competition. Identify your competition. Use the Internet and other sources to make sure you have included all relevant competitors. Visit their locations or call them to learn about their business. Talk with persons who have been customers of the competition. Ask what they liked and did not like about the product/service. Find out what they perceive is unique about the product/service and what they would change if they could. Use the headings on the matrix provided to guide your research or develop your own.

Step 3
Complete matrix with information on your competition. Using your research about competitive products or services, complete the matrix. For each line, start with the competitor’s name, followed by specific information about the company.

Step 4
Analyze the matrix to strengthen your competitive edge. After looking at the competition, see if you can identify any ways that your business can stand out from the crowd. How can you be different? What will make people chose your business over the competition?
<table>
<thead>
<tr>
<th></th>
<th>Your Business</th>
<th>Competitor A</th>
<th>Competitor B</th>
<th>Competitor C</th>
<th>Competitor D</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>COMPETITOR ANALYSIS MATRIX</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Quality</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Unique features</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Distribution system</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Marketing/advertising</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Location(s)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Price</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Weaknesses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Strengths</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Identify how you will stand out from the competition.
7.3.6 SWOT Analysis

Entrepreneurs need to understand how each competitor is positioned in the market. This knowledge provides a basis to determine a distinct position for their product/service in the marketplace based on their competitive advantage. Competitive advantage refers to the perceived advantage, or benefit, that one entrepreneur’s product/service has compared to its competition.

To establish their competitive advantage, entrepreneurs need to match their distinct capabilities with the business opportunities that exist in the market. One tool which helps entrepreneurs analyze this information is a SWOT analysis.

SWOT stands for:
  Strengths
  Weaknesses
  Opportunities
  Threats

Using a SWOT analysis, entrepreneurs look internally at the strengths and weaknesses of their companies, and externally at opportunities and threats in their environments. Listing this information in a four-quadrant chart helps entrepreneurs pinpoint how to position their business and what strategies to implement.

Following is an example of a SWOT Analysis completed for a small start-up technology consulting company.

**SWOT Analysis Chart for 20/20 Tech Consultants**

<table>
<thead>
<tr>
<th>Internal</th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Strong technology background and specialized security skills from past employment.</td>
<td>• Unsure of capital needed for start-up and first year.</td>
</tr>
<tr>
<td></td>
<td>• Knowledge of current technologies.</td>
<td>• Difficulty finding employees with right training/hard to increase staff if demand is high.</td>
</tr>
<tr>
<td></td>
<td>• Savings and spouse’s paycheck means business does not have to be profitable during the first year.</td>
<td>• Weak background in marketing.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>External</th>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Increase in perceived need for security for computer systems by businesses.</td>
<td>• Reduced budgets at potential clients’.</td>
</tr>
<tr>
<td></td>
<td>• Reduced staff at potential clients’ operations creates need to use outside consultants.</td>
<td>• Businesses with less than 25 employees typically cannot afford long-term services.</td>
</tr>
<tr>
<td></td>
<td>• Security products can be sold with consulting work.</td>
<td>• Companies’ internal staff and general technology consultants also do the same work.</td>
</tr>
<tr>
<td></td>
<td>• Strategic alliances with other consultants.</td>
<td>• Rapid changes in technology.</td>
</tr>
<tr>
<td></td>
<td>• Long-term consulting contracts: set up system, monitor, and maintain.</td>
<td>• Potential for new competition.</td>
</tr>
<tr>
<td></td>
<td>• Most competitors in same geographical area do not have the same level of experience or skill.</td>
<td></td>
</tr>
</tbody>
</table>
Based on the SWOT Analysis chart for 20/20 Tech Consultants, the entrepreneur drew the following conclusions:

**SWOT Analysis for 20/20 Tech Consultants**

20/20 Tech Consultants can position itself as the technology security expert for businesses in its service area. By offering clients security systems and contracts for monitoring and maintenance, 20/20 can develop a long-term revenue stream while saving clients the need to budget staff for this complex task. The contracts will also discourage clients from switching to new competitors. The key benefit for clients is peace of mind from state-of-the-art security. The company will also need to develop strategies to address its critical weaknesses and threats.

Once the SWOT chart is complete, entrepreneurs set priorities to focus on those items which are critical to the success of the venture. Perhaps one of the business’ strengths provides a competitive advantage that will attract customers. Maybe certain weaknesses can be overcome to improve the company’s profitability. Entrepreneurs answer questions such as, “What is the best opportunity on the chart? Which threats could undermine the success of the company?” This analysis can be used to determine the overall direction of the company and set specific goals to get there.

### 7.3.7 Building on Competitive Advantage

Once entrepreneurs understand how their business compares with the competition, they will know their company’s competitive advantage. The next step is to ask which of these advantages are important to the market. The company can build on and promote the competitive advantages valued by the market.

**Reality**

Entrepreneurs need to build a competitive advantage into their products/services. Still, it is the customer who decides whether the competitive advantage is great enough to steer them away from the competition.

**from real entrepreneurs**

By positioning its toothpaste as a natural product, Tom’s of Maine created a new category in the toothpaste market. Since no other toothpaste filled this need, the company was able to charge a premium price.
The majority of businesses in any industry compete on the basis of one or two competencies. These competencies may be unique to the specific industry or general to most industries, including the following:

- **Low cost**—The business has lower costs relative to its competitors. This advantage could be caused by low labor costs or efficient operations. Lower costs can be passed on to customers in terms of lower prices. Walmart is known for its efficient distribution system, thus contributing to its ability to offer low prices to its customers. Lower price without the benefits of lower costs is a recipe for disaster. It is difficult for small businesses without the advantages of quantity discounts and economies of scale to have lower costs. Large, established competitors often are more competent as low-cost providers.

- **Market differentiation**—The product/service has special features that appeal to customers. These features provide benefits to the customer that the competition does not provide. As a result, the business may be able to sell more units or charge a premium price. Customers may also be more loyal.

- **Niche focus**—The business chooses to serve a niche, a narrow portion of the market where the customers have special needs or preferences that do not appeal to the broad market. This niche could be defined by geography, serving customers in a specific area. It could also be defined by how the product/service is used or other benefits. For example, instead of directly competing with the giants in the pet food industry, such as PetSmart and Petco, Delena Stout, carved out a market niche by offering natural and holistic pet food and treats and all natural products for pet grooming in her business, Brookside Barkery and Bath.

Entrepreneurs should not compete directly against the market leader on its terms. With market differentiation or a niche focus, an entrepreneur can redefine the market and eliminate some of the competition.

### Reality

A successful market differentiation strategy must be based on product or service improvements that customer value highly.

#### 7.3.8 Identifying a Position

Customers are bombarded with considerable information each day are not interested in learning all the ways in which a product/service differs from competing ones.

To distinguish a business from its competitors, the entrepreneur should select one or two of its competitive advantages that result in benefits with strong appeal to customers. Positioning refers to creating a perception that links the business to the benefits in the customer’s mind.

Positioning can be based on real or perceived benefits. For example, the perception that one product/service is better than another may be caused by actual features or simply by marketing messages from the company. What makes a product/service appear unique or desirable is its positioning. For example, a restaurant may decide to promote its “low fat, heart healthy” menu using the low-fat, low-sodium menu items it has always served.
The position of a company is always relative to its competitors. If an existing competitor changes its strategy or if a new competitor enters the market, the position of the other companies could change. Entrepreneurs need to stay aware of how competitors are positioning themselves and any changes in how customers perceive them.

With a focused position, a business can communicate its position in the market. Positions can be based on benefits derived from:

- Quality
- New technology
- Specific usage occasions
- User categories
- Comparison against another product/service
- Added variety
- A new product/service category

Once a business determines its position, it must back it up with marketing strategies to communicate it to potential customers.

**Reality**

A product/service can lose its prestigious image by being on sale too frequently or by being sold in the wrong place.

**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.

**Tip**

In the factory we make cosmetics, but in the stores, we sell hope.

—Charles Revlon
Exercise 7.3.8
Analyzing Your Business

Learning Objective
• Conduct a SWOT analysis on your business and the environment in which you operate.

Overview
A SWOT analysis can help you to identify your strengths and weaknesses and to examine the opportunities and threats you may face. Understanding these factors can help you determine how you can compete in the marketplace.

Strengths and weaknesses are factors internal to the company. A company’s strengths might include management skills and experience, access to products, low overhead, a strong distribution system and a network of resources. A company’s weaknesses might be, among other things, an absence of these strengths.

Opportunities and threats are factors external to the company. Threats might include changes in legal regulations, new technologies, the economy or new competition. On the other hand, these factors might be opportunities. It all depends on how they impact your business.

Tools
Use the research you have already gathered on your management team, the industry and the marketplace. You may need to conduct more research using the methods discussed earlier.

Step 1
On the SWOT analysis chart, list your company’s internal strengths and weaknesses. Consider factors such as distribution, innovation, marketing, management, resources, supplies, cash flow, and access to capital.

Step 2
On the SWOT analysis chart, evaluate the external opportunities and threats. Consider factors such as competitors, the economy, technology, industry trends, regulations and demographics.

Step 3
Once the SWOT chart is complete, take time to analyze it. Perhaps one of the business’ strengths provides a competitive advantage that can be used to attract customers. Maybe certain weaknesses can be overcome to improve the company’s profitability. Ask yourself questions such as, “What is the best opportunity on the chart? Which threats could undermine the success of the company?” This analysis can be used to determine the overall direction of the company and set specific strategies to get there.
### SWOT Analysis Chart for

<table>
<thead>
<tr>
<th>Internal</th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>External</th>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
</table>

**Based on the SWOT analysis for your business:**

Have you identified any strengths that could become a competitive edge?

____________________________________________________________________________________________________

____________________________________________________________________________________________________

____________________________________________________________________________________________________

Have you identified any opportunities that you could pursue to provide a competitive edge?

____________________________________________________________________________________________________

____________________________________________________________________________________________________

____________________________________________________________________________________________________

Which weaknesses should you address to help strengthen the business?

____________________________________________________________________________________________________

____________________________________________________________________________________________________

____________________________________________________________________________________________________
Are there any threats that need to be managed? How might you do that?

Assignment 7b: Marketing Plan—Competitive Analysis Section

The competitive analysis section of the marketing plan is your opportunity to demonstrate that you have identified the competition, understand their key attributes, and know how your product/service compares with theirs. The research you completed to do the competitive matrix in Exercise 7.3.5 is a good foundation for this section. Include information from the matrix in your marketing plan, and the matrix itself, in the appendix.

While it is usually easy to identify direct competitors, it can be more difficult to identify indirect competitors. Don't overlook them. They can be a greater threat to your business than direct competitors. In addition to indirect competitors, address how future competition could impact the success of your business.

The most important question in this section is “What is your competitive advantage?” Be sure you understand on what terms your product/service will compete and that you clearly explain your competitive advantage from the customers’ point of view in the marketing plan.

Thorough research is necessary because the information about the industry, market, customer profile, and target market is the basis for the decisions documented in this section.

Assignment 7b: Marketing Plan—Competitive Analysis Section

<table>
<thead>
<tr>
<th>Business Plan Questions</th>
<th>Section Content Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Competition</td>
<td>7.3.2</td>
</tr>
<tr>
<td>What direct competition exists for your product/service? What companies sell similar products/services to the same target market? Cite the sources of information.</td>
<td></td>
</tr>
<tr>
<td>Indirect Competition</td>
<td>7.3.3</td>
</tr>
<tr>
<td>What indirect competition exists for your product/service? What companies sell different products/services that fill the same need as your product/service? Cite the sources of information.</td>
<td></td>
</tr>
<tr>
<td>Future Competition</td>
<td>7.3.4</td>
</tr>
<tr>
<td>What future competition do you expect to have for your product/service? Cite the sources of information.</td>
<td></td>
</tr>
<tr>
<td>Competitive Analysis</td>
<td>7.3.5 to 7.3.8</td>
</tr>
<tr>
<td>What is your competitive advantage? Include a competitive analysis chart (Exercise 7.3.5) in the appendix and summarize key points in the body of the plan. How will your product/service compete in the areas of price, quality, unique features, distribution system, marketing/advertising, geographic location, and strengths/weaknesses?</td>
<td></td>
</tr>
</tbody>
</table>
Summary

This chapter outlined the basic structure of market planning. The chapter also discussed details of the industry and competitive analysis portion of the marketing plan. This chapter included the following key points:

- The five parts of a marketing plan include an industry profile, competitive analysis, market analysis, market penetration and pricing plans.
- The research necessary to create an industry profile will allow the entrepreneur to determine if the industry is strong and has a good future.
- The marketing plan should have an industry section that indicates where the venture will fit into the current market.
- Every feasible venture has competition.
- Competition may be direct, indirect, or future.
- Entrepreneurs will be one step ahead if they collect and analyze information about their competition and the industry and continue to accumulate it.
Market Planning: 
Market Analysis

Overview
Entrepreneurs analyze the market to understand market characteristics, determine which market represents the best opportunity for a specific product/service, and gain insight into the typical customer in that market. This chapter will lead you through the process of conducting a market analysis—researching market characteristics, selecting a target market, and developing a customer profile. The results of the market analysis can be used to confirm or modify the company’s strategic position. The analysis is used as a basis for many decisions, from promotion and distribution to pricing and projecting sales.

Objectives
In this chapter, you will learn to:

• Understand market research and analyze the market.
• Select a target market.
• Create a customer profile.
8.1 Understanding Market Research

8.1.1 Finding Market Information

Entrepreneurs begin their market research as they develop the business concept. They continue analyzing the market as they plan, start, and grow their businesses. Market research is an ongoing process that uses data to drive business decisions.

The specific sources an entrepreneur uses will depend on the type of business and potential markets. Demographics and other useful information may be obtained from the Census Bureau, libraries, government reports, and trade associations. Searching by SIC and NAICS codes can lead to market information for similar businesses. The local Small Business Development Center or chamber of commerce can connect an entrepreneur with market information resources in the community. An abundance of secondary market research is available in libraries and on the Internet.

Tip
If you are not comfortable with using technology for research, talk with those who are. Other entrepreneurs, business librarians, and researchers can give you tips to help you find the information you need.

Primary market research is often necessary to learn specialized information about the target market. Interviews, questionnaires, surveys, and focus groups can give an entrepreneur insight into the potential customer’s mind. For more ideas on conducting research, review section 3.4.

8.1.2 Researching Market Characteristics

Using a systematic process to conduct research can help entrepreneurs determine where to focus their efforts. Market research answers these questions:

- Which markets have the greatest potential?
- What are the needs of the market?
- Who makes up the target market?
- What is the size of the potential market?

Tip
Market research has definite value. It provides the basis for many of the decisions that determine the financial results of a company.

8.2 Targeting Markets

8.2.1 Identifying and Selecting a Target Market

Entrepreneurs should try to pinpoint the markets in which their ventures will most likely be well received. A well-constructed matrix can be a handy tool for analyzing the various identifiable markets for a concept. For example, a business manufacturing golf balls might identify four potential markets. Each of those markets can then be analyzed as to the features its members value. The high handicap golfer might be most interested in a durable golf ball with a low cost. Yet, the corporate market might want a ball with a recognizable brand name.

The makers of a new golf ball would study the matrix carefully to determine which target market they could best serve. Based on the matrix, the golf ball manufacturer in this example concluded that the professional golfer would be the least likely to accept their product and that the recreational player would be the most likely. Thus, the manufacturer would target the recreational player.
Once the possible markets have been identified, a target market should be selected. A target market is a group of customers to which the business aims to sell. This market segment is an identifiable group which has similar characteristics. For example, the target markets identified by the golf ball manufacturer are similar in their product usage—how often they play golf. The golf ball manufacturer may select the recreational golfer segment of the market as their target market. This doesn’t mean that the company will refuse to sell golf balls to retail outlets that cater to professional golfers. It means that identifying a specific market will help focus marketing efforts. In other words, the entrepreneur knows who to market to. This focus creates a more effective and efficient marketing plan that will save the entrepreneur both time and money.

Special marketing tactics are developed for each target market. Therefore, it is best to begin with a primary target market. Later, as marketing strategies are streamlined to reach the primary target market, a secondary target market can be added.

In making a determination of which target market to pursue, entrepreneurs consider factors such as:

- Ease of sales
- Profit potential
- Frequency or quantity purchases
- Entry barriers which prevent additional competitors

Entrepreneurs should refrain from entering markets that are not right for the company or in which they have no competitive advantage. They should select markets that perceive the benefits of their product/service as superior.

Markets that are not price sensitive are best for start-ups. In such markets, customers are willing to pay for the benefits provided by the product/service. Attractive gross margins are crucial during a business start-up phase and cannot be achieved by selling into price-sensitive markets.

### Tip

Use focus groups, one-on-one interviews, online surveys, or mail-in surveys to gather feedback to help identify which markets have the most potential.
A business plan should clearly identify the target market selected and “paint” a picture of that market. For example, an accountant may decide that possible target markets include individuals, small businesses in general or a specific segment of small businesses such as restaurants. Assume that the accountant decides to specialize and selects the target market to be restaurants within a specific metropolitan area. To “paint” of that market, he would include in his plan details regarding the number of restaurants in that area, size, number of employees and type (fast food, casual dining, fine dining). This target market profile is developed using demographic data available through the Census Bureau, library databases and government reports.

Reality
The more narrow a target market is defined, the fewer the number of potential customers. Then the question is whether the target market is large enough to sustain the business.

from real entrepreneurs
Bob Lasser wanted a marketing strategy for his wakeboard manufacturing company that would be hard to duplicate. The best way to stop competition is to erect an intricate barrier to entry. Bob decided to work hard on becoming an excellent wakeboarder by performing difficult tricks, to become well known and admired by potential wake boarders.

In just two years, he won the U.S. Wakeboarding Championship and the Pro World Wakeboarding Championship. Bob personally autographs wakeboards for all of his young customers, makes public appearances and talks about the sport. His customers are impressed, and his cash register keeps on ringing.

Exercise 8.2.1
Identify Target Markets

Overview
To succeed as an entrepreneur, you need to focus your marketing efforts on the best market segments for your product/service. This exercise takes you through the process of surveying potential market segments and identifying the one with the most potential.

Advanced Preparation
Prior research on your market and the competition is necessary to complete this exercise.
Step 1 Potential Market Segments

Brainstorm potential market segments. Brainstorm a list of potential market segments (customer groups) for your product/service. Use your research about the competition to help determine which segments have unmet needs or problems relevant to your product/service. Remember, the market segment is an identifiable group which has similar characteristics. The similarities might be by characteristics such as user group, geography, interests, occupation or affiliations. Write your answers below.

**EXAMPLE:** Electrical contracting—market segments include commercial construction, residential construction, remodeling, and repairs.

**Yours**

Step 2 Select a target market

Select the market segment from the list in Step 1 that appears to be the best fit for your business concept. This segment is your target market. A target market is usually chosen because the market is easy to enter, it offers a significant profit potential, or the competitors have identifiable weaknesses. Consider not only whether the customers in your target market have an unmet need but also whether they can afford your product/service, how often they would purchase it, and whether you can effectively reach them with your marketing messages.

**EXAMPLE:** Target market is residential construction because of my expertise and the ease to enter this market with my current network of contacts. More specifically, it is residential construction within 25 miles of the city where my business is located.

**Yours**

8.2.2 Identifying Customers

As demonstrated, market planning begins with clearly identifying the market segments to which a company will sell. Now it is time to identify who within that target market might be customers for your product/service. At one end of the continuum stand entrepreneurs with a product/service they will sell to clearly identified customers, making market planning much easier. At the other end of the continuum are entrepreneurs whose customers are not as apparent or readily defined. Research and market testing will be required to clarify who these customers likely are.

The initial breakdown of markets has to do with whether the customer is another business or the end user, the consumer. In some cases a business’ obvious customers are other businesses. Entrepreneurs refer to this as B2B marketing (business to business). In other cases, customers are clearly consumers, often referred to as B2C marketing (business to consumer). When customers may be both, careful analysis can help the entrepreneur determine which market has the greatest potential.

**Tip**

Successful entrepreneurs realize they don’t have the resources to try to reach all potential buyers. Market planning is the key to using their resources effectively.
Energy Sentry products help conserve energy used by home appliances. Selling these products to individual customers would be prohibitively expensive, so a marketing strategy was developed to work closely with local power companies. The devices were then sold in large batches; one rural power company bought 9,000 units for its customers.

8.2.3 Consumer Markets

The consumer market consists of individuals who buy goods or services for their own or family use. The growing diversity of the nation’s population results in opportunities for entrepreneurs to meet the needs of an increasingly fragmented consumer group, something for which small business is uniquely qualified. The more information entrepreneurs learn about customers, the more precisely they can target their marketing efforts to effectively reach them. A great deal of information is available to help entrepreneurs identify and locate potential customers through government and secondary market research.

As a two-time breast cancer survivor, Kathy Dibbens, was adamant that other cancer survivors should not have to experience what she did trying to find the post-surgery products she needed. She founded Absolute Dignity to provide these products to survivors like herself. Kathy is a certified specialist in fitting customers with prosthesis and wigs. She frequently hears comments that her customers can feel warmth and positive energy when they walk in her door.

More Info

American Consumers—Demographics and spending patterns. Publisher’s website: newstrategist.com

American Demographics—Publications that provide research about consumers such as demographics and spending patterns. americandemographics.com

American Generations Series—Series of books that help identify the characteristics of potential customer groups. Publisher’s website: newstrategist.com/store

Demographics USA—Provides effective buying income and buying power index and other demographic and marketing data. Usually available in business libraries. Publisher’s website: tradedimensions.com/prod_dus.asp

American Consumer Series—Get fast access to the numbers you need in this series of quick-reference books that sum up the U.S. population. Usually available in business libraries. Publisher’s website: newstrategist.com/store/index.cfm/category/2/consumer-series.cfm

Consumer Expenditure Survey—Provides information on the buying habits of American consumers, including data on their expenditures, income, and consumer unit (families and single consumers) characteristics. The survey data are collected for the Bureau of Labor Statistics by the U.S. Census Bureau. bls.gov/cex/home.htm#tables

SRDS The Lifestyle Market Analyst—Demographic and lifestyle profiles from more than 19 million U.S. households; profiles arranged by city, gender, age range, etc. Publisher’s website: srds.com
8.2.4 Business Markets

Marketing a product/service to a business differs from marketing to consumers. When selling to businesses, an entrepreneur may have fewer, larger customers, which can increase efficiencies and profits as well as risk.

from real entrepreneurs

With 75 percent of his revenue coming from one business client, the owner of a small public relations firm realized his company's vulnerability in being so reliant on one customer. Yet, because of the workload and income generated by this major client, the entrepreneur lacked the motivation to engage in the marketing efforts needed to expand his customer base. Just as he feared, when his major client began experiencing financial difficulties and cut spending, his company's very survival was at risk.

An entrepreneur will need to understand the purchasing behavior of the businesses in the potential market. For example, does a proposal need to be submitted for each sale? Do customers expect to negotiate prices and terms? The purchase decision typically includes many persons within a business. One person or department may make the actual purchase, another one decides to make the purchase, while still another is the end user of the product/service. Many other people may be influential in the specific product/service purchased.

WHO’S INVOLVED IN THE PURCHASING PROCESS?

<table>
<thead>
<tr>
<th>LEVEL OF INVOLVEMENT</th>
<th>USER</th>
<th>DECISION MAKER</th>
<th>BUYER</th>
<th>INFLUENCER</th>
</tr>
</thead>
<tbody>
<tr>
<td>VERY INVOLVED</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOMEWHAT INVOLVED</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NOT INVOLVED</td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

Purchasing Steps

1. Need defined
2. Budget established
3. Proposals requested
4. Proposals reviewed
5. Contract completed

When a business is the customer, multiple individuals may be involved at each step in the process; one common arrangement is shown above. Understanding the purchasing process and players for potential business customers is part of market analysis.

The government is a special business market to consider. Polartec® LLC, the developer, manufacturer, and marketer of Polartec® fabric, well know for keeping outdoor enthusiasts warm and dry, provides garments to the U.S military designed to provide protection and comfort to soldiers in some of the harshest environmental conditions. While governmental buying can seem complex, the purchasing process is centralized for many agencies. For example, the General Services Administration and the Defense Department handle many of the purchases for the federal government. At the state and local levels, schools, hospitals, and highway departments are potential customers.
The purchasing process for many private businesses and the government has undergone major changes with the increased use of the Internet. Many of these organizations prefer purchasing online as it saves time and money. This practice can be an opportunity for entrepreneurs who conduct their transactions online.

More Info

Encyclopedia of Associations—This reference book found in most business libraries provides information on more than 25,000 United States trade associations. Most trade associations provide market research information. A membership in the association is usually required.


Commerce Business Daily—Searchable database and listings of proposed government procurement actions, contract awards, and other procurement information. cbd-net.com

Association of Procurement Technical Assistance Centers—Government agency developed to help businesses seeking to compete successfully in federal, state and local government contracting. aptac-us.org/new/

Dun and Bradstreet Million Dollar Directory—Subscription database with information on over one million U.S. public and private companies with sales greater than $1 million. Usually available in business libraries. dnb.com

Reference USA—Subscription database contains over 14 million business listings with company profiles and consumer listings from telephone white pages. Usually available in business libraries. referenceusa.com

SRDS Direct Marketing List Source—Subscription database has variety of targeted marketing lists. Usually available in business libraries. srds.com

Telephone Directories on the web—Index of online phone books with links to yellow pages, white pages, business directories, e-mail, and fax listings. teldir.com/eng

8.2.5 Create a Customer Profile

As part of market planning, entrepreneurs create a detailed profile of the customers who make up their target market. An entrepreneur must know customer psychographics and demographics, including where customers purchase and how often they buy.

A customer profile provides a clear picture of the typical person or business an entrepreneur is planning to serve. Most, but not all, of their customers will fit into the customer profile. For example, the customer profile of a minivan buyer is a married couple in the 30-45 year age range with

Tip

Even a small business can have a large presence on the Internet. Online marketing has allowed many small businesses to effectively compete nationally and globally with large companies.

Tip

The customer profile is a picture of the typical customer. The majority of customers will resemble the profile.
children and a household income over $60,000 a year. Even though some young professions or older retirees may drive a minivan the largest percentage of buyers will fit the profile. This information helps drive marketing strategy and such marketing efforts as promotional design and sales tactics.

One of the challenges in creating a customer profile is identifying who the customer really is. The customer may not be the actual consumer of the product/service. Entrepreneurs should think of the customer as the individual, or business, who pays for the product/service. The consumer is the end user. If the customer and consumer are the same person, or business, the task of identifying a customer profile is simplified.

### 8.2.6 Customer Characteristics for B2C

In B2C (business-to-consumer) marketing, it's critical to identify the common characteristics of potential customers. It speeds up the sales cycle, saving time and money. Customer characteristics are usually based on the following:

- **Demographics**—The target market is described in terms of age, gender, education, occupation, geographic location, nationality, race, income, religion, and other commonly used census categories. Entrepreneurs must identify which variables are relevant to their target market. For example, a women’s clothing retailer must know the age bracket, occupation types, and income level of its target customer.

- **Psychographics**—Customer groups can be identified according to lifestyle or personality characteristics. It may be helpful to describe customers in terms of their desires for status, comfort, security, adventure, and physical pleasures. For example, new products are often marketed to first adopters, people who think of themselves as innovative, open-minded, and adventuresome. Lifestyle variables such as how consumers spend their time, their activities, and their interests, further define the customer. Information such as media preferences and membership in organizations is useful. For example, knowing a potential customer group heavily listens to the local top 40 radio station can help determine promotional strategy.

- **User-Team Characteristics**—Customers can be described in terms of how they will use the product/service. Common classifications include heavy users versus light users; site of consumption, such as the at-home market versus the away-from-home users; and the purpose of the use, such as professional versus amateur usage.

The customer profile should fit the product/service plan. The benefits described in the product/service plan should be the benefits valued by targeted markets. Entrepreneurs who decide to target more than one market will need to develop several customer profiles. Even within the same target market, diversity may require a primary and secondary customer profile.

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**from real entrepreneurs**

Users of the iPad and iPhone mobile devices tend to be younger and wealthier than typical mobile subscribers, according to a survey by The Nielsen Company. Nielsen’s research showed that about 40% of iPad users and 30% of iPhone users fall into the 25-36 category, compared to about 20% of all mobile subscribers. About 50% of both iPad and iPhone users earn $75,000 or more annually.
8.2.7 Customer Characteristics for B2B

In B2B (business-to-business) marketing, knowing the characteristics of business customers helps entrepreneurs develop effective marketing strategies. Business characteristics can be described using the following four characteristics:

- **Demographics**—The target business is usually described by its broad category: industrial, reseller, or governmental. The Standard Industrial Classification (SIC) or North American Industrial Classification System (NAICS) code is used to describe the type of business. Business size is described in terms of annual sales, the number of employees, geographic location and target market.

- **Use of product/service**—The target business will either use the product/service to make money, decrease operating costs, or to comply with governmental regulations. The business will have a specific need and seek specific benefits. A reseller may want such features as a broad assortment, exclusive lines, cooperative advertising, or generous return and exchange policies. An industrial customer may require such features as overnight delivery or compliance with ISO standards developed by the International Organization for Standardization.

- **Organizational factors**—The target business has policies, procedures, and an organizational structure that affect the buying process. For example, a governmental agency may need to select the lowest priced bid that meets the specifications for the product/service. Processes such as centralized purchasing and online buying will make a significant difference in marketing strategy.

- **Individual factors**—While the organization is the customer, recognizing the common characteristics of the individuals who are the buyers is useful. What job title, age, education, income, and other relevant demographic and psychographic characteristics define the buyer? Do they prefer sales persons to communicate through phone calls, personal visits, or e-mail? Are their primary sources of information: trade shows, trade journals, catalogs, or other media? What organizations do the buyers tend to join? For example, if most target customers are members of a national trade association, the entrepreneur should consider joining and being an active member.
Exercise 8.2.7
Customer Profile

Learning Objective

- Define a customer profile by identifying the characteristics of those most likely to purchase your product/service.

Overview

While ANYONE might buy your product or service, every business has a typical customer...or those most likely to buy. It's important to know who that “typical customer” is and to focus marketing efforts toward that audience. Businesses that market to everyone waste marketing dollars on unlikely candidates.

The charts in this exercise are tools to help you to identify the characteristics of those most likely to purchase your product/service – in other words, develop a customer profile. You will be describing some characteristics that are demographic (age, income, gender) and some that are psychographic (values, attitudes).

Step 1

Determine if you are marketing to a Consumer Market or a Business Market or both.

Those involved in Consumer Markets have sales that are B2C – business to consumer.

Those involved in a Business Market have sales that are B2B – business to business. Some businesses have a product or service that they sell to both business and consumer markets. If that is the case, you will need to include a profile for both in your plan.

Step 2

Using the appropriate chart, research the characteristics of the typical purchaser of your product or service. Be specific, broad ranges (i.e. Age 20-80) are not specific enough. Identify the characteristics that are relevant to your market. It is not necessary to have a response in every box. The following are abbreviated examples of customer profiles:

**Business to Consumer**

The customer profile includes females, ages 25 – 40, professionals, household income in $100,000-$150,000 range, married with 2-3 children, in a metropolitan area.

**Business to Business**

The customer profile includes builders with 1-10 employees, 5-15 homes constructed at a time, homes in $150,000-$250,000 range, and construction in a metro area.

In your Industry research, you may have found a profile that describes the typical customer of your product or service. If you did not, observation, research and surveys are helpful tools. After your business is established, your own records will help you confirm the profile.
### Step 3

Using the chart(s) which follow, develop a Customer Profile to be used in your Marketing Plan. Add any information you found in your Industry Research.

#### Consumer Markets

**B2C, Business-to-Consumer Sales**

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td></td>
</tr>
<tr>
<td>Gender</td>
<td></td>
</tr>
<tr>
<td>Occupation</td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td></td>
</tr>
<tr>
<td>Family Status</td>
<td></td>
</tr>
<tr>
<td>Size of Household</td>
<td></td>
</tr>
<tr>
<td>Geographic Location</td>
<td></td>
</tr>
<tr>
<td>Ethnic Origin</td>
<td></td>
</tr>
<tr>
<td>Attitudes, values, beliefs</td>
<td></td>
</tr>
<tr>
<td>Social Status</td>
<td></td>
</tr>
<tr>
<td>User characteristics</td>
<td></td>
</tr>
<tr>
<td>Benefits sought</td>
<td></td>
</tr>
</tbody>
</table>
### Business/Industrial Markets
B2B, Business-to-Business Sales

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business type (wholesale, retail, gov't)</td>
<td></td>
</tr>
<tr>
<td>Product/Service Offered</td>
<td></td>
</tr>
<tr>
<td>Use of Product/Service</td>
<td></td>
</tr>
<tr>
<td>NAICS/SIC codes</td>
<td></td>
</tr>
<tr>
<td>Annual Sales</td>
<td></td>
</tr>
<tr>
<td>Number of Employees</td>
<td></td>
</tr>
<tr>
<td>Geographic Location</td>
<td></td>
</tr>
<tr>
<td>Number of Locations</td>
<td></td>
</tr>
<tr>
<td>Service/Sales Area</td>
<td></td>
</tr>
<tr>
<td>Age of Company</td>
<td></td>
</tr>
<tr>
<td>Target Market of Company</td>
<td></td>
</tr>
<tr>
<td>Buying process</td>
<td></td>
</tr>
<tr>
<td>Benefits sought</td>
<td></td>
</tr>
</tbody>
</table>
8.3 Analyzing Markets
8.3.1 Customer Buying Behavior

The entrepreneur should also be able to answer the following questions as they relate to their customers:

• Where do the customers want to buy?
• When do they buy?
• What do they buy?
• Why do they buy?
• How do they buy?
• How often do they buy?
• How much do they buy?

The answers to these questions provide a foundation on which to build the marketing strategy for reaching the target market.

from real entrepreneurs

Applying the concept of Jiffy Lube to watercraft, Naut-a-Care Marine Services, Inc., provides services such as oil changing, steam cleaning of marine bilges, and maintenance of systems, to boat owners. After surveying the market, Naut-a-Care’s owner found that his potential customers were looking for convenience and on-site service. So, the company custom-designed boats to serve their customers at the marina rather than having the customer come to them. By operating from a boat, they also avoid the highly expensive waterfront real estate needed for most successful marine-oriented businesses.

Another relevant factor in customers’ buying behavior is their level of involvement in the buying decision. The customer may have low involvement, making the buying decision fairly quickly or impulsively. The decision to place a loaf of bread in the grocery cart is an example of low customer involvement.

An expensive or complex purchase typically requires more customer involvement. Selecting a computer is typically a high-involvement buying decision. In this case, the customer must learn about product features and evaluate the various brands and available options.

Post-purchase behavior should also be considered in developing the marketing strategy. Customers will be satisfied with a product/service if it meets their expectations. Satisfied customers are likely to become repeat buyers and to share their positive opinions with others. Dissatisfied customers tend to tell even more people about their negative experiences. Entrepreneurs who want satisfied customers plan how they will manage customer expectations and follow up after the purchase.

Tip

By analyzing how customers purchase and use a product/service, entrepreneurs can recognize clues about their needs and create benefits to meet them.
from real entrepreneurs

The target market for the board game Cranium is individuals between the ages of twenty-five and thirty-five, with an attractive disposable income. Research shows that this demographic group seems to have a natural social tendency to play games. Inventors of Cranium, Whit Alexander and Richard Tait decided to bypass traditional game retailers and toy trade shows. Instead, they chose to sell their game through other retailers where their potential players shopped. This unusual positioning has resulted in their largest sales coming through Starbucks stores, an unconventional channel. The game also sells well on Amazon.com, and through Virgin Megastores and Barnes and Noble.

8.3.2 Analyzing Target Market Against Customer Profile

Once the customer profile is complete, the entrepreneur needs to look at it in relation to the target market identified earlier. For example, a B2C company offering child care services identified their customer profile as married and single professionals between 18 and 40 years of age, with one or more pre-school children and an annual income of $50,000 a year or more. Market characteristics analyzed for the area surrounding the proposed child care center location included factors such as population, income level, age, marital status, occupation and education. Finding that a large percentage of the population in the area was working parents, in the 22-40 year age range with incomes over $50,000, the entrepreneurs determined the target market would likely support a child care business. If they had found that a majority of the population in the area were over the age of 50, they would have looked for an alternative location.

A B2B company selling equipment to photography studios identified their customer profile as photography studios with multiple locations, classified as NAICS 541922, with annual sales over $1,000,000, and located in the New England states. A target market profile for this business included the number of photography studios, the number of locations for each studio, the NAICS, annual sales and location. By comparing the customer profile to the target market profile, it was possible to determine that there are enough potential customers within the target market to support the business.

Scenario 8.3.2

Run KC—Matching Customer Profile to Target Market Profile

Learning Objective

- To determine if there are enough potential customers within a target market to support specific business.

Overview

A target market profile is developed using demographic data available through the Census Bureau, library databases, and government reports. The target market profile should include the variables used to describe the typical customer. Keep in mind, for B2C businesses, variables include factors such as age, income, and gender; and for B2B businesses, variables include factors such as annual sales, number of employees and type of business.

Once the customer profile is complete, the entrepreneur needs to look at it in relation to the target market profile. By comparing the customer profile to the target market profile, it is possible to determine if there are enough potential customers within a target market to support the business.
Scenario

Tim Clark’s research resulted in the following Customer Profile and Target Market Profile.

Customer Profile

The typical customer of Run KC can be described as follows:

- **Gender**: male or female
- **Household Income**: over $75,000
- **Age Range**: primary 30 - 60 years, secondary 14-29
- **Education Level**: some college; college grad
- **Employment**: students; professional
- **Housing Type**: homeowners; living with parents
- **Family Types**: family; singles
- **Lifestyle**: runner; participate in leisure sports; reads Runners World; Internet user

According to the Running USA State of the Sport 2010, core runners are highly educated with 79% having a college diploma; are affluent with 73% having a household income over $75,000; and purchase an average of 3.2 pair of running shoes per year. Of this group, 64.4% of the women spent over $90+ per pair and 50.1% purchased their running shoes at a specialty running store; 56.4% of the men spent $90+ and 42.9% made their purchases at a specialty running store.

Target Market Profile

The target market for Run KC will be Johnson County, Kansas – the fastest growing county in Kansas.

According to the US Census, the market profile for Johnson County in 2009 can be described as:

- **Total Population 2009**: 542,737
- **Average Household Income**: $89,925
- **Average Home Value**: $249,000
- **Total Housing Units**: 217,867
- **% Population change 2000-2009**: +20.2%
- **% Male Population**: 49.4%
- **% Female Population**: 50.6%
- **Median age**: 35.7
- **Ethnic Diversity**: White with a growing Asian population
- **Family Types**: Couples and families
- **Education Levels**: Bachelor’s Degree 47.7%
- **Employment Levels**: Professional; White Collar

Map Info reports that within a 5 mile radius of the store the average household income is $119,343 with a population growth rate of 25% from 2000 to 2009.
2009 Retail Sales Volume within 5 mile radius

<table>
<thead>
<tr>
<th>Category</th>
<th>Sales Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shoe stores</td>
<td>$45,382,304</td>
</tr>
<tr>
<td>Sporting Good Stores</td>
<td>$40,562,993</td>
</tr>
</tbody>
</table>

Based on the information provided, do you believe that the customer profile for Run KC matches the target market profile? In other words, are there enough potential customers in the area to support this business? Cite specific information to justify your answer.

More Info

City-Data.com—Provides in-depth data at the city, county or zip code level.

U.S. Census—Official resource for social, demographic, and economic statistics. census.gov


Sourcebook of Zipcode Demographics (CACI)—Demographic and consumer market statistics and information arranged by zip code. Usually available in business libraries.

Loopnet.com—Commercial real estate site provides demographics and retail sales volume for a 1, 2, and 3 mile radius around each property listed.

Complete Economic and Demographic Data Source (CEDDS)—Contains census and statistical data arranged in a variety of ways. Usually available in business libraries. Publisher’s website: woodsandpoole.com

U.S. Census County Business Patterns—Annual detailed geographic, industry, and other information for U.S. business establishments. census.gov/econ/cbp/index.html

Traffic Volume Maps—The Department of Transportation in many states have maps which document traffic counts. Contact the State Department of Transportation

8.3.3 Targeting an Online Market

Even though entrepreneurs who market their products/services on the Internet may never meet a customer face-to-face, the same market planning considerations and constraints that apply to traditional markets also apply to online markets. Entrepreneurs should conduct a market analysis, select the best market to target, and develop a detailed customer profile.
Knowledge of who uses the Internet will help an entrepreneur determine if online marketing will be an effective strategy for their product/service. According to the Pew Research Center’s Internet and American Life Project survey of persons aged 18 and older, Internet users are:

- **Upscale**—Internet usage rises with family income. Ninety-five percent of those with incomes over $75,000 use the Internet.
- **Well-educated**—Internet usage rises with education. Ninety percent of college educated households use the Internet.
- **Both Male and Female**—Seventy-nine percent of both males and females use the Internet.

Online surveys are a tool entrepreneurs can use to gain more specific information about market potential. Once entrepreneurs determine that potential customers will purchase over the Internet, they should analyze other marketing aspects of this distribution method, such as can their target market be attracted to their particular website? How much will this type of promotion cost? Is their budget adequate to cover the cost of creating and maintaining a website? Can their business handle a large volume of orders in a short time? This can happen with a popular site.

Even if entrepreneurs do not sell directly over the Internet, they should consider using the Internet for other marketing purposes such technical assistance, advertising, or customer service.

**More Info**

U.S. Census—Measuring the Electronic Economy

Audio, Leveraging the Internet to Improve Market Share—A niche apparel manufacturer. View this resource using the More Info link in the online course.

**8.3.4 Future Markets**

Whether the company’s goal is growth or stability, the entrepreneur needs to consider future markets. Every product/service has a life cycle, some shorter than others, depending on how fast changes occur in customer needs and preferences. Future markets can be opened up by adding a product/service, improving a current one, or by selling an existing or new product/service to a new market.

The search for future markets should be driven by customer demand. An entrepreneur must ask these questions before pursuing future markets:

- Does adding a product/service to meet customer demand make sense with my overall vision?
- Will a new product/service fit within our existing organizational structure?
- Will daily operations of the new product/service mirror the operations of existing product/service lines?
• Will additional research and development be needed before launching the new product/service?

• Will the profit margin for the new product/service make the opportunity worth pursuing?

• How much do we stand to lose if sales the new market do not meet sales goals?

The future success of the business likely depends on the entrepreneur’s ability to identify new market opportunities. The answers to the questions above will help the entrepreneur determine whether pursuing a new market is the right thing to do.

from real entrepreneurs

Legendary founder of the Virgin Group, Richard Branson, grew a small record company, Virgin Records, into a multi-billion dollar conglomerate with over 200 companies around the world. Branson’s Virgin Group has expanded into travel, leisure, mobile, broadband, TV, finance and health. Branson’ states that contrary to appearances, Virgin is focused. “Our customers and investors relate to us more as an idea or philosophy than as a company. We offer the Virgin experience, and we make sure that this experience is consistent across all sectors. It’s all about the brand.”

Assignment 8: Marketing Plan—Market Analysis section

For this assignment, you will create a customer profile in which you describe your intended customer with relevant demographic and psychographic characteristics. Remember, the customer may not be the actual consumer of the product/service. Think of the customer as the individual or business who pays for the product/service.

In the target market profile, describing the market in terms of size and potential sales volumes helps you and readers of your business plan understand the current opportunities for your concept. By listing future markets, you identify potential opportunities. Briefly reference the results of any surveys or focus groups conducted with your target market in this section. Include a more detailed summary in the appendix.

The information in this section will lead to the market penetration strategies in the next assignment. The customer profile and target market information will support and reinforce the other sections of the marketing plan and the entire business plan.

Reality

Entrepreneurs that claim, “Everyone is my market!” will have a hard time focusing in on a specific, viable target market.

Tip

You may choose to create two or more customer profiles if you are targeting several different markets.
Assignment 8a: Marketing Plan—Market Analysis Section

<table>
<thead>
<tr>
<th>Business Plan Questions</th>
<th>Section Content Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Target Market Profile</td>
<td>8.2.1 to 8.2.4; 8.3.3</td>
</tr>
<tr>
<td>What target market will be selected? How many potential customers and/or potential dollars are available in this market segment? Describe the characteristics of this target market. 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.</td>
<td></td>
</tr>
<tr>
<td>Customer Market Profile</td>
<td>8.2.5 to 8.2.7</td>
</tr>
<tr>
<td>What is the profile of the intended customer, including 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?</td>
<td></td>
</tr>
<tr>
<td>Market Analysis</td>
<td>8.3.2</td>
</tr>
<tr>
<td>Do the demographics of the target market match the customer profile? In other words, are there enough potential customers within the market to support the business?</td>
<td></td>
</tr>
<tr>
<td>Future Markets</td>
<td>8.2.4</td>
</tr>
<tr>
<td>What opportunities could occur in future markets, including market size, method of market penetration, projected date of entry, and approximate costs?</td>
<td></td>
</tr>
</tbody>
</table>

Summary

This chapter outlined the basic structure of market planning. The chapter discussed the details of the overall plan that entrepreneurs use to bring their products/services to market.

- Entrepreneurs use a systematic process for market research to understand and monitor changes in their market. This information helps drive marketing decisions.
- Market planning begins by clearly identifying the business or consumer markets to which a company will sell its products/services.
- A criteria for selecting a target market includes: ease of selling, profit potential, frequency or quantity of purchase, and entry barriers which prevent additional competitors.
- The decision to pursue future markets depends on customer demand and how well the new market matches the goals of the business.
Overview
With literally thousands of things you could do to promote your business, what will you base your marketing decisions on? Who is most likely to buy what you’re selling? What image, strategies, and techniques will create a connection with your market?

You have already begun to answer these questions with market research in Chapters 2 and 8. In this chapter, you will plan ways to reach the markets you have identified. You can determine how to sell your product/service by exploring various strategies used by other entrepreneurs. You can develop a mix of advertising, publicity, or promotions to fit your business’s needs. After you have identified how you will penetrate the market, you will write your findings in the Marketing Plan section of your Business Plan and determine the estimated costs to implement them. These projected costs will be used when you build your Financial Plan.

Objectives
In this chapter, you will learn to:
- Create a brand for your business.
- Consider effective ways to reach your target market.
- Develop a plan to penetrate the market.
9.1 Creating an Image
9.1.1 Establishing an Image

A brand establishes an image of the product/service, or business. It creates a visual, emotional, and cultural connection between customers and the company and conjures up powerful images for customers, both consciously and subconsciously. It paints a picture about the company, the product/service, and the type of customer it represents. For example, Disney® has a strong brand as the family entertainment leader. It strives to portray a positive business image and ensures that customers’ experiences keep them coming back. Disney communicates messages of family fun, clean environments, and service excellence. Employees are referred to as “cast members” and attend Disney University to learn their roles, responsibilities, and service standards.

Businesses with strong brands often see these benefits:

- Higher perceived value for their products or services.
- Higher profit margins than competitors.
- Loyal customers who don’t switch to competitors easily.
- Cross-selling other products and services.
- Development of new products/services more quickly and cost-effectively.

When customers buy a brand, they buy its values and promises, and feel that their expectations are aligned with the company. The product/service the customers buy and the quality experience they receive is what persuades them to buy the same brand again. The product/service and brand have a direct reflection on one another.

A strong brand will communicate a clear image of the business to customers. This image impacts how customers feel about your business. You don’t want to leave this emotional response to chance. You can influence your business’s image by creating a brand.

The business’s image should align with customers’ needs and expectations to attract customers who fit your customer profile. By emphasizing your competitive advantage as part of your image, you can position your products or services to stand out in the market and attract more customers.

A number of companies have successfully created a brand that stands out in customers’ minds. A successful brand has a positive association, a recognized name, and a higher perceived value than its competitors. For example, Apple® commands higher prices than its competition because it has a loyal following that appreciates its innovative, counter-culture image. The Southwest Airlines brand is widely known as one that is reliable, safe and fun. This strong, focused image has guaranteed it steady sales.

from real entrepreneurs

For Valerie Jennings, combining her passion for healthy food with a love of problem-solving and a commitment to the environment was the perfect recipe for business success. Jennings owns Hippie Chow Natural Foods. Hippie Chow gourmet granola is handmade and uses all natural ingredients with no artificial flavors or preservatives. In defining and building her brand, Valerie wanted to stay true to her mission: Deliver exceptional and sustainable value to all stakeholders through the production of high-quality, high-character natural foods.
A core value of the Hippie Chow brand is to recognize the positive effect that can be made by connecting business with ecology — making a simple pledge to help the planet. Jennings feels so strongly about this that her organization is a member of 1% for the Planet, a global group of companies that commit to donate at least 1% of their annual net revenues to environmental organizations worldwide. Jennings recognizes that there is tremendous synergy in connecting her corporate brand with her personal values. In every way Hippie Chow is an authentic representation of how she sees her business having a positive impact on the world.

### 9.1.2 Communicating an Image

Most people think of branding as visual components such as logos and stationery. Marketing collateral, a general term for marketing materials, refers to brochures, business cards, and websites. Although branding often results in marketing collateral, branding encompasses more than what customers see. You can create branding for your company by thinking through the many points of contact you have with your customer.

Valerie Jennings worked on every aspect of her branding process as she launched her company. She developed a name, logo and tag line that clearly defined her mission. She took a big picture perspective when looking at what her brand should represent in the marketplace. It was important to her that the company values be in alignment with her personal values — they needed to be authentic. All of these activities enhanced her company image and resulted in her business success.

### 9.1.3 Name

A memorable name is a valuable part of a company’s brand. An entrepreneur should select a name that will be appropriate for the company throughout its business life. When Marion Luna Berm started her own automobile dealership in Corpus Christi, Texas, she chose the name Love Chrysler, Inc. She uses the tag line, Love keeps you Going, along with a heart as part of her logo. Berm’s savvy ability to create a strong brand helped her succeed. She was recently inducted into the International Automotive Hall of Fame.

When selecting a business name, consider these elements:

- **Names of competitors**—Your name should distinguish your business from its competitors, but still fit within the industry. For example, in many locations law firms use only the last names of the partners. The name Legal Ease is creative, but it may set a new law firm too far apart from its competitors.

- **Message it communicates**—Your company name should fit with your business image. The name Curl Up and Dye might be a creative name for a hair salon in writing, but potential customers may not be impressed when they call to make an appointment and are greeted with, “Curl up and die.”

- **Uses of the name**—Will the customer’s primary experience with the name be written or oral? Your business may have a cool sounding name, but if customers can’t spell it, they may not be able to find your phone number or website to contact you.

- **Business it describes**—Organized Living® and Holiday Inn® are more descriptive of their products or services than Verizon and Amazon®. A descriptive business name can help create the image you desire.
In Chapter 5, you learned that your company name, product names, logos, and taglines are intellectual property and should be trademarked or registered. Remember to talk with an attorney about protecting them.

More Info

5 Branding Myths Debunked—Don’t get tripped up by these common misconceptions. entrepreneur.com/marketing/branding/webbrandingcolumniststarrhall/article201918.html

Business Name and Tag Line Generator—19 steps to follow to create imaginative company names or tag lines. yudkin.com/generate.htm

The Art of Branding, Guy Kawasaki—A blog entry about the art of branding. blog.guykawasaki.com/2006/01/the_art_of_bran.html#axzz1HuRsrMVL

9.1.4 Location

Today’s business environment offers you more options for choosing a location than ever before. Will you need a storefront for customers to come to? Will you choose an office suite or a home office? Location, accessibility, parking, and visibility all have an impact on your ability to reach your market.

Product-based businesses may need warehouse space in addition to administrative areas such as accounting and customer service. Many service businesses start out in the entrepreneur’s home and then expand to commercial office space as needed.

Here are some of the many location options available to you:

- **Home office**—Can you start your businesses using space in your home? This option is the most cost-effective and allows you to use existing space, furniture, and amenities without incurring too many additional expenses. Check with your accountant on home office tax deductions you may be able to take.

- **Executive suites**—You may want to sublet office space on a temporary basis. This type of commercial arrangement usually offers a phone line, mailbox, shared receptionist, business equipment, such as fax and copy machines, lunchroom and vending services, and conference rooms. Depending on the monthly fee for services, the receptionist can answer your business calls, take messages, or page someone for assistance. Most executive suites also offer a virtual tenant option for entrepreneurs who want a physical location for mail and a phone line, but choose not to rent office space.

- **Commercial leases**—You can lease office, production, and warehouse space based on square footage. Monthly lease rates depend on the going market rate in your area and the size of the space you lease. Long-term contracts are generally required. Some leases allow for entrepreneurs to sublet extra space to other companies. You might sublet part of your space to another business or you might find a current business owner to sublet a section of their space to you. If you choose either of these options, make the selection carefully to be sure that the...
businesses are complimentary rather than competitive. In addition, make sure the business values and images are in alignment.

There’s a lot to know about negotiating commercial leases. Read the fine print about policies on subletting space and early lease-terminations. Do not sign a lease before consulting an attorney experienced in business leases. Many items in a lease are negotiable. Neighboring businesses can help you learn about the customers who frequent the area and how satisfied they are with the traffic flow and the landlord.

- **Buying or developing a building**—Although it’s not always a feasible option for a start-up business, you can buy an existing office building or have one custom built to meet your needs. One of the big advantages of owning your own building is that, in the long run, your business has real estate equity and can lease out space to other companies. Talk with your accountant before making this decision and compare the tax advantages of leasing or buying the space you need.

- **Business Incubators**—Another option for some businesses is to locate within a business incubator. These facilities provide a professional business environment for a variety of businesses. In addition to space, incubators typically provide shared administrative services and access to equipment. They might also provide management assistance, access to capital, manufacturing facilities, advisory boards and training. Many incubators are funded through economic development agencies and the government while others are supported by academic institutions. Incubation programs are specifically designed for start up businesses and provide support for a variety of industries from the arts to high technology.

If customers will be coming to your business location, select a location that matches your marketing strategy to reach your target market. Are you expecting walk-by traffic? Will people drive out of the way for your products or services?

Considerations about your business location should include the following:

- Cost and lease terms
- Suitability of physical space
- Demographics of the area
- Customer traffic in the area
- Visibility to potential customers
- Ease of access for customers
- Parking availability
- Image of the space
- Competitors’ locations
- Neighboring businesses
- Availability of employees

When you have settled these marketing issues that have long-term impact on your brand, such as your name and location, then you can turn your attention to the specific marketing messages you want to communicate to reach the customer you have identified as most likely to buy from you.

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**Tip**

It can be difficult to anticipate the exact amount of space you will need for your business. Many entrepreneurs find themselves moving multiple times to accommodate growth.

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**Reality**

Don’t select a space just because the rent is low. The low price may reflect low desirability. The location won’t seem like a bargain if your customers don’t want to come to it.

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**Tip**

Your local Small Business Development Center, chamber of commerce or Department of Transportation may be able to direct you to information on traffic counts and demographics for a specific business location.
More Info

How to Find the Best Location—What “location, location, location” means and other related factors to consider as you search for the right spot for your business.

entrepreneur.com/startingabusiness/startupbasics/location/article73784.html

Loopnet—This commercial real estate site provides insight into property types and their costs. In addition, each listing provides demographics for the area surrounding the property. loopnet.com

from real entrepreneurs

Valerie Jennings of Hippie Chow Granola needed an approved kitchen facility when she started making granola for her business. She got creative and located space in a kitchen at the local county fairgrounds. As her business grew, she was able to find shared part-time commercial kitchen space at a local culinary incubator.

9.2 Communicating the Brand
9.2.1 The Brand Message

Your brand encompasses the total experience customers will have with your company from the first sale. It is more than the company’s name, tagline, and advertising. It is projected in how the phone is answered, what the invoices look like, the company’s involvement in civic organizations and causes, and so much more. In essence, everything you do communicates your image.

Consider the inconsistent brand message sent when an eco-friendly business owner drove to work every day in his Hummer. Luckily, he recognized the confusing message he was sending and quickly replaced his car with a fuel efficient model.

The bad news is that once you establish an image, it is difficult to change the way customers view your company. The good news is that you can build a strong brand image without breaking the budget. Planning how to effectively communicate your brand will save you time, money and your business’s reputation in the long run.

9.2.2 Define the Message

Before you create marketing collateral, define what you want your brand to communicate to your target market. Maybe you want to communicate more than one message, or, perhaps, you want to communicate the same message to more than one target market.

Many entrepreneurs start by identifying the core values they want to communicate to customers. Core values are important characteristics that entrepreneurs personally possess and want reflected in their business. Common core values include integrity, responsibility, honesty, and community service. As the business owner, you can set the tone of your business and link your products or services to your intended target market by the type of message you communicate in your marketing materials.

Tip

The visual image of a business is reinforced through its website, signage, and printed materials.

Tip

Test your brand ideas on members of your customer profile. Your perspective is not as important as theirs.
9.2.3 Convey the Message

The next step in building your image through branding is to decide how to convey your message. Once you have identified your company’s core values, you can create a mission statement that describes what customers and employees can expect from doing business with you. A mission statement highlights your core values and states a promise to meet customers’ expectations. You may already have written the essence of your mission statement in your business concept statement in Chapter 3. Look it over now and consider what you could use from it to turn into a branded mission statement.

Your message to the public might take the form of a story. To communicate his passion for his coffee business, Danny O’Neill of The Roasterie® 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…”

Similar messages may be communicated in employee handbooks, company policies, and in marketing materials. Valerie Jennings, Hippie Chow Granola, communicates to her market through her tagline “Peace. Love. Granola.” Some companies create guarantees or statements that highlight their competitive advantage, particularly when the advantage promises superior service or a high-quality product. For example, one company’s website states, “We are committed to building value not only for our customers and our business, but also for the communities that our company and our employees call home. We strive to participate responsibly in the global marketplace in which we operate.”

These examples may help you identify messages you intend to communicate to customers through your brand:

- We hire the best, deliver the best, and stand behind our work.
- We appreciate your business and work to surpass your expectations.
- We treat our customers and employees like family.
- Quality you can trust. Guaranteed.

Every aspect of your business communicates a message about your image to the customer, including cleanliness, landscaping, hours of operation, employee appearance, and customer service.

9.3 Marketing Materials

9.3.1 Designing Marketing Materials

Once you have defined your message and decided how your brand should be communicated, you are ready to design marketing materials to promote your business and build your brand. You can spend a lot of money designing and developing marketing materials to build your brand. Depending on your budget, you may choose to start with a few items and then add others when you have more to invest.
Determine which marketing materials to start with by thinking about how you are most likely to reach your target customer. Will flyers, brochures, or direct mail be a good approach for your audience? If you think you may change the marketing content on a frequent basis or are trying to reach a plugged-in market, perhaps a website or electronic marketing is a better path to pursue. The following discussion outlines common marketing materials businesses use to promote their brand.

9.3.2 Logo

Your logo is usually the first thing potential customers notice and is a critical part of your company’s brand. The purpose of the logo is to identify the company, communicate a message, and leave a lasting, positive impression with the customer. Some companies, like Nike® and Coca-Cola®, can be identified by their logos only, reflecting the power of a well-designed logo.

A successful logo design will be:

- **Timeless**—A logo, like classic clothing design, does not become dated over time. Stay away from trendy designs and colors. Consider a logo that will identify your company’s look ten or twenty years from now.

- **Symbolic**—The logo should convey some type of symbolic meaning that contains literal or metaphoric imagery. A candle, for example, may symbolize eternity, light, or leadership. Colors also convey symbolism. For example, blue represents loyalty and bravery, while white communicates purity.

- **Simple**—A logo should be readable and reproduce clearly in both color and black-and-white images. An ornate logo may not communicate your message quickly.

- **Unique**—A logo should be identified with a specific company. Use distinctive features such as vivid or contrasting colors, interesting design elements, or an optical illusion that is easy to distinguish.

You may think using a professional designer for your collateral materials is cost prohibitive. Although doing it yourself may appear to cost less, it may take you longer, and the results may be less than professional. Stick to your strengths and use outside help when it’s appropriate.

9.3.3 Business Cards and Stationery

Once your logo is designed, incorporate it into your business card and stationery design. Today, a variety of options exist for these collateral materials in color choices, paper texture, and graphics. Although the initial design costs may seem high, business cards and stationery are often the most cost-effective marketing pieces you can use to promote your business.

Consider these options and guidelines before designing your business card and stationery:

- What are the benefits of putting your photo on the business card?
- Do you want prospective and current customers to be able to write on the back of the business card?
• How will you use business stationery as part of your regular correspondence (for example, letters, proposals, thank you notes, follow-up, inquiries)?
• Will you need additional pages of stationery for longer letters or proposals?
• Will you use note cards for handwritten correspondence (for example, thank you notes, invitations, staying in touch with customers)?
• What do you want imprinted on the envelopes (for example, logo, business name, tagline, mailing address)?

9.3.4 Brochures and Flyers

The purpose of a brochure or flyer is to provide overall information about a company or a specific product/service. Depending on how you plan to reach your target market and its preferences, decide if you need a brochure or flyer to market your business. Not every business needs a brochure. Some businesses such as dry cleaners or car washes use flyers to promote their services. Consultants and engineering firms may use brochures to send to prospective clients. If you market to a younger target market, you may find that this audience prefers electronic marketing and online resources. In that case, you may be better off investing your resources in a website rather than print materials. Consider these questions before producing a brochure:

• How will the brochure be distributed (for example, trade shows, proposals, letters, sales presentations)?
• How many brochures do you estimate using monthly, quarterly, or annually?
• How often will brochures be updated to reflect changes?
• Can flyers or postcards be used in place of brochures? If so, when and how will this substitution change the quantity you need of each?

A business’s logo, stationery, brochures, flyers and website all provide visual images of the brand to the target market. These materials should reflect a consistent look and message. Don’t overlook your invoice. Your logo should appear there as well. A brand is reinforced when customers recognize the business when they see its materials.

9.4 Create a Digital Presence

9.4.1 Promoting Electronically

Promoting your brand and business electronically typically requires a multifaceted approach, including both a website and presence on one or multiple social media venues. Just as with other marketing opportunities, a careful analysis of your target market and customer profile will help you determine how to best communicate with potential and current customers electronically.

Tip

Hire a graphic designer to achieve a distinct identity and professional look for all your materials. And don’t forget the website. Customers should know they are at your website by the overall look.
9.4.2 Website

Websites are standard for doing business in many markets. Most customers will expect you to have one. Even if you don’t plan to transact business on your website, having one to showcase your business builds credibility. 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 every day 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.

Creating an effective website entails more than just hiring a designer to put up a pretty homepage. It 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.
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 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 expert 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, albeit 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/services online? If yes, consider e-commerce capabilities and security issues. An electronic catalog can be made available to customers on your company website. The advantages include no printing or mailing costs and product/service descriptions and prices can be updated anytime.

Who will manage and maintain my website once it has been launched? 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.

My site is launched, now what? The marketing begins. Think of the launch of your website as the opening of a store. Send out press releases, e-mail customers and partners, 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 when the site is launched. 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.
9.4.3 Social Media

Social media is transforming the ways companies do business. It offers unprecedented ways to reach customers and plays 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.

Consider setting up a Linkedin site for your business. There are interest groups for most industries or professions, making it a useful platform for sharing solutions and building your professional reputation.

**Twitter**—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 or to provide quick updates about hours of operation or specials.

Tax preparation giant H & R Block uses Twitter for customer care@HRBlock as a quick response vehicle for addressing customers’ questions with links to the corporate website or to connect them with service representatives directly. The feed is an immediate channel to inform customers of tax code changes or tax-related news.

**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, 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.

**Facebook**—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. Use it to promote incentives, sales and specials, share news, announce events, and provide content that creates loyalty to your business.

A survey by Lucid Marketing found that many moms use Facebook to communicate with family and friends; that three-quarters had “fanned” at least one brand; and that
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**—Thanks to blogging software such as WordPress or Blogger, any business can have an attractive, dynamic site of their 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.

### 9.4.4 Increasing Social Media Effectiveness

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 or support your business goals and to attract 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.

### More Info

SBA Video—Fuego Mundo discusses how social media has become a critical part of their marketing program. (3:11)  [sba.gov/content/fuego-mundo-interact-with-your-community-using-free-marketing](sba.gov/content/fuego-mundo-interact-with-your-community-using-free-marketing)

SBA Video—Lumus Construction explains how they engage customers through their website. (2:29)  [sba.gov/content/lumus-construction-engage-customers-with-website](sba.gov/content/lumus-construction-engage-customers-with-website)

SBA Video—The owner of Asset Group discusses why a website is important and what it should include.  [sba.gov/content/strategies-growth-technology-and-growth](sba.gov/content/strategies-growth-technology-and-growth)

SBA Video—Salon Red: Establish your Online Presence (3:21) A salon owner explains what an online presence did for her business.  [sba.gov/content/salon-red-establish-your-online-presence](sba.gov/content/salon-red-establish-your-online-presence)

Building Your Brand with Social Media—Five steps to establishing a credible online presence for your small business.  [entrepreneur.com/article/217815](entrepreneur.com/article/217815)

Networks Solutions—Check for existing domain names or register a domain name.  [networksolutions.com](networksolutions.com)

Topics in E-mail Marketing, ClickZ Experts—Advice on how to strategically use e-mail to market your business.  [clickz.com/type/column/category/email](clickz.com/type/column/category/email)

### 9.4.5 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 are mentioned online. TweetBeep.com will notify you if you are mentioned on Twitter. Facebook also has an insights function (facebook.com/help/search/?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.
9.5 Enhance Customer Service

9.5.1 Customer Service Strategies

As part of your Marketing Plan, customer service strategies can build the reputation you desire for your business and products/services. No matter how carefully your company operates, sometimes customers will be unhappy. If you can resolve customer problems, you may win a customer for life. As part of your customer service strategies, establish policies for warranties, guarantees, and customer complaints. Industry standards for returns and service costs can serve as a baseline for determining what you might encounter and how others have handled these issues.

Employees are the face of the business to a customer; they comprise part of the brand image and its message. Train employees so they know exactly how you want them to treat customers. Most businesses do not adequately empower their employees to handle problems. An unhappy customer does not want to be told to wait until the employee can check with the owner.

Customers like to feel appreciated and recognized for their patronage. Frequent-buyer punch cards and special sales for preferred customers are some of the ways businesses build customer loyalty. Consider how you will build on each first-time sale and create reasons for customers to buy from you again. As your business grows, you may also want to create incentives for customers to provide referrals. Don’t forget to calculate the financial impact of these incentives on your cash flow and profitability.

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Tip

Listen to your customers. Customer feedback cards can keep you in touch with what your customers expect. The most valuable ones are those with complaints. If you follow up with customers who have quit buying, you may get valuable feedback and encourage them to come back.

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from real entrepreneurs

“I want to keep taking things off customers’ to-do lists,” says 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 restaurants 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.

9.6 Marketing Activities

9.6.1 Reaching the Target Market

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 won’t work for your new business. Registering with the secretary of state and printing business cards doesn’t mean customers will magically appear with cash in hand.
To reach your target market, you will promote your products or services over and over again and convince potential customers that your product/service meets their needs. The marketplace is highly competitive and your potential customers have many options to choose from, including your new business. You have to convince them that your product/service is as good, if not better, than the other choices available.

Reaching the target market successfully involves using a combination of approaches. In this section, you’ll explore a mix of marketing activities and determine which might be appropriate for your business. Then, you will analyze that marketing mix and select those options that best support your marketing strategies.

A good marketing mix incorporates advertising, publicity, and promotional strategies. Advertising alone is ineffective. Publicity can provide great company visibility, but is difficult to sustain without using other effective marketing strategies, and the media will only do so much for any one company. Promotions bring in the crowd intermittently, but require ongoing time and investments. If you offer incentives too often, customers may wait until the next incentive before buying again.

Technology has changed the way businesses promote products and services. Internet marketing, when used as part of a comprehensive marketing plan, can build sales and target a large customer base inexpensively. Business websites can show and explain your product/service, take orders using e-commerce or secured transaction protection, provide customer support for your product/service, and in some cases even deliver the product/service over the Internet. For example, people can buy an e-book and download it within seconds of purchasing it. You can use e-mail to contact new customers, promote products or services, offer special discounts, or remind customers about a specific product/service now available. Keep these electronic options in mind as you consider the marketing mix that is best for your business.

Keep in mind that marketing always involves time, money, or both. You can’t do everything on your wish list at once. You will need to prioritize your marketing investments.

### 9.6.2 Advertising

Advertising is one way to get information about your product/service to potential customers. Because advertising can be expensive, you will want to limit your reach to a very narrow target market—which means getting in front of specific prospects most likely to be interested in what you offer. For example, if you have a day care center, advertising it in selective local publications that target parents with young children may be less costly and more effective than an advertisement in the city newspaper. Or, you could consider advertising in school newsletters that reach families within a ten-mile radius of your center. Advertising is only effective if it reaches the eyes and ears of your intended audience.

Find out which media are most likely to reach your target market. Then, use your competitive advantage and brand messages in your ads. Focus on what’s unique about your business, product, or service and how customers will benefit from doing business with you.
Print and Media Advertising

Print and media advertising sites include newspapers, magazines, television, radio, and the Internet. In choosing among these options, consider how consumers reading and listening habits have changed. Traditional newspapers, in particular, have experienced precipitous declines in readership and revenues as online readership grows. Television viewing is more fragmented with the hundreds of channels viewers have at their fingertips.

If you are considering advertising in any of these venues, you need to ensure that the advertising will yield the results you desire. The medium needs to produce quick results and rapid sales. Consider the advantages and disadvantages of each of these advertising venues.

from real entrepreneurs

When a Boston public radio station needed office relocation assistance, entrepreneur Gretchen Fox saw an opportunity to get the message out about her new company. Instead of a fee-for-service arrangement, she swapped her relocation services for radio spots promoting Fox Relocation. The market synergy was perfect; top executives of professional and financial firms in Boston listened to the station. 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.

Tip

Don’t expect results from a single ad. Marketing experts believe average consumers need to hear or see a message at least seven times before they act.

Advertising in traditional media 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, however, 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.
### Other Forms of Advertising

**Print and media advertising**—Print and media advertising sites 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. The medium needs to produce quick results and rapid sales. Consider the advantages and disadvantages of each of these advertising venues:

<table>
<thead>
<tr>
<th>Medium</th>
<th>Advantages</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Newspapers</strong></td>
<td>Reach a large audience</td>
<td>Short life span of ads</td>
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<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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<td></td>
<td>Have short deadlines that make placing or changing ads easy</td>
<td>Clutter of other ads</td>
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<td></td>
<td>Offer special feature sections and articles</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>Have 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 a superior production quality</td>
<td>Fewer options for ad sizes and formatting</td>
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<td></td>
<td>Offer unsold spaces at deeper discounts</td>
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<td></td>
<td>Provide extra services such as reader-response cards which allow you to build a mailing list</td>
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<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>
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<td></td>
<td>Conveys messages using visuals, language, sound, and motion</td>
<td>Short exposure</td>
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<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>
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<td></td>
<td></td>
<td>Competition from national and larger companies</td>
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<tr>
<td><strong>Infomercials</strong></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>
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<tr>
<td>(cable television show)</td>
<td>Reach large population bases where high sales can result</td>
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<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>
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<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>
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<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>
Other popular advertising venues include direct mail, flyers, catalogs, and ads as well as new and creative advertising options that are just emerging.

Direct mail—Direct mail means sending marketing information and sales literature to potential customers by mail. Direct-mail marketing provides a way to reach a large number of customers quickly. It is selective and accountable because it allows you to easily measure the response. The accuracy of the mailing list makes a major impact on the effectiveness of your campaign. If you purchase a mail list, beware that many lists are only updated annually and the contact information may be outdated quickly. Some lists are one-time-use only and suppliers can track how often the labels are used by planting fictitious names and addresses throughout the list.

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 averaging about 1 to 3 percent. Know who your typical customer is and develop your own mailing list around that customer. Carefully targeting the recipients will improve your response rates.

Before undertaking an extensive or expensive direct mail campaign, you should test the promotion on a limited basis. You can use the results of the test to improve the mailing before expanding it. For example, a printing company can send out a direct mail campaign to a hundred local businesses and measure the results before mailing out 5,000 postcards.

Your best mailing list comes from actual customers. If you keep track of names and addresses via receipts and order forms, you automatically have a list. Asking customers to sign a list or enter e-mail information builds your customer mailing list.

More Info

Video—SBA award winner, Brenda Reynolds of Sweet Success, discusses how she uses direct mail to market her business. (7:52) sba.gov/content/sba-delivering-success-promoting-growing-your-business

Audio, Database Marketing for Sustaining Customer Loyalty—Useful tips on how to build a “smart mailing list.”

Direct marketing Association (DMA)—The DMA monthly newsletter covers government activities regarding direct mail and the association’s lobbying efforts. the-dma.org/index.php

Tip

Although flyers are inexpensive to design and produce, they should maintain the look and feel of our other marketing collateral. Avoid too many type fonts, sizes, or colors. Maintain the image you have set for your business.

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 since you can design them 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 sales. Online catalogs greatly reduce catalog distribution costs. Develop a targeted customer list before investing in catalog production.

**Web banners**—You can place advertisements for your company, product, or service on other companies’ websites. Some banners appear along the top or sides of the web page, while others open separate windows.

**The Not-So-Ordinary Options**

Entrepreneurs are exploring newer options for advertising that allow them to target customers based on behavioral variables. Ads can be placed in airports, on ski lifts, and even on television monitors in grocery 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.

Once you know which medium you want to use for advertising, you can decide on the format that works best and the message you want to present. For each medium you can find experts who can help you design advertising that fits your goals and budget. Effective media advertising meets the following criteria:

- Creates awareness, arouses curiosity, and persuades the audience that your product/service meets its needs.
- Educates the audience about the benefits and uniqueness of your product or service in a way they can understand. The ad provides contact and purchasing information.
- Uses illustrations, metaphors, or analogies conveyed through words, images, or sounds that grab and hold the audience’s attention.

**9.6.3 Publicity**

Besides paid advertising, you can get the word out about your business through publicity. Publicity is known as “free advertising” because stories or notices about businesses, products, or services are published by the media at no cost. You can use publicity to market your business when it’s new and once it’s established. Public relations specialist with experience in your industry can be especially helpful in guiding your initial publicity efforts and opening doors based on the media connections they have.
from real entrepreneurs

Having your picture on over 20 million cereal boxes is the kind of publicity most entrepreneurs could only dream of. When Kathy Dibben of Absolute Dignity, a retail specialty boutique in Smithville, Missouri, was first contacted about being featured on General Mills cereal boxes, she thought it was a hoax.

Kathy is a two-time breast cancer survivor. General Mills discovered Kathy through her company’s Myspace website and wanted to include her, along with four other ambassadors for Pinktogether.com, their breast cancer awareness campaign on cereal boxes. Kathy was later also featured on Fiber One Bars and Chex Mix Select.

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.

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.” Ever since, publicity rather than advertising has been the cornerstone of their marketing mix—so much so that their paid advertising costs were less than $1,000 the next year.

Today, the Three Dog Bakery Foundation continues to attract media attention as it strives to raise awareness of and support for dogs in need. Donating up to 1% of net profits annually to its Foundation, they award ‘Gracie Grants’ to deserving organizations across the country that help underprivileged pets and that place an emphasis on adoption, spaying and neutering and have a no-kill policy.

Tip

“Free advertising” or publicity can be expensive in terms of the time and resources you invest in it. When planning publicity efforts, consider the time requirements as well as the financial costs of contacting editors and submitting information.

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 or two pages. 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, especially those that feature these components:

- Controversial issues
- Links to current local, regional, or national news
- New trends
- Celebrity or well-known personalities
- Shock value or hard-to-believe facts
- Timeliness

And don’t forget that your business’s grand opening may warrant a press release as an event of interest to your local community.

Using press releases, you might also establish yourself as an expert on a topic related to your industry. For example, the owner of a lawn and landscape business might send press releases with tips for maintaining a healthy lawn. The media may or may not run the tips. However, even if they are never used, there is a chance that the owner could be called as a source of expert advice during a summer drought.

**Community Recognition**—Other ways you can gain positive publicity are by sponsoring an award or community event or donating your product/service as a prize for a local charity. This recognition provides visibility to your business as well as for the charity or causes 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, make categories for entries, and offer awards or prizes to the winners. For example, if you are a photographer, you could stage a “Best Vacation Shot” contest and set the criteria for winning. Of course, you or a celebrity panel can be the judges, and you can display the entries on your website. Or, contests run through Facebook can be an excellent way to increase your fan base.

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.

**Tip**

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 the editor or reporter for suggestions.

**More Info**

Chase’s Calendar of Events—A comprehensive reference of more than 12,000 special events, holidays and anniversaries. A useful tool for creating a news angle for a press release. Copies are usually found in libraries. [mhprofessional.com/templates/chases/](http://mhprofessional.com/templates/chases/)
9.6.4 Promotions

You have to find ways to promote your products or services to the same buyers or target market over and over again. Do not underestimate 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/service demonstrations. Telemarketing, trade shows, and networking also may be ways that you get the word out about your business and stay in front of your target market. Emerging technologies also offer avenues for promotion.

**Premiums**—Premiums or gifts offer prospects or customers something at no extra charge. Also called promotional products or advertising specialties, premiums include t-shirts, mugs, magnets, or unique gadgets to capture people's attention.

The objective behind premiums is to provide 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 volume orders, so it pays to order in larger quantities.

**Coupons**—Coupons provide a variety of options to promote your business. Coupons may offer a price reduction, two-for-one offer, or incentive for purchasing products or services. An incentive can be anything from a free gift, an opportunity to win a grand prize, or discounts on future purchases. Companies such as Groupon, Living Social and Restaurant.com have become a popular means of offering coupons with a twist by offering customers the option to buy into a good deal.

Rebates fall into the same category and are redeemed by the customer or by the vendor who sold the product/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. Online coupons using current and targeted customer lists encourage return store visits and repeat purchases.

**Demonstrations**—Demonstrations, or demos, allow prospects and customers to try a product/service before they purchase it. Although demos may be expensive since they require planning, labor, and other hard costs, they allow people to sample what they normally might not buy, and 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.

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With no sales her first day in business, out of desperation Debbi Fields put her cookies on a cookie sheet and left her store to go up and down the street, stopping people and even buses to offer samples of her now legendary Mrs. Fields® Cookies. Responses were so positive that some customers followed her back to the store to make purchases, launching her “try it and buy it” approach to marketing that is still used in many of her stores today.
Telemarketing—The telephone is a major sales tool as a result 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. 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.

Networking—Word-of-mouth marketing through networking is the 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 and more comfortable.

Trade Shows—Another face-to-face opportunity to interact with prospects is to participate in trade shows. 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 well as 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. Making the most of a trade show requires that the entrepreneur plan how to attract traffic to their booth, quickly build rapport, and follow up on leads.

E-Newsletters—Stay in touch with customers, educate them about new products or services, and offer incentives that they can download and use for their next purchase through your company’s e-newsletter. This form of communication costs less than a print version of a newsletter by eliminating printing and postage costs.

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 and social media sites 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, electronic communication is faster and, sometimes, more reliable.

More Info
Small Business Sourcebook—Reference book found in most business libraries. Provides sources of information for over 340 industries including trade associations and trade show details.

Trade Shows: A Key Tool For Marketers—Provides a nine-step plan to execute a solid trade show presence, such as meet with media at the show and allow attendees to demo your product/service. entrepreneurship.org/en/resource-center/trade-shows-a-key-tool-for-marketers.aspx
Video—SBA Delivering Success: Marketing 101 (12:42). This SBA video highlights how four small business owners have implemented a variety of marketing techniques to build a customer base. [sba.gov/content/sba-delivering-success-marketing-101](http://sba.gov/content/sba-delivering-success-marketing-101)

Video—SBA Strategies for Growth: Marketing (6:59)—middle video. Casey Willson, Marketing expert with the Maryland Small Business Development Center, offers advice on various techniques used when marketing a business. [sba.gov/content/strategies-growth-marketing](http://sba.gov/content/strategies-growth-marketing)

Do More with Less—New communications and PR tools offer marketers less costly (and equally effective) alternatives for building brand and product awareness. [entrepreneur.com/marketing/publicrelations/prcolumnistrachelmeranusarticle200452.html](http://entrepreneur.com/marketing/publicrelations/prcolumnistrachelmeranusarticle200452.html)

Guerilla Marketing Articles—Nearly 200 articles on a variety of marketing topics on a site hosted by guerilla marketing guru Jay Conrad Levinson. [gmarketing.com/articles/](http://gmarketing.com/articles/)

### 9.7 Sales Methods

#### 9.7.1 Developing a Sales Strategy

All the marketing strategies in the world will be ineffective if they do not result in sales. No business will survive without sales. Without sales, you cannot pay for overhead and operating expenses. No sales—no profits.

Sales methods vary widely depending on the industry, sales volume, type of products or services being sold and resources the entrepreneur has 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 additional methods used by businesses outside your industry.

Sales methods can generally be broken down into those using an internal sales team and those using an external sales team.

#### 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>Company can direct their sales efforts</td>
<td>Call their own shots</td>
</tr>
<tr>
<td>Compensation</td>
<td>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 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 company’s knowledge or personal relationships</td>
<td>May have pre-existing customer relationships</td>
</tr>
<tr>
<td>Products sold</td>
<td>Only the company’s</td>
<td>Often sell products of more than one company</td>
</tr>
<tr>
<td>Customer service</td>
<td>Provided by the company</td>
<td>Provided by the sales agent</td>
</tr>
</tbody>
</table>
9.7.2 Internal Sales Methods

In an internal sales method, individual or 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/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.

These 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 don’t 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 the business and are paid straight salary, salary plus commission, or straight commission. The advantage of using a direct sales force is that you can orchestrate their sales efforts and monitor their activities closely. 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 successful sell products or services over the Internet or on websites. Technology is quickly changing industry distribution patterns, such as in the distribution of books, music, and software products. Using this method initially allows some sales functions to be done electronically. Over time, this sales method will increase the need to hire other staff in operations or to outsource entire functions such as sales processing and fulfillment.

9.7.3 External Sales Methods

The advantage of using an external sales method is that your company does not incur any sales costs until the customer pays for the product/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 disadvantage is that you have no control over external sales teams since they are subcontractors and do not work directly for you.

Tip

Using external sales methods may be a good strategy during your start-up phase. Paying commission after the customer pays for the products or services helps you manage cash flow.
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 up-front and annual fees, licensees typically pay the licensor a royalty percentage for each product sold. If you have a solid product, in many cases you can grow faster by licensing the rights to sell your product/service to other entrepreneurs.

Licensors rates for licensing their product/service are typically between 5 to 12 percent of wholesale revenues over the life of the agreement.

**Tip**

Both the licensee and the licensor should seek professional advice from an intellectual property attorney before signing a licensing agreement.

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Opus®, makers of bird feeders in Bellingham, Massachusetts, secured a license to use the Disney name to help tap the kids’ market. Opus invested $50,000 upfront in design, merchandising, and promotion, consulted with Disney during the year-long process, and was ultimately able to place the Opus/Disney feeders in about 3,000 stores.

**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 some common products that have well established wholesale distributor channels. Earlier, you looked at potential distribution or marketing channels for your product/service. In this context you can see why distribution is a marketing issue because it affects your approach to sales.

**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 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 incurred in selling your product/service such as product samples, travel, office, telephone, and supplies. You save the cost of full-time employees.

**Tip**

Investigate how open members of an existing distribution system are to offering new products or the products of new a business. Often distributors look for established products and companies.

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**More Info**

Video—Seed the Clouds and Watch the Sales Grow (3:57) Guy Kawasaki looks at who really buys the product or service and how to focus sales to reach those individuals.

[ecorner.stanford.edu/authorMaterialInfo.html?mid=1180](ecorner.stanford.edu/authorMaterialInfo.html?mid=1180)

Technical Sales Association—A Network for Advancing Technical Sales.

[technicalsalesassociation.org/site/](technicalsalesassociation.org/site/)

American Wholesalers and Distributors Directory—Industry information on 31,000 U.S. wholesalers and distributors. Usually available in business libraries. Publisher’s website.

Scenario 9.7.3

Run KC—Branding and Marketing a Business

Learning Objectives

• Define a company’s brand.
• Recommend market penetration tactics for a given product/service.

Overview

To attract customers who fit the defined customer profile, a business should establish an image that aligns with their customer’s needs and expectations. A company can influence the business’s image by creating a brand which paints a picture of the company, the product or service, and the customer it represents. A brand should create a visual, emotional, and cultural connection between customers and the company. An entrepreneur can establish a brand for their company through the many points of contact they have with the customer. This might include everything from marketing collateral to physical layout/environment, uniforms or dress codes, customer service, and packaging design.

Scenario

The customer profile that Tim has identified for Run KC can be described as follows:

• students and educated professionals
• incomes over $75,000
• primary age range 30-60 years; secondary age range 14-29 years

From this experience in the industry and as a runner, Tim believes that to succeed, he must meet the key needs and expectations of his customers, which include quality, experience, support, and knowledge of both the sport and products. He also knows that customer service is critical. His observations over time have taught him that while most businesses say they have great customer service, few really do. Therefore, he feels that he should make sure this message comes across both in the company’s image and in reality.

Step 1

Creating a Brand

Tim has identified “quality, experience, support, knowledge, and excellent customer service” as the adjectives or phrases he wants customers to use when they think about or describe his business. How would you recommend that Tim communicate this message to establish a brand? Where should these terms appear? Check the methods you recommend. Then, indicate how he can use each method to establish the Run KC brand.
Check

_____ Company Name
_____ Logo/color scheme
_____ Taglines/slogans/jingles
_____ Customer service/experience
_____ Ads
_____ Business cards and letterhead
_____ Brochures
_____ Flyers
_____ Publications
_____ Promotional products
_____ Website
_____ Point-of-purchase displays
_____ Product packaging and labeling
_____ Physical layout and décor (themes, colors, patterns, icons)
_____ Signage
_____ Uniforms or dress code
_____ Other

Step 2
Marketing Activities

Advertising

How would you recommend that Tim use advertising to reach his market? Remember, because advertising can be expensive, you want to be sure the advertising gets in front of those prospects most likely to be interested in what is offered.

Indicate those advertising options you would recommend for Run KC with a checkmark. Then, provide specific information regarding how you might use the options checked. Reference the Print and Media Advertising Chart within section 9.6.2 Advertising.

Check

_____ Newspaper
_____ Magazines
_____ Television
_____ Infomercials
_____ Radio
_____ Direct mail
_____ Flyers
_____ Catalogs
_____ Web banners
_____ E-commerce catalogs
_____ Social media
_____ Other
Publicity

How would you recommend that Tim use publicity to reach his market? Publicity is known as “free advertising” because stories or notices about the business’ products or services are published by the media at no cost. In order to gain publicity, however, the business owner must usually create or promote something unique or compelling about the product/service that would interest the media’s audience. Indicate those publicity options you would recommend for Run KC with a checkmark. Then, provide specific information regarding how you might use the options checked.

Check

_____ Feature story
_____ Press release
_____ Sponsor award
_____ Sponsor community event
_____ Contest
_____ Industry expert
_____ Other
_____ Other

Promotions

How would you recommend that Tim use promotions to reach his market? Do not underestimate the importance of staying in front of potential or existing customers. The most common promotional activities include premiums, coupons and rebates, product or service demonstrations, and networking. Indicate those promotional options you would recommend for Run KC with a checkmark. Then, provide specific information regarding how you might use the options checked.

Check

_____ Promotional products
_____ Coupons
_____ Demonstrations
_____ Telemarketing
_____ Trade show
_____ Networking
_____ E-newsletters
_____ Web page
_____ Social media
_____ Sponsorship
_____ Samples
_____ Other
Exercise 9.7.3: Branding and Marketing Your Business

Learning Objectives

- Define your company’s brand.
- Examine market penetration activities and identify those which might be appropriate for your business.

Overview

There are literally thousands of methods which could be used to promote a business. An entrepreneur should carefully study various methods and determine which are most likely to effectively reach and connect with their target market. This will provide the entrepreneur a mix of advertising, publicity and promotions which might be used to execute the business’s marketing strategy.

Step 1

In small groups, brainstorm a list of all the promotions/advertisement/publicity methods you can think of. The large group leader should then develop a master list on a flip chart or whiteboard by having each group contribute one method at a time until all groups run out of ideas. As the class creates a master list, you should add those that you haven’t already noted to your own list.

Step 2

Go back over the list and circle any methods that you would consider to be Publicity. The remaining items on the list are advertising and promotions. This will help clarify the difference between advertising and publicity.

Step 3

Work through the following worksheet to develop an initial list of possible marketing activities for your business. In Exercise 9.8.2, you will develop a marketing strategy and then determine which of these methods support that strategy.
Brand Marketing Your Business

Directions: Answer the following questions in preparation for writing the Market Penetration section of the business plan.

Creating a Brand

What messages do you want to communicate about your business to customers? What adjectives or phrases do you want your customers to use when they think about or describe your business?

How will these messages support your competitive advantage?

Branding

How will you communicate these messages? Where will they appear in your business? Check the methods you might use to establish your brand. Then describe how each will be used to reflect your brand.

Check

- Company Name
- Logo/color scheme
- Taglines/slogans/jingles
- Customer service/experience
- Ads
- Business cards and letterhead
- Brochures
- Flyers
- Publications
- Promotional products
- Website
- Point-of-sale displays
- Product packaging and labeling
- Physical layout and décor (themes, colors, patterns, icons)
- Signage
- Uniforms or dress code
- Other
Marketing 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 be sure your advertising gets in front of those prospects most likely to be interested in what you offer.

Indicate those advertising options you might use to market your product/service with a checkmark. Then, provide specific information regarding how you will use the options checked (specific publication, station, etc.). Reference the Print and Media Advertising Chart within section 9.6.2 Advertising.

Check

- Newspaper
- Magazines
- Television
- Infomercials
- Radio
- Direct mail
- Yellow Pages
- Flyers
- Catalogs
- Web banners
- E-commerce catalogs
- Social Media
- Other

Publicity
Besides paid advertising, you can get the word out about your business through publicity. Publicity is known as “free advertising” because stories or notices about businesses, product or services are published by the media at no cost. In order to gain publicity the business owner must usually create or promote something unique or compelling about the product/service that would interest the media’s audience.

Indicate those publicity options you might use to market your product/service with a checkmark. Then, provide specific information regarding how you might use the options checked.

Check

- Feature story
- Press release
- Sponsor award
- Sponsor community event
- Contest
- Industry expert
- Other
- Other
Promotions

Do not underestimate the importance of staying in front of potential or existing customers. 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 promote your business. The most common promotional activities to keep you in front of your target market include premiums, coupons and rebates, product or service demonstrations and networking.

Indicate those publicity options you might use to market your product/service with a checkmark. Then, provide specific information regarding how you might use the options checked.

Check

- Promotional products
- Coupons
- Demonstrations
- Telemarketing
- Trade show
- Networking
- E-newsletters
- Web page
- Social media
- Sponsorship
- Samples
- Other

Sales

Think about which sales methods are most often used by competitors in your industry? Check those that you believe will work best for your business. How will you use each?

Check

- Solo
- Internet
- Existing distribution channels
- Direct sales force
- Licensing
- Sales or manufacturer’s reps
9.8 Exploring Marketing Strategies

9.8.1 Focus on a Target Market

As a new entrepreneur, you have a lot to do with few resources. It’s important that you focus your marketing energies on target markets where you have the greatest opportunity to succeed.

Your market analysis in Chapter 8 enabled you to identify your target market and prioritize opportunities. You can now use that analysis to develop a marketing strategy that focuses on:

- Selected target markets you are most able to reach during your first year of business.
- Specific markets and selected products/services that best meet their needs.
- Your competitive advantage.

Marketing strategies focus on a target or niche market, offer a specific product/service to meet unmet market needs, and use specific strengths as an advantage. Sometimes you may need to target more than one market to accomplish your marketing strategy. For example, a security business could target architects, developers, and high-end homeowners in selected zip codes with the goal of being the preferred business for security systems in a geographic area.

The marketing strategy you develop in this program will focus on the target market you have decided to reach during the start-up phase of your new business. Once you have been in business for six months to a year, you may want to develop additional marketing strategies based on the information you gather about customers’ buying patterns, market responses to your product or service, or reactions of your competition.

9.8.2 The Marketing Map

The best marketing plans work from a focused “strategy”, through a set of carefully designed tactics, outward to an array of specific activities to implement. Call it the Marketing Map. Tactics define the marketing message and how it is communicated. Activities are the specific actions that must be implemented for the tactics to be successful. Activities are concrete action items with deadlines and responsibilities. Strategies have little meaning or effectiveness without tactics or activities to support them.

For example, Run KC’s strategy is to maintain high visibility and be seen as experts by runners who value advice, customer service, training and a connection to the running community. The tactics for Run KC include: being a strong strategic alliance partner; being an integral part of the community and being an expert in the running field. Activities to support the strategy and tactics range from partnerships with vendors, insurance companies, fitness clubs and community organizations to instructional classes and articles, attendance at national trade shows and ongoing staff training.

A sample Marketing Map for Run KC follows. In Exercise 9.8.2 – Marketing Map, you will map your marketing strategy. If you have more than one marketing strategy, use the same format to create additional maps.

Before you determine which marketing activities to undertake, it is important to understand how they relate to your marketing strategies, and why they are the best activities to select. The next section on Marketing Activities will give you some ideas of specific activities you may want to include in your marketing strategy.
Marketing Map for Run KC

Tactic
Run KC is a strong strategic alliance partner

Activities
1. Promotional events with major running shoe manufacturers
2. Involvement with major running events (sponsorships, packet pick up, etc)
3. Partner with health insurance companies, fitness clubs, running clubs, school teams
4. “Spike Night” each school district at the beginning of each season

Tactic
Run KC is an integral part of the community

Activities
1. Involvement in local chambers and running clubs
2. Discounts to local clubs and school teams
3. Product donations for fundraisers
4. Recognition of race winners and customer’s accomplishments on store website
5. Sponsorship of Run KC Club
6. Presence on Facebook and Twitter

Strategy
Maintain high visibility and be seen as experts by runners who value advice, customer service, training and a connection to the running community

Tactic
Run KC is an expert in the field of running

Activities
1. Staff will be dedicated runners who will receive ongoing training both in techniques and product knowledge
2. Manufacturer’s sales reps will conduct in-store training for staff
3. Informational articles will be sent to the media in the form of press releases
4. Tips and informational articles will be posted on the website
5. Management will attend national trade shows
6. Classes and training events offered by Run KC
7. Informational seminars for track and cross country coaches
Exercise 9.8.2a: Marketing Map

Learning Objective

- Develop a marketing map for your business that includes marketing activities that support focused strategies.

Overview

The marketing plan should begin with focused strategies. Each strategy is then implemented through carefully designed tactics and activities. The tactics define the marketing message and the way it should be communicated while the activities are the specific actions that must be implemented for the tactics to be successful. Strategies, tactics, and activities must all work in combination with one another.

In activity 9.7.3, you identified Market Penetration activities that you felt might be appropriate for your business. In this activity, you will identify marketing strategies and tactics for your business and then determine which of the marketing activities you identified earlier support these strategies and tactics.

Step 1

Determine marketing strategies for your business. A business marketing strategy specifies the way a firm competes in an industry.

Respond to the following questions to identify marketing strategies for your business.

a. Which target markets are you most able to reach over the next year?

b. What specific needs does your target market have that are not currently being addressed well?

c. What products or services can you offer to best meet these needs?

d. How does your competitive advantage meet these needs?

e. Based on your responses above, write one strategy statement for your business.

Strategy statement:
Step 2
Create your Marketing Map. Identify one marketing strategy in the oval. In each of the three triangles, identify a tactic that will support this strategy. Then identify two or more marketing activities for each tactic. Remember, the marketing activities must support both the tactics and the strategy detailed above. Refer to the Run KC Marketing Map on page 312 if you need ideas. If you have more than one marketing strategy, use the same format to create additional maps. Use the blank marketing map on the next page to complete this exercise.

Marketing Map for

<table>
<thead>
<tr>
<th>Tactic</th>
<th>Tactic</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Activities</td>
<td>Activities</td>
</tr>
<tr>
<td>1.</td>
<td>1.</td>
</tr>
<tr>
<td>2.</td>
<td>2.</td>
</tr>
<tr>
<td>3.</td>
<td>3.</td>
</tr>
<tr>
<td>4.</td>
<td>4.</td>
</tr>
<tr>
<td>5.</td>
<td>5.</td>
</tr>
</tbody>
</table>
Exercise 9.8.2b: Marketing Costs

**Learning Objective**

- Identify costs associated with the marketing activities you have planned for your business.

**Overview**

Some entrepreneurs determine how much they will spend on marketing each year and then create a marketing schedule based on how much they are willing to spend. Others create a list of marketing activities, research the cost of those activities and include that as part of their overall budget for the year. In either case, entrepreneurs need to recognize the cost of marketing and anticipate the return-on investment.

**Step 1**

Think about the costs associated with the marketing activities you have planned for your business. Some of the costs are one-time only, such as designing the company logo, while others, such as advertising may occur monthly or quarterly. The chart on the following page lists possible costs. In Column 1, put a check by each that might apply to your business.

**Step 2**

Research the cost of those marketing activities that you have identified as those you will implement in your business. Document the costs of each activity in Column 2. In Column 3, provide details related to the cost. For example, details for a brochure might include the number of copies as well as the number of colors used in the design; details for an association would include the name of the association; and details for a website might include the number of pages for the site and possibly a shopping cart option. In column 4, document the source of this information. You will need that for your financial assumptions.

**Step 3**

Summarize the various marketing activities and transfer your projected marketing budget to the Financial Assumptions worksheet you have been working on throughout the course.
<table>
<thead>
<tr>
<th>Source of Info</th>
<th>Marketing Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logo</td>
<td>Check</td>
</tr>
<tr>
<td>Creating marketing materials</td>
<td></td>
</tr>
<tr>
<td>Business cards</td>
<td></td>
</tr>
<tr>
<td>Stationery package</td>
<td></td>
</tr>
<tr>
<td>Brochures/Flyers</td>
<td></td>
</tr>
<tr>
<td>Postcards</td>
<td></td>
</tr>
<tr>
<td>Website</td>
<td></td>
</tr>
<tr>
<td>Ads</td>
<td></td>
</tr>
<tr>
<td>Advertising placements</td>
<td></td>
</tr>
<tr>
<td>Memberships and dues to associations</td>
<td></td>
</tr>
<tr>
<td>Marketing events</td>
<td></td>
</tr>
<tr>
<td>Promotional Products</td>
<td></td>
</tr>
<tr>
<td>Contests</td>
<td></td>
</tr>
<tr>
<td>Coupons</td>
<td></td>
</tr>
<tr>
<td>Direct mailings (include postage)</td>
<td></td>
</tr>
<tr>
<td>Yellow Pages ads</td>
<td></td>
</tr>
<tr>
<td>Newsletter or e-newsletter</td>
<td></td>
</tr>
<tr>
<td>Trade shows</td>
<td></td>
</tr>
<tr>
<td>Electronic media promotions</td>
<td></td>
</tr>
<tr>
<td>Networking lunches, coffees</td>
<td></td>
</tr>
<tr>
<td>Sponsorships</td>
<td></td>
</tr>
<tr>
<td>Samples</td>
<td></td>
</tr>
<tr>
<td>Sales team</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
</tr>
</tbody>
</table>
9.8.3 Marketing Activities Schedule

Once you know your marketing strategies and activities, you can create a schedule of those strategic activities you will implement on a weekly, monthly, quarterly, or annual basis. Before creating the schedule, you should list all your marketing ideas. You won’t have enough time to do everything on the list or enough money to budget for them. But, from this list you can make a plan.

Once you have created the list of ideas, estimate the amount of time or expense involved with each item. Then prioritize those you want to implement first. Depending on the outcomes of these activities, you can determine which ones to repeat or if you need to introduce new activities. See the Run KC strategic marketing activities schedule below.

### Marketing Activities Schedule for Run KC

<table>
<thead>
<tr>
<th>Activities</th>
<th>Start-up</th>
<th>Jan</th>
<th>Feb</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-opening advertising</td>
<td></td>
<td>5000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Printed marketing materials</td>
<td></td>
<td>1500</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ad in local sporting magazine</td>
<td></td>
<td>700</td>
<td>700</td>
<td>700</td>
<td>700</td>
<td>700</td>
<td>700</td>
</tr>
<tr>
<td>Web page</td>
<td></td>
<td>2000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chamber of Commerce Membership</td>
<td>300</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotional Products</td>
<td></td>
<td>1000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Store runs/sponsorships</td>
<td></td>
<td>500</td>
<td>750</td>
<td>1000</td>
<td>1000</td>
<td>1500</td>
<td>1500</td>
</tr>
<tr>
<td>Publicity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Feature Stories</td>
<td></td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Press releases</td>
<td></td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Articles, newsletter stories</td>
<td></td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

X = signifies time but no additional expense
Exercise 9.8.3: Develop a Marketing Activities Schedule

Learning Objective

- Determine which advertising, publicity, and promotional activities you will use to market your business for the next six months to a year.

Overview

Once the marketing strategies and activities that will be implemented in the business have been identified, an entrepreneur can create a marketing activities schedule. The schedule will vary by business type.

While some businesses will have a similar schedule year round, most marketing schedules will vary based on factors such as seasonality, weather and holidays.

Step 1

Using your Marketing Map from Exercise 9.8.2., create a Marketing Activities Schedule for your business. You may need to prioritize those you want to implement first. Be sure to consider factors specific to your business such as seasonality, weather and holidays. Include costs if you know them. If you don’t, plan time to research them in the near future. For items such as association dues and trade show fees, document them in the month you will pay that fee. See the example of marketing activities schedule for Run KC within section 9.8.3 Marketing Activities Schedule.

Develop a Marketing Activities Schedule
## Marketing Activities Schedule

<table>
<thead>
<tr>
<th>Activities</th>
<th>Month 1</th>
<th>Month 2</th>
<th>Month 3</th>
<th>Month 4</th>
<th>Month 5</th>
<th>Month 6</th>
<th>Month 7</th>
<th>Month 8</th>
<th>Month 9</th>
<th>Month 10</th>
<th>Month 11</th>
<th>Month 12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Publicity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
9.9 Measuring Marketing Effectiveness
9.9.1 Tracking Performance

How will you know if your marketing efforts are paying off? You keep track of the performance of each marketing activity so you know which ones are producing results and which ones aren’t. Remember, though, that it may take some time before marketing initiatives show results. For instance, it may take two or three months or more before networking efforts generate appointments or sales.

9.9.2 What to Measure

For each item in your marketing mix, determine how you will measure whether the item or activity was effective. If you pass out coupons for a discount to buy your product, you can count how many coupons are redeemed. If you place an ad in a local organization’s newsletter, you may consider every phone call or e-mail that results from the ad as a response to that effort.

It typically takes multiple exposures to the same marketing activity with the same target market before customers buy a product/service. If such is the case, you may need to repeat the marketing activity several times for six months or even a year before making a decision to try something new.

Tracking the performance of marketing activities is important. It helps you measure how effective your marketing activities were in penetrating the market and increasing sales. First, entrepreneurs should document marketing activities by identifying the following:

- Media used
- Responses generated
- Timing of the promotion
- Sales generated
- Cost Return on sales (the sales generated minus the cost)
- Reach (the number of persons exposed to the promotion)

Then they should determine the effectiveness of each marketing activity through one or a combination of the following feedback mechanisms:

- Asking customers how they heard about the business
- Counting coupons used for purchases
- Conducting a focus group to review ads, offers, and incentives and measuring responses
- Interviewing potential customers to determine where they buy similar products/services
- Reviewing the number of hits to a Web site
- Offering a special gift with each purchase and tracking how many were distributed
- Videotaping prospects’ reactions to product sampling

More Info
Audio, Database Marketing for Low-tech Businesses—Tracking customers using the information technology of today. View this resource using the More Info link in the online course.
Assignment 9a: Marketing Plan—Market Penetration Section

<table>
<thead>
<tr>
<th>Business Plan Questions</th>
<th>Section Content Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Company Image</strong></td>
<td>9.1 and 9.2</td>
</tr>
<tr>
<td>How will you create a brand for your business? What image do you wish to project?</td>
<td></td>
</tr>
<tr>
<td>How will you convey that image to customers (how the phone is answered, what the invoices look like, the company’s involvement in civic organizations and causes, etc.)?</td>
<td></td>
</tr>
<tr>
<td><strong>Location</strong></td>
<td>9.1.4</td>
</tr>
<tr>
<td>Where will the business be located? How will this site promote your business? What are the demographics of the surrounding neighborhood? What makes this a good location for your business?</td>
<td></td>
</tr>
<tr>
<td>How long do you plan to be at this location?</td>
<td></td>
</tr>
<tr>
<td><strong>Customer Service</strong></td>
<td>9.5</td>
</tr>
<tr>
<td>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?</td>
<td></td>
</tr>
<tr>
<td><strong>Advertising and Promotions</strong></td>
<td>9.6.2, 9.6.4 and 9.8</td>
</tr>
<tr>
<td>What are your marketing strategies? What advertising/promotion activities will be used?</td>
<td></td>
</tr>
<tr>
<td>What media will you use to promote your business? What will the advertising/promotion cost?</td>
<td></td>
</tr>
<tr>
<td><strong>Publicity</strong></td>
<td>9.6.3 and 9.8</td>
</tr>
<tr>
<td>What activities do you have planned for obtaining publicity for your business?</td>
<td></td>
</tr>
<tr>
<td>What events will you promote through press releases?</td>
<td></td>
</tr>
<tr>
<td>What media will you attempt to solicit publicity from?</td>
<td></td>
</tr>
<tr>
<td><strong>Telemarketing/Direct Mail</strong></td>
<td>9.6.2, 9.6.4 and 9.8</td>
</tr>
<tr>
<td>Will telemarketing or direct mail be used to sell the product/service to the end user?</td>
<td></td>
</tr>
<tr>
<td>Where will you obtain a mailing list? What is your schedule for telemarketing/direct mail and estimated response rate? What will the direct mail/telemarketing cost (mailing list, print materials, postage, and cost per contact)?</td>
<td></td>
</tr>
<tr>
<td><strong>Internet</strong></td>
<td>9.4 and 9.7.2</td>
</tr>
<tr>
<td>How will you use the internet to market your services? What features will you have on your website?</td>
<td></td>
</tr>
<tr>
<td>Will you use e-mail to communicate with customers? What will it cost to build and maintain a website?</td>
<td></td>
</tr>
<tr>
<td>How will you use social media?</td>
<td></td>
</tr>
<tr>
<td><strong>Trade Shows</strong></td>
<td>9.6.4</td>
</tr>
<tr>
<td>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)?</td>
<td></td>
</tr>
<tr>
<td>What trade shows do you plan to attend without an exhibit?</td>
<td></td>
</tr>
<tr>
<td><strong>Internal Sales</strong></td>
<td>9.7.2</td>
</tr>
<tr>
<td>Will you be the solo sales force? Will a direct sales force or internal salespeople 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)? Will sales occur over the Internet?</td>
<td></td>
</tr>
<tr>
<td><strong>External Sales</strong></td>
<td>9.7.3</td>
</tr>
<tr>
<td>Will sales representatives be used to sell the product/service to the end user?</td>
<td></td>
</tr>
<tr>
<td>How many representatives will be used? What will be the cost of using sales representatives (compensation package, allowances, catalogs, brochures, and samples)?</td>
<td></td>
</tr>
<tr>
<td>Will the product/service be licensed to others? Will distributors be used?</td>
<td></td>
</tr>
<tr>
<td><strong>Market Penetration Effectiveness</strong></td>
<td>9.9</td>
</tr>
<tr>
<td>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?</td>
<td></td>
</tr>
</tbody>
</table>
Assignment 9b: Financial Assumptions

Refer back to the Marketing Costs Exercise 9.8.2b and the Marketing Activities Schedule Exercise 9.8.3. to review the frequency of the advertising, publicity, and promotional activities and the estimates of how much it will cost to implement them. Summarize the various marketing activities and transfer your projected marketing budget to the Financial Assumptions worksheet.

Be sure to cite sources for the estimates that are the basis for your assumptions. For example, you may have researched the expected costs for designing logos and marketing materials. Provide both the details of the estimated costs and the source of the estimate. Completing your Financial Assumptions now while you work on your Marketing Plan will save time later when you fill out the Financial Template and make financial projections.

Some of the expenses for which you should now have estimates include but are not limited to:

- Web design
- Web hosting and maintenance
- Marketing materials
- Advertising placements
- Memberships and dues in associations
- Sales team

Summary

This chapter introduces the concepts you need to reach your target market. Marketing is not an exact science. You can market your product/service many ways; thus, you must make many decisions about your marketing strategy, tactics, and activities. You considered the marketing mix you may want to use to bring your products or services to market. You have literally thousands of alternatives from which to choose. This chapter should help you develop a sales process and an awareness of the need to measure market effectiveness.

Key Things to Remember:

- Whether you intend to or not, you will create an image of your business in the minds of potential customers. It is better to be in control of this image through branding.
- Location can be a critical component in your business’s image.
- Marketing your business includes setting a strategy, developing tactics, and planning specific activities to implement the strategy.
- A successful marketing mix will include a blend of advertising, publicity, and promotions.
- Your schedule of marketing activities will have a direct impact on your budget and should be tracked to ensure its effectiveness in penetrating the market.
- Following a sales process can help you or your sales team close sales, build relationships with customers, and ensure repeat sales.

Congratulations on completing the market penetration section of your business planning process! This major component of your plan touches many areas of your business, and has a significant impact on your ability to project its financial situation. Before you delve into the financials, however, you will turn your attention to how you will price your product/service in Chapter 10.
Market Planning: Pricing

Overview
Pricing is a complex issue. Some experts consider it a marketing concept. Others argue that it is a financial concept. The truth about pricing is that it affects both marketing and finance. Marketing strategies must include plans for pricing the product/service. These prices affect the sales and resulting financial projections.

This chapter will help you identify pricing strategies that will support your marketing plan. These strategies may help you reinforce a premium image or help you break into a new market. Formulas for calculating prices for both products and services are included.

Objectives
In this chapter, you will learn to:

• Evaluate pricing strategies.
• Evaluate pricing constraints and sensitivities in the market.
• Consider pricing strategies that reinforce your marketing plan.
• Set prices based on your pricing strategies.
10.1 Pricing Products/Services

10.1.1 Key to Profits

Pricing is one of the most complex challenges entrepreneurs face when starting a new venture because it affects both marketing and profitability. Marketing strategies help determine the price for products/services. For example, a branding strategy that attempts to create a premium image will likely include a premium price. A strategy designed to penetrate the market will likely include a low price.

The amount of profit a company can make depends on how much they can get for their products above and beyond costs. Once costs are covered (including overhead costs), the remaining money earned goes directly toward profit. Based on this rationale, entrepreneurs may try to raise their profits by charging higher prices for their products or services. It is not that simple, however. The price of a product/service also has a direct impact on how much is sold. If the price is set too high and no one is willing to purchase the product, then the company will probably not attain profitability. If the price is set too low and costs are not covered, the company will not be profitable either. In fact, the company will lose money.

Profit involves several different elements:

\[
\text{Profits} = \text{Revenues} - \text{Costs}
\]

\[
\text{Profits} = (\text{Unit sales} \times \text{Price per unit}) - \text{Costs}
\]

The above formula highlights the significance of the impact price has on profits.

from real entrepreneurs

Antonio wants to add an extra $25 to the price of a new chair he manufactures under his brand, Eclectics. If his business sells 100 chairs a month, that is $2,500 extra profit for that month. That does not sound like much when the trade press discusses sums in the millions and billions of dollars. To Antonio, however, the additional $2,500 a month is all profit, which will contribute substantially to his bottom line. So Antonio will evaluate the market in which he sells chairs to determine what type of impact a $25 per unit increase in price will have on the number of units he sells.

Reality

Since the right price is what customers are willing to pay for a product/service, the real question is whether the business can make a satisfactory profit at that price.

10.1.2 Pricing Process

Although setting prices is not an exact science, the following four-step process can make the task easier.

1. Determine the relevant price range.
2. Evaluate the price constraints and sensitivities.
3. Select a strategy.
4. Set the price.
It is important to note that this four-step process is never really complete. Prices must always be evaluated and adjusted to meet the constant changes in the market place. As new information becomes available, entrepreneurs will reevaluate the pricing strategies and select a new price when necessary.

It is much easier to lower a price set too high than it is to raise a price that is set too low. If entrepreneurs are trying to lower prices, they can use many creative promotions to stimulate sales. The use of promotions is not an option for entrepreneurs who must increase prices. And, pricing too low is a more common mistake than pricing too high.

Typically, there is a lot of learning that happens early in a venture. Therefore, it is best to start out with low levels of activity. A low price may attract more customer than the organization can handle, which can lead to an unfortunate reputation for poor service while the company is still trying to impress the market.

More Info

Case Study: How to Raise Prices—How one company tried to raise their initial low pricing and their customers’ response. inc.com/magazine/20110201/case-study-how-to-raise-prices.html

10.2 Evaluating Price
10.2.1 Determine the Price Range

To get started, an entrepreneur must know the reasonable range in which a price must be set. The bottom of the range, price floor, is usually set by costs. Just how little can a business sell its product/service for and still survive? This is the same as the break-even point. It is critical to determine the bottom of the range value so that prices are set above it.

At the top of the range of prices is the ceiling price. What is the maximum a product/service will sell for? This is determined by competition and your position in the market. This is far more difficult to answer than the question concerning the price floor.

The market price, what a seller is willing to sell the product/service for and what a buyer is willing to pay, is probably somewhere between the floor and ceiling prices. This is not necessarily how much entrepreneurs would like to charge.

To understand the market price, entrepreneurs must first research the price, features, and benefits of competitors’ products/services. Information on similar products/services should also be sought. With this information, entrepreneurs can compare their products/services to estimate the price the market will pay. For customers to pay more than the market price, a product or service must have perceived benefits that exceed the competition.

Many market factors, such as cost of goods, demand, competition, margin standards, and customer perceptions will influence how you set your prices. In turn, how you set
your prices will impact your sales volume, revenue, and profitability as well as market share and company image. (See Pricing Diagram below) Keep in mind that customers often rely on price to help form their value judgment of the product/service.

More Info
The Price Is Wrong—An overview of pricing based on value to the customer instead of cost to the producer, this article provides both theory and examples of the theory at work. It's a quick, useful read. forbes.com/entrepreneurs/2006/02/28/starbucks-salesforce-google-cx_tt_0301straightup.html?partner=rss

10.2.2 Price Constraints
Pricing constraints are those things that keep you from having much flexibility in your pricing position. Constraints are often industry specific. In other instances, constraints are set by the competition or government.

In many industries there is a rigid market price for the company’s products/services. It is difficult to charge a higher price for a product/service than what the marketplace dictates. Entrepreneurs should avoid markets in which individual businesses have little control over price. This is common in markets in which products/services are not easily differentiated from one another, such as in farming. It is difficult to make a profit in this type of a situation unless the business has some distinct cost advantages.

Also, in industries such as real estate the so-called prices are really invitations to negotiate. In other industries, asking prices are firm. Yet many “firm” prices are not really firm. There are all sorts of ways to cut price when the seller needs to do so.

In some industries, the government regulates prices. Sometimes this is helpful and sometimes it is not. Some airlines might prefer to return to the time when the government set their prices, because they made more money that way. After they started to compete with each other, many airlines discovered that they could not remain profitable.

Other constraints are created by the market prices of the direct competition. The prices of similar products limit pricing freedom. Both, directly competitive and substitute products affect what a business can get for its product. It is usually difficult to charge more for goods than a competitor charges for a similar or somewhat superior item.
Even if there is little direct competition, there are always substitutes seeking customers’ dollars. There is a point at which a product is simply priced out of the market—it costs too much to produce relative to the price that can be obtained for it in the marketplace.

**from real entrepreneurs**

When she raised her prices, the operator of a Utah ski resort made sure she kept the price of her lift tickets in line with those of neighboring resorts. She still lost business when potential customers decided to spend their dollars in more affordable outdoor activities, such as cross-country skiing, snow tubing, backpacking, and camping.

**10.2.3 Price Sensitivities**

In most markets, customer demand is sensitive to the price. Elasticity refers to the degree that a change in price affects the quantity of demand. If demand is very elastic, a lower price means the amount purchased increases significantly. If demand is inelastic, the amount purchased does not vary much with price changes. Understanding the elasticity of demand for a market helps entrepreneurs recognize opportunities in setting their prices.

Price points should also be considered when setting prices. Businesses do best if they carry products to sell at the price points experience indicates customers are willing to buy. Market research can help entrepreneurs learn the price points which exist for their products/services.

**from real entrepreneurs**

A menswear merchant has three price points for his suit department, $195, $250, and $325. The merchant goes to market to buy suits to fit into those price points, sometimes called price lines. Because he marks the suits up 100%, the merchant tries to buy suits for a cost of approximately $97.50, $125, and $162.50 to fit into those price points.

**10.3 Consider Pricing Strategies**

**10.3.1 Common Pricing Strategies**

Your pricing strategies depend heavily on the market position you want for your product or service. They reinforce your pricing position. Strategies dictate how you will price products or services to be competitive and make a reasonable profit. They also take into account customers’ thresholds. Consider your target market before selecting or changing a pricing strategy. You may position and price your product or service based on customers’ attitudes or perceived benefits, special niches or applications, specifically targeted users, or the level of quality you offer your customers.
Pricing can send a message to your target market. Some companies target a high-end buyer and are successful pricing their product or service higher than competitors. For example, Lexus® and Land Rover® charge more for their cars because their customers think these cars are offer more prestige and better value than Ford® or Chevrolet®.

Consider the most common pricing strategies in the Pricing Strategies checklist on the next page. Many of them rely on your knowledge of competitors’ pricing and how your prices will relate to theirs. Some have a more internal focus, based on your costs and desired profit margins. Notice how they support the three pricing positions—lower, higher, and parity pricing. This will help you consider broad strategies.

from real entrepreneurs

When developing her business plan for My Blue Heaven, a blue jeans retail shop, Sarah realized the importance of location and image in determining her pricing strategy. One can buy blue jeans for as little as $5 a pair in a thrift store, but on Rodeo Drive in Beverly Hills, some people will pay $200 for them. Sarah realized this was a strategic decision which would have a great impact on her ability to command a reasonable price for her merchandise.

Reality
It is nearly impossible to charge more for a product/service than a competitor’s product/service that has somewhat superior features.

Tip
Do not fall into the trap of setting your prices low at the inception of your business to try to gain market share. It is very difficult to raise your prices later and keep the same customers.

from real entrepreneurs

George’s Automotives makes additional money by charging higher prices for after-market add-ons to their cars. For example, the car buyer pays little attention to the price of its radio. What is $500 in a $20,000 package? Yet $300 could be saved by buying the radio elsewhere. High profits can be made when selling products that are small in the total package of benefits purchased by the buyer.
## 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.</td>
<td>Price matches customer’s enhanced perception. Customers see brands as status symbols, in high demand with limited quantities.</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.</td>
</tr>
<tr>
<td>Examples: car and computer accessories, food, supplies, household items</td>
<td>Examples: signed, limited editions, luxury perfume, cars</td>
<td>Examples: gasoline, airfare, hotels/motels, electrical goods</td>
</tr>
<tr>
<td>Predator pricing</td>
<td>Opportunistic pricing</td>
<td>Keystone or target pricing</td>
</tr>
<tr>
<td>Deliberate price-cutting to prevent others from entering the market. Forces competitors to compete on price and low profit margins. Offer free gifts and bundling of products/services that competitors can’t meet effectively.</td>
<td>Set premium prices for products/services in high demand with short supplies.</td>
<td>Set prices to reach or maintain specific profit levels. Mark-up is standard over cost.</td>
</tr>
<tr>
<td>Examples: computer and software packages, cell phones and special provider service plans</td>
<td>Examples: fresh fish, pharmaceuticals</td>
<td>Examples: clothing and department store items</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. Exaggerated form of penetration pricing. May offer temporary price reductions to increase sales. May offer lower-cost version to gain acceptance and then switch to higher-cost version after purchase. Prices hurt other competitors.</td>
<td>Premium pricing on high-demand products in the early stage of its life cycle. Gain maximum profit from the market for high-tech or new inventions.</td>
<td>Set prices to cover variable costs and a portion of fixed costs. Follows industry standards for costs and profits.</td>
</tr>
<tr>
<td>Examples: magazine and newspaper subscriptions, CD music and DVD clubs, software</td>
<td>Examples: plasma or high-definition TVs, video games, PDAs</td>
<td>Examples: seminars, airfare, catering</td>
</tr>
</tbody>
</table>

Which pricing strategies will most likely help me achieve my goals?

---

### More Info

- How to Formulate A Premium Pricing Strategy—6 tips to earn the right to charge your customers top dollar [entrepreneur.com/article/217176](https://www.entrepreneur.com/article/217176)
10.3.2 Mathematical Pricing

In mathematical pricing the entrepreneur sets a price by adding a specific percentage, or multiplier, to the cost of the product/service. This is standard markup or cost-plus pricing. This pricing strategy only works if it is compatible with other pricing strategies the company has. For example, if an entrepreneur uses a standard industry mark-up and has a goal of keeping prices in line with those of the competition, then mathematical pricing is fine. If an entrepreneur uses a standard industry mark-up and has a market penetration strategy of pricing products low, this mathematical approach will not work. It is important to keep marketplace factors and marketing goals in mind while using a mathematical approach to pricing.

10.4 Setting Prices

10.4.1 Pricing Products

When pricing products or services, the price must be set at a point that will both contribute to profits and compel customers to purchase. When pricing a product, the complexity of needing to cover the direct costs of the product itself as well as the operating costs are united. The prices a business establishes for its products are affected by several things:

- **The cost of the product.** This is the starting point in making a pricing decision. The price must adequately cover the cost and provide a reasonable profit.
- **The uniqueness and specialty of the product.** A higher price can be charged for a unique product with high customer demand.
- **The competitors’ prices.** The range of prices offered by the competition may limit the pricing options.
- **Personal goals of the entrepreneur.** The price should contribute to the overall profitability and help reach the entrepreneur's personal goals.
- **Marketing strategy.** When large amounts of time are spent marketing and distributing a product, the price will generally be higher.
- **Location.** The location of the business will affect the price charged for a product.
- **The amount customers are willing to pay.** This is sometimes the hardest to determine, especially before starting a business.
- **The break-even point.** This is the point at which the costs to operate the business are covered. Any additional money that comes in is profit.
The tool in Exercise 10.4.1 can be used to estimate a product’s price. It has been designed to help establish a price that takes into consideration all costs of developing and selling a product. This price cannot be established without an adequate understanding of the market, competition, and customers. After calculating a price using this tool, an entrepreneur may find that customers are not willing to pay that price. If that is the case, profitability should be assessed at the price customers are willing to pay.

Scenario 10.4.1

Run KC—Pricing

Learning Objective

• Identify factors that impact both pricing and profitability.

Overview

Pricing decisions have a major impact on the profitability of a business. The amount of profit a company can make is dependent upon how much they can get for their products above and beyond costs. Once costs are covered (including overhead costs), the remaining money earned goes directly toward profit.

Based on this rationale, entrepreneurs may try to raise their profits by charging higher prices for their products or services. It is not that simple, however. The price of a product/service also has a direct impact on how much is sold. If the price is set too high and no one is willing to purchase the product, then the company will not attain profitability. If the price is set too low and costs are not covered, the company will not be profitable either. In fact, the company will lose money.

Scenario

Tim knows that in his industry, retail athletic footwear, his pricing strategy will start with mathematical pricing. He will begin the pricing process by adding a specific percentage to the cost of his product – also referred to as standard mark-up. He will then consider the possibility of adjusting prices based on both customer-focused and competition-focused strategies. Tim also knows that when he sets his prices, he needs to be sure that his Costs of Goods are covered as well as all other costs, including overhead, sales, and administrative.

Step 1

Identify costs that impact pricing.

List all the costs related to selling athletic footwear in a retail shop.
Step 2

Consider the Competition.
A large chain sporting goods store located in the area sells some of the same brands of running shoes as Run KC. Since the chain store buys in large quantities, they are able to sell their shoes at a lower price than Tim is considering. Determine how Tim should respond to the competition’s pricing.

Step 3

Identify alternatives to low pricing.
Tim knows that pricing mistakes occur more often by pricing too low than too high and that it is easier to lower prices than it is to raise them. With that in mind, he has decided to price himself above the chain store competition. Later when he is in a position to lower prices, he will use creative promotions to stimulate sales. In the space below, determine how Tim could use such promotions.

Exercise 10.4.1: Set a Product Price

Learning Objective
• Use a given formula to determine a price for your product.

Overview
For a product to succeed, the owner must determine a price that will cover all costs to make or acquire the product, pay for expenses of the business, provide a salary to the owner (sufficient to meet the owner’s needs), produce a profit so that the business may grow, and at the same time not be grossly over or under priced when compared to the competition. Some businesses just look at the competition and charge somewhere within the range charged by others, hoping that will cover the costs of the product, their expenses, a salary, and provide a profit. That is risky at best. Others will pick a price lower than the competition. Rarely does this method succeed. While there are other valid methods, the following is one way to set a product price.
Step 1

**Determine pricing for your product.** Use the following formula to consider pricing options. Use your facts, and remember this is only one way to look at it.

<table>
<thead>
<tr>
<th>Question</th>
<th>Formula</th>
<th>Enter Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. What is your cost of product per unit?</td>
<td>Enter unit cost</td>
<td>$</td>
</tr>
<tr>
<td>B. How many units do you estimate you will sell in one year?</td>
<td>Enter estimate of number of units sold in one year</td>
<td></td>
</tr>
<tr>
<td>C. What is the total product cost?</td>
<td>Cost per unit (A) x units sold (B)</td>
<td>$</td>
</tr>
<tr>
<td>D. What are your estimated yearly operating expenses (excluding your salary)?</td>
<td>Estimated monthly operating expenses x 12</td>
<td>$</td>
</tr>
<tr>
<td>E. How much salary per year do you want to make?</td>
<td>Salary per year</td>
<td>$</td>
</tr>
<tr>
<td>F. How much pretax profit do you want to make? (Enter a reasonable profit percentage here. It should be at least 10 to 20 percent.)</td>
<td>(Total product cost (C) + yearly operating expenses (D) + salary per year (E)) x profit percentage</td>
<td>$</td>
</tr>
<tr>
<td>G. What is your yearly estimated tax liability for payroll taxes* on your salary and federal and state income taxes on the profit?</td>
<td>Salary per year (E) x 12% + profit (F) x 30%</td>
<td>$</td>
</tr>
<tr>
<td>H. How much annual revenue will you need to generate?</td>
<td>Total product cost (C) + yearly operating expenses (D) + salary per year (E) + desired profit (F) + yearly estimated tax liability (G)</td>
<td>$</td>
</tr>
<tr>
<td>I. What is the wholesale price for your product?</td>
<td>Annual revenue required (H) / estimated number of units sold (B)</td>
<td>$</td>
</tr>
<tr>
<td>J. What is the retail price for your product?</td>
<td>Wholesale price per unit (I) x 2**</td>
<td>$</td>
</tr>
</tbody>
</table>

* The payroll taxes represent the employer’s responsibility to match both Social Security (6.2%) and Medicare (1.45%) and to pay unemployment taxes to the state and federal governments.

** The 2 is called a “multiplier.” Some industries have established multipliers that create standard pricing. Research will uncover any multipliers for your industry.
Step 2
Consider strategies to bring price within competitors’ range. Answer the following questions and then discuss your answers with a partner or expand your answers below each question.

1. Is the price you calculated reasonable?
   Yes ☐ No ☐
2. Does the price fall within the range of competitors’ prices?
   Yes ☐ No ☐
3. Based on your knowledge of the competition, how much higher or lower is your price?
   $\text{and } %$
   Higher by
   Lower by

Step 3
Consider strategies to bring price within competitors’ range. If the price you calculated is not within the high/low range of competitors, your price is probably not realistic. Suggest some strategies which might help bring the price within that range. Discuss these strategies with a partner.

1. 

2. 

3. 

4. 

10.4.2 Pricing Services

There are several ways to obtain pricing information to help price a service. The first step is to determine what price a potential customer is willing to pay versus what the entrepreneur wants to charge. Entrepreneurs can interview several potential customers and ask them what they are willing to pay for the services. They can also conduct a focus group with potential customers and ask how much they are willing to pay for different services. Keep in mind that some potential customers are willing to pay more than the price they share.

Reality

In service industries, prices are often invitations to negotiate. Entrepreneurs must be careful to avoid the trap of negotiating away too much and working for less than they want.

The second step is to find out what competitors charge for similar services. Both direct competitors and substitute services affect what one can charge for services. A professional association can be contacted and asked what type of pricing is standard for the industry.

When obtaining pricing information from potential customers and competitors, entrepreneurs will find a range of different prices. Entrepreneurs should consider pricing their services within this range. Perceived value and what customers are willing to pay are key factors in setting service prices.

If an entrepreneur has designed a service with greater perceived value, a higher price can be charged. Experts report that professionals who charge fees in the higher range are usually the most successful. Prices for services can be based on the entrepreneur’s reputation, years of experience, amount of competition, length of time as a service provider, and what the market will allow.

Tip

Consider non-billable time and taxes when setting prices. Include enough to pay federal and state income taxes, and payroll taxes including FICA (social security and Medicare taxes) and federal and state unemployment taxes. Be sure to use income tax rates based on your own individual tax situation.

The tool in Exercise 10.4.2a can be used to determine how much time is spent on non-income producing activities such as recordkeeping, maintenance, and training. This figure will be needed for Exercise 10.4.2–Set a Service Price. Together, these two tools help establish a price that takes into account all the costs of providing a service. This price cannot be established without an adequate understanding of the market, competition, and customers. After calculating a price using this tool, an entrepreneur may find that the customers are not willing to pay that price. If that is the case, profitability should be assessed at the price customers are willing to pay.
Exercise 10.4.2a: Non-Income Producing Time

Learning Objective

- Determine the number of billable and non-billable hours you will need for your service business to succeed.

Overview

All businesses require management duties that are necessary but are not directly involved in providing the product or service to the customer. Entrepreneurs frequently fail to plan for the time that must be spent in these non-income producing activities. This is true for all businesses, but especially so in service businesses. Businesses often overestimate the amount of time that the entrepreneur has available to be directly involved in providing a service. It is quite common that only two thirds of the entrepreneur’s work time is available for hourly billing, performing the contract, or consummating the sale. Product-based businesses also require large amounts of the entrepreneur’s time with activities not directly dealing with customers.

Step 1

Estimate your non-billable time. As the owner of your own business, you will spend a certain number of hours each month managing it. Many business owners providing services plan on only 15 billable days per month. The remaining five workdays are dedicated to such activities as:

- Networking.
- Marketing.
- Billing and collecting from customers.
- Professional development.
- Preparation for new contracts.
- Personnel matters.
- Ordering supplies and materials, dealing with vendors.
- Physical office matters.
- Governmental compliance.
- Record keeping.
- Other.

This time is not billable nor directly income producing. In this exercise, you will estimate the time you will spend on these marketing and management activities. For each of the following categories, briefly list the activities and then estimate the number of hours each month you will spend doing them.

A. Networking: List the networking activities necessary for your business to succeed.

<table>
<thead>
<tr>
<th></th>
<th>Hours/Month</th>
</tr>
</thead>
</table>
B. Marketing: List the marketing activities necessary for your business to succeed.  
__________________________ Hours/Month  

C. Billing and collecting from customers: List the billing and collection activities necessary for your business to succeed.  
__________________________ Hours/Month  

D. Professional Development: List the professional development activities necessary for you and your business to succeed.  
__________________________ Hours/Month  

E. Preparation for new contracts: List the preparation activities necessary for your business to succeed.  
__________________________ Hours/Month  

F. Personnel matters: List the personnel matters necessary for your business to succeed.  
__________________________ Hours/Month  

G. Ordering supplies, materials, dealing with vendors: List the activities for ordering supplies and materials and dealing with vendors necessary for your business to succeed.  
__________________________ Hours/Month  

H. Physical office matters: List the activities necessary for maintaining your physical office and technology equipment.  
__________________________ Hours/Month  

I. Governmental compliance: List the governmental compliance activities necessary for your business to succeed.  
__________________________ Hours/Month  

J. Record keeping: List the record keeping activities necessary for your business to succeed.  
__________________________ Hours/Month  

K. Other: List other non-income producing activities necessary for your business to succeed.  
__________________________ Hours/Month
Step 2

**Project income-producing hours per month.** Assume each month contains 20 work days and each work day is 8 hours. (20 days x 8 hours = 160 hours per month.) Subtract from 160 hours the total number of hours you will need to spend on non-income producing activities each month as calculated in Step 1.

A. How many hours remain per month for you to work directly on income-producing activities? Hours

B. Is this a sufficient number of hours for your business to succeed? Check one: Yes ☐ No ☐

C. Discuss your conclusion with a partner. What strategies could you use to increase the number of income-producing hours per month? Discuss whether these strategies are realistic and workable.

1.

2.

3.

4.
Exercise 10.4.2b: Set a Service Price

Learning Objective
- Use a given formula to determine the hourly price for a service business.

Overview
For a service business to succeed, the owner must determine a price per hour for the service that will pay all the expenses of the business, provide a salary to the owner (sufficient to meet the owner’s needs), produce a profit so that the business may grow, and at the same time not be grossly over or under priced when compared to the competition. Some new service businesses just look at the competition and charge somewhere within the range charged by others, hoping that will pay all of their expenses, a salary, and provide a profit. That is risky at best. Others will pick an hourly rate lower than the competition. Rarely does this method succeed. While other valid methods exist, the following is one way to set a service price.

Step 1
Determine pricing for a service business. Use the following formula to consider pricing options. Use your facts, and remember this is only one way to look at it.

<table>
<thead>
<tr>
<th>Question</th>
<th>Formula</th>
<th>Enter Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. How much salary per year do you want to make?</td>
<td>Salary per year</td>
<td>$</td>
</tr>
<tr>
<td>B. What are your estimated yearly operating expenses?</td>
<td>Estimated or actual monthly expenses x 12</td>
<td>$</td>
</tr>
<tr>
<td>C. How much pretax profit do you want to make? (Enter a reasonable profit percentage here. It should be least 10 percent to 20 percent.)</td>
<td>(Salary per year (A) + yearly operating expenses (B)) x profit percentage</td>
<td>$</td>
</tr>
<tr>
<td>D. What is your yearly estimated tax liability for payroll taxes* on your salary and federal and state income taxes on the profits?</td>
<td>Salary per year (A) x 12% + profit (C) x 30%</td>
<td>$</td>
</tr>
<tr>
<td>E. How much annual revenue will you need to generate?</td>
<td>Salary per year (A) + yearly operating expenses (B) + desired profit (C) + yearly estimated tax liability (D)</td>
<td>$</td>
</tr>
<tr>
<td>F. How many billable hours will you work in one year***</td>
<td>Number of billable hours per day x number of days per week x number of weeks per year</td>
<td>$</td>
</tr>
<tr>
<td>G. What is your hourly rate?</td>
<td>Annual revenue (E) / number of billable hours (F)</td>
<td>$</td>
</tr>
</tbody>
</table>

* The payroll taxes represent the employer’s responsibility to match both Social Security (6.2%) and Medicare (1.45%) and to pay unemployment taxes to the state and federal governments.

** Be sure you are only calculating time which will be billed to your clients. Do not include expenses such as nonbillable administrative, sales and marketing time.
Step 2

**Compare your price to competitors.** Answer the following questions and then discuss your answers with a partner.

1. Is the price you calculated reasonable?  
   - Yes ☐  
   - No ☐
2. Does the price fall within the range of competitors’ prices?  
   - Yes ☐  
   - No ☐
3. Based on your knowledge of the competition, how much higher or lower is your price?  
   - $ and %
   - Higher by ☐
   - Lower by ☐

Step 3

**Consider strategies to bring your price within competitors’ range.** If the price you calculated is not within the high/low range of competitors, your price is probably not realistic. Suggest some strategies which might help to bring the price within that range. Discuss these strategies with a partner.

1. 
   __________________________________________
   __________________________________________
   __________________________________________
   __________________________________________
2. 
   __________________________________________
   __________________________________________
   __________________________________________
   __________________________________________
3. 
   __________________________________________
   __________________________________________
   __________________________________________
   __________________________________________
4. 
   __________________________________________
   __________________________________________
   __________________________________________
   __________________________________________
from real entrepreneurs

When Sam started her new training company, Training Tracks, she realized communicating credibility would be one of her biggest challenges. To attract new customers to her company, she invited representatives from potential customer companies to sit in on existing training at no cost. She knew she could sell future training sessions once she proved herself.

10.4.3 Pricing Policies

The list of pricing policies is lengthy. It is only possible to present some of the more common policies that entrepreneurs will likely encounter.

Motivate Large Orders with Volume Pricing—Studies show that small orders are costly, and many are even sold at a loss. Entrepreneurs should study costs carefully to determine how much they can afford to reduce prices in order to encourage large orders.

Avoid Price Conflicts—If a price war develops, a firm should try to respond in an indirect way instead of trying to match the competitor’s price cuts.

From real entrepreneurs

To counter a competitor’s annual sale, a gypsum company offered free sacks of plaster with every load of wallboard.

Bundle Products and Services—By selling related products or services together, entrepreneurs increase the amount of sales per purchase and profitability.

Offer Tiered Pricing—Through tiered pricing, the entrepreneur can provide the customer with multiple price points to consider by offering similar products of different quality for high, medium and low-end markets.

Bid a Fixed Price—Instead of charging an hourly rate, entrepreneurs can provide a fixed price bid for the job. This protects the customer and provides an incentive to the entrepreneur to work efficiently. The customer is paying for results, not time.

Disguise Price Cuts—Price reductions should be disguised so that the previous price structure is not destroyed. A business may want to go back to an earlier pricing structure when difficult market conditions are over. Disguised cuts might include discount cards, rebates, “off peak” pricing, gift with purchase or coupons. An “introductory” price can be effectively used by startup businesses to bring customers in the door yet not position themselves as a low-price provider. The fact that customers are getting a discounted price should be communicated clearly.

Tip

If entrepreneurs are not happy with sales volume at the existing prices, they can consider cutting prices or providing incentives such as free goods with a purchase.
Offer Creative Pricing—Some of the biggest fortunes have been made by people who develop slightly different ways of pricing their goods to the market: payment terms are one way of creatively pricing products/services. Trade-ins, add-ons and “tenth item free” are also methods that can be used with a creative twist.

from real entrepreneurs

People do not buy products, they buy benefits. A tire company sold aircraft tires to an airline on a per landing basis. It agreed to keep the tires on the planes in good shape for a certain price per landing. The airline was buying safe landings and takeoffs.

Push High-Margin Products—Different products often have different gross margins. An astute business owner develops strategies to push those products which have high margins. For example, a restaurant owner might have their wait staff aggressively promote appetizers and desserts as the profit margins on these items are high.

Consider the Terms—Some business owners stand firm on price and offer other “bonuses” such as free shipping, delayed interest charges or a cash discount for early payment. This may be a desirable policy for your business but be sure you cost out any concessions to be sure that you don’t make money on the price and lose it on the terms.

Use Price List to Win Orders—Unfortunately, some businesses open without having developed a price list. When customers call asking about quantity discounts, the entrepreneur does not have the answer. Featuring quantity discounts on the price list can be a highly profitable marketing strategy.

from real entrepreneurs

Regarding his company’s pricing and payment terms, one entrepreneur glibly said, “I’ll sell at the price you want if I get to set the terms.” In some industries, the terms of a sale make the difference in whether or not a business is selling at a profit or loss.

Use Discount Pricing—But, use it strategically. When entrepreneurs need to move inventory or keep employees busy, they might offer discount prices for a short period of time. For example, a carpet cleaning company is usually slow during the month of January. A carpet cleaning special for that month might keep their employees busy enough to at least cover payroll during the slow time.

Tip

Your price list can be one of the most important marketing pieces your company distributes.

More Info

8 Pricing Strategies You Can Implement Right Now—A combination of strategy and policy ideas which appeal to human behavior. smallbiztrends.com/2008/08/8-pricing-strategies-you-can-implement-right-now.html
10.4.4 Price List

Learning Objective
A price list can be one of the most important marketing tools a business has. Customers should be motivated to purchase a product/service just by reading a price list. The price list should be attractive, informative, easy to read, and make ordering easy for customers. Most entrepreneurs make the mistake of including only their prices on the list. A price list should clearly identify all the different products/services, how much each costs, and the terms of the sale.

Tip
Don’t forget to include information on where and how the goods can be purchased. Experts recommend that an entrepreneur provide at least three ways of placing an order including traditional mail, Internet ordering, fax, phone, or e-mail.

The main purpose of a price list is to make ordering or requesting products/services as easy as possible. The following ideas can be used to transform a price list into an effective marketing tool.

• Use easy-to-mail order blanks.
• Obtain a toll free telephone number and feature it on the price list.
• Display products/services on the reverse side of the price list.
• Keep the price list out of the customer’s files by placing it on some useful advertising-specialty item such as a calendar, business card holder, or paper pad holder.
• Post the price list where it can easily be found on your website.

More Info
Critique of a Price List, Kauffman Foundation—This sample price list identifies improvements necessary to turn the price list into a marketing tool. View this resource using the More Info link in the online course.
## Sweet Regards Bakery

123 Main St.
Cookieville, USA 12345
913-555-1212
E-mail: info@sweetregards.com

### Price List

<table>
<thead>
<tr>
<th>Item</th>
<th>Size</th>
<th>Details</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Layer Cakes</td>
<td>9” 2 layers</td>
<td>Serves 12</td>
<td>$35</td>
</tr>
<tr>
<td></td>
<td>9” 3 layers</td>
<td>Serves 16</td>
<td>$45</td>
</tr>
<tr>
<td>Carrot Cake</td>
<td>9” 3 layers</td>
<td>Serves 12</td>
<td>$40</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$4/slice</td>
</tr>
<tr>
<td>Flourless</td>
<td>8” 1 layer</td>
<td>Serves 10</td>
<td>$30</td>
</tr>
<tr>
<td>Chocolate Torte</td>
<td></td>
<td></td>
<td>$3.50/slice</td>
</tr>
<tr>
<td>Cupcakes</td>
<td></td>
<td></td>
<td>$2.50 each</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$24/dozen</td>
</tr>
<tr>
<td>Cookies</td>
<td>3”</td>
<td>Chocolate Chip</td>
<td>$1.50 each</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cranberry Pecan</td>
<td>$13/dozen</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Oatmeal Raisin</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Double Chocolate</td>
<td></td>
</tr>
<tr>
<td>Cinnamon</td>
<td>Jumbo</td>
<td></td>
<td>$2.50 each</td>
</tr>
<tr>
<td>Buns</td>
<td></td>
<td></td>
<td>$24/dozen</td>
</tr>
</tbody>
</table>

Price subject to change.
Delivery not included.
Prices vary for custom orders. Requires 50% deposit.

Order online at SweetRegardsBarkery.com or call (123)123-1234 Visa and MasterCard accepted.
10.4 Setting Prices

Assignment 10a: Marketing Plan—Pricing Section

Learning Objective

This pricing assignment is the final section of the marketing plan. You will describe your pricing strategy, include a price list, and explain your pricing policies. This section helps you establish the validity of the prices you will charge.

When you explain your pricing strategy, be sure to state your rationale for setting these prices. In your rationale, reference the industry, competitors, special pricing, and customer buying points.

An important step in establishing price validity is to complete a break-even analysis. This will be done in the financial section of this plan. Be sure to review your pricing section after determining your break even point to make sure it reflects a successful pricing strategy for your business.

Reality

Too many entrepreneurs try to compete primarily on price when it is not the most important thing to their target market.

Tip

Remember, the price of the product/service must be consistent with its image. If you are selling a product to an upscale market, do not charge the lowest price. The same is true for service businesses. If you are a consultant, recognize that being the cheapest consultant may create a misperception about your ability.

Assignment 10a: Marketing Plan—Pricing Section

<table>
<thead>
<tr>
<th>Business Plan Questions</th>
<th>Section Content Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pricing Strategy</td>
<td>10.3</td>
</tr>
<tr>
<td>What are your short-term and long-term pricing strategies?</td>
<td></td>
</tr>
<tr>
<td>Why have you selected these strategies?</td>
<td></td>
</tr>
<tr>
<td>What are the competitors’ pricing strategies?</td>
<td></td>
</tr>
<tr>
<td>What pricing constraints and sensitivities exist for your</td>
<td></td>
</tr>
<tr>
<td>product/service?</td>
<td></td>
</tr>
<tr>
<td>Price List</td>
<td>10.4.4</td>
</tr>
<tr>
<td>What is your price list, including purchase price, quantity</td>
<td></td>
</tr>
<tr>
<td>discounts, introductory offers, shipping costs, and</td>
<td></td>
</tr>
<tr>
<td>warranties/maintenance contracts.</td>
<td></td>
</tr>
<tr>
<td>Pricing Policies</td>
<td>10.4.3</td>
</tr>
<tr>
<td>What are your pricing policies, including volume pricing,</td>
<td></td>
</tr>
<tr>
<td>avoiding price conflicts and bundling products and services?</td>
<td></td>
</tr>
</tbody>
</table>
Assignment 10b: Marketing Plan Feasibility Checklist

For your assignments in Chapters 7 through 10, you created the marketing plan. Now check your plan against the marketing criteria for the model business. By using the model business feasibility checklist, you can identify areas in your marketing plan that should be addressed before you start the business. If you score below a three for any criterion, consider whether or not this aspect is fundamental to the success of your business.

Don’t be surprised if some of your answers have changed from when you used this tool in Assignment 4. Also at this point, you should be able to answer all questions, including those that you weren’t able to answer in Assignment 4.

Your answers on this checklist will influence your financial assumptions. For example, if your customers do not purchase frequently, you will need to spend more money to find new customers on an ongoing basis. If the business is low on news value, you will either need to develop a creative angle for your product/service or plan an adequate budget for promotion.

Assignment 10b: Model Business Feasibility Checklist—Market

Learning Objective
• In a comparison of your marketing plan to the Model Business Feasibility Checklist, identify areas of your plan that require improvement to enhance market feasibility.

Overview
The Model Business Feasibility Checklist identifies the major criteria that can make or break the success of a business. This checklist has already been used to evaluate the overall feasibility of earlier sections of the plan. Now, you will use the market criteria to reevaluate the feasibility of your marketing plan. By doing this, you can develop benchmarks for improvement.

Tools
Model Business Feasibility Checklist-Marketing

Step 1
Rate your marketing plan. Using a scale from 1 to 5 (1 meaning that your concept absolutely does not meet these criteria and 5 meaning that your concept entirely meets these criteria), rate your business concept against the model business criteria by circling the number corresponds to the rating you believe matches your business.

Step 2
Evaluate your marketing plan. When testing a business concept against the model business no score guarantees a feasible business. Generally, for a marketing plan to be feasible it must achieve at least one-half of the possible points overall and at least one-half of the possible points in any of the three sections. A score less than 3 for any individual criterion indicates a weakness in the marketing plan, which requires further consideration.
Step 3

Identify one or two criteria that you rated low. Consider ways that you can improve these scores as you go through the course. Do you need more information, a unique marketing strategy, or creative solutions? Most scores can be improved over time.

List several options that could raise the scores of the low criteria you identified.

### Run KC Business Feasibility Checklist

<table>
<thead>
<tr>
<th>MARKET FEASIBILITY</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market can be recognized and measured.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Existing competition has identifiable weaknesses.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distribution system is established and receptive.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customers purchase frequently.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business has great news value.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td>/25</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Model Business Feasibility Checklist—MARKET FEASIBILITY

If you need help rating your business using the Model Business Feasibility Checklist, check out the following guidelines. Look closely at the options for each model business factor. Then, choose the one that most closely represents your situation. Be honest! 1=Low 5=High

| Market can be recognized and measured. | 1. My customers could be just about anyone, so targeting a certain group may not be easy.  
2. I have many potential customers, so I need to do more research to find my target market.  
3. I have identified my potential customers, but they will be somewhat difficult to reach because of their demographics/buying patterns.  
4. With some effort, I can use my customers’ demographics/buying patterns to find them.  
5. My potential customers are easy to find because of their demographics/buying patterns. |
|--------------------------------------|---------------------------------------------------------------------------------------------------------------|
| Existing competition has identifiable weaknesses. | 1. I have lots of competition who have been in this business longer than I.  
2. I have no competition! Hmmm, I wonder why?  
3. I have identified my competition, but I do not know their weaknesses.  
4. I know my competition and their weaknesses, but I need more research.  
5. I have limited competition, and I know their weaknesses. |
| Distribution system is established and receptive. | 1. I must develop a brand new distribution system.  
2. My current distribution system offers only limited options.  
3. I’ve found a distribution system already established with several options.  
4. Several distributors seem receptive to carrying my products/services.  
5. Distributors are calling me wanting to carry my products/services. |
| Customers purchase frequently. | 1. Customers will only buy once from me, so I must find new customers all the time.  
2. Most customers will only buy once from me.  
3. Customers will buy more than once, but not frequently.  
4. Some customers will purchase products/services frequently.  
5. My existing customers purchase products/services very frequently. |
| Business has great news value. | 1. My business has zero news value.  
2. My business just doesn’t seem to have great news value.  
3. I think I can come up with an angle to get some publicity.  
4. I know my business has news value, and I can get some good media coverage if I work at it.  
5. My business is so new and interesting that getting in the news is easy! |
Step 3: Identify low rated criteria and consider ways to improve score.

Identify one or two criteria that you rated low.

Consider ways that these scores could be improved. Is more information needed? Is there a unique marketing strategy that would help? Or is there another creative solution?

Most scores can be improved over time. List several options that could raise the scores of the low criteria you identified.

Summary

This chapter outlined the basic process behind pricing. The chapter reinforced that pricing is both a marketing concept and a financial concept.

- Pricing a product/service is a critical factor that affects profitability.
- Each pricing strategy must be aligned with the overall marketing plan.
- Prices should not be set before completing a thorough analysis of the market's pricing constraints and sensitivities.
- Analysis of the competition and market can help you establish the price ceiling—the highest price you can set.
- The pricing tools provided in this chapter are helpful tools that should only be used in conjunction with research and analysis of the market.
- Pricing policies should be established before the business is started.
Overview
In the financial chapters, Chapters 11-14, you will learn about the various financial concepts that entrepreneurs use to plan a successful venture. These financial planning chapters will help you understand key financial terms, project accurate financial statements, and calculate financial ratios.

Your business plan will include three types of financial statements—a Cash Flow Statement, an Income Statement and a Balance Sheet. Preparing financial statements that accurately represent your business is critical to success. You will begin to prepare these statements in Chapter 11 by precisely estimating your start-up costs. If you do not project accurate start-up costs, your business could run into immediate financial difficulties.

You will walk through the financial template step-by-step. Each step focuses on projecting key elements of the financial statements including operating expenses, sales, inventory, and other cash payments. You will use the financial assumptions you compiled earlier to complete each step. After completing all steps, the financial statements—Cash Flow, Income Statement and Balance Sheet—will be automatically generated.

Understanding financial issues is an ongoing learning process. This chapter will introduce and reinforce financial concepts that will assist you in determining feasibility and developing a profitable venture.

Objectives
In this chapter, you will learn to:

• Understand key financial terms.
• Research financial information.
• Develop accurate start-up estimates.
• Understand the basic concepts of financial statements.
11.1 Introduction to Financial Planning
11.1.1 Financial Terms and Statements

Have you ever traveled to a foreign country only to find that your lack of understanding of the language prevented you from taking full advantage of the experience? Perhaps you could not understand the local people with whom you crossed paths or you couldn’t order off the menus in restaurants. Maybe you weren’t able to learn as much about the country and culture as you wished because of your inability to understand the language.

How much more would you have gained from the travel experience if you had been fluent in the language? Your options for overcoming this barrier might be to get assistance from someone else who could speak the language, or even to learn the language yourself. If you were going to be living in this foreign country for some time, it would be especially important that you have a basic understanding of the language.

Tip
Understanding accounting and financial concepts is similar to learning a foreign language. It is not a difficult task but will take some time and effort on your part. The first step entrepreneurs may take is to seek the assistance of others who have an understanding of accounting while they seek to acquire those skills themselves.

Tip
Each time you hear financial concepts, your knowledge base will grow. If financial terms are new to you, your learning will begin to take place right now. In the future, talk with other entrepreneurs and financial advisors, read books or magazines about financial concepts, and take classes to further your understanding.

Entrepreneurs without an understanding of basic accounting and financial concepts are like travelers in a foreign country who do not understand the language. Accounting is the language of business. An entrepreneur needs to understand the basic concepts represented by three key financial statements - the Income Statement, Cash Flow Statement, and Balance Sheet. They also need to understand the related terminology to effectively plan and manage the financial aspects of their business.

Financial Statements and their related terminology are detailed below:

Income Statement—This financial statement shows the net income or loss the business has experienced over a period of time—in other words, the company’s financial grade card. The Income Statement is sometimes referred to as the Profit and Loss or P&L statement.

Key financial terms on the income statement include:

- **Sales or Revenues**—Money or the promise of money received from providing a product/service.
• **Cost of Goods Sold (COGS)**—The cost of raw materials, purchased parts, and labor required to produce or provide a product/service, or the purchase price of the merchandise to be resold. Note that in the Income Statement on the next page, the COGS is expressed both as a dollar amount and as a percentage of the net sales. This percentage will be an important figure to have when completing your financials. See 11.1.3 Finding Financial Information as a guide to finding the industry standard COGS for your business.

• **Operating Expenses**—The costs incurred in operating the company and providing the product/service. This includes selling, administrative, and general overhead costs involved in the business’s operations.

• **Net income**—The amount that remains from revenues when all expenses have been paid.

Following is a simplified Income Statement for Backyard Solutions:

<table>
<thead>
<tr>
<th>Backyard Solutions—Year-End Income Statement (Projected)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Year</td>
<td></td>
</tr>
<tr>
<td>Net Sales</td>
<td>$775,177</td>
</tr>
<tr>
<td>– Cost of goods sold</td>
<td>$542,623</td>
</tr>
<tr>
<td>= Gross income</td>
<td>$232,554</td>
</tr>
<tr>
<td>– Operating expenses</td>
<td>$171,370</td>
</tr>
<tr>
<td>= Operating income</td>
<td>$ 61,184</td>
</tr>
<tr>
<td>– Interest Expense</td>
<td>$ 3,477</td>
</tr>
<tr>
<td>= Net income</td>
<td>$ 57,707</td>
</tr>
</tbody>
</table>

**Cash Flow Statement**—This financial statement reflects cash flowing into and out of the business, similar to a check register. Sources of cash are recorded under the Cash In category and cash expenditures are recorded under the Cash Out category.

Key financial terms on the income statement include:

• **Beginning Cash Balance**—Either start-up cash or cash balance remaining from the prior month.

• **Cash In**—Sources of cash you expect to receive on a monthly basis. This list includes cash sales, collections from accounts receivable, equity contributions, and loans.

• **Cash Out**—Cash used to pay for both operating and non-operating expenses. Non-operating costs include items such as interest payments, loan payments, and owner’s draw.
Following is a simplified Cash Flow Statement for Backyard Solutions:

Make the following assumptions:

- Sales are $50,200 in month 1 and $56,224 in month 2 and half of all customers pay in cash each month; the rest are invoiced and given 30 day terms.
- Inventory and raw materials are purchased on credit and paid for in 30 days; therefore, no payment for inventory is made in month 1 and $35,140 is paid in month 2.
- Operating expenses are $11,680 in month 1 and $12,950 in month 2 and are paid in the month they occur.
- The beginning cash balance for Month 1 is $10,000.

### Backyard Solutions—Year-End Income Statement (Projected)

<table>
<thead>
<tr>
<th></th>
<th>Month 1</th>
<th>Month 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Beginning Cash Balance</strong></td>
<td>$10,000</td>
<td>$23,131</td>
</tr>
<tr>
<td><strong>Cash In</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Sales</td>
<td>$25,100</td>
<td>$28,112</td>
</tr>
<tr>
<td>Received on Acct (AR)</td>
<td>$25,100</td>
<td></td>
</tr>
<tr>
<td><strong>Total Cash In</strong></td>
<td>$25,100</td>
<td>$53,212</td>
</tr>
<tr>
<td><strong>Total Cash Available</strong></td>
<td>$35,100</td>
<td>$76,343</td>
</tr>
<tr>
<td><strong>Cash Out</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory Expenditures</td>
<td>$35,140</td>
<td></td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>$11,680</td>
<td>$12,950</td>
</tr>
<tr>
<td>Interest</td>
<td>289</td>
<td>289</td>
</tr>
<tr>
<td><strong>Total Cash Out</strong></td>
<td>$11,969</td>
<td>$48,379</td>
</tr>
<tr>
<td><strong>Monthly Cash Flow</strong></td>
<td>$13,131</td>
<td>$4,833</td>
</tr>
<tr>
<td><strong>Ending Cash Balance</strong></td>
<td>$23,131</td>
<td>$27,964</td>
</tr>
</tbody>
</table>

(Beg Cash Bal +/- Monthly Cash Flow)

### Balance Sheet

- **Balance Sheet**—This financial statement reports what the company owns (assets), what it owes (liabilities), and the net worth that remains for the owners of the business. The Accounting Equation is:

$$ A = L + E $$

A balance sheet is a snapshot of the business at a specific point in time.

Key financial terms in the Balance Sheet include:

- **Asset**—An item that has value and is owned by the business.
- **Liability**—An amount owed or an obligation to perform a service to creditors, employees, government bodies, or others.
• **Equity**—Money invested in a company that is not intended to be repaid but represents an ownership interest. This may be called owner’s equity as it represents the actual dollar value of the total owners’ investment in a business, plus any net profits that have been retained in the business from year to year. This amount is determined by subtracting liabilities from assets.

Following is a simplified Balance Sheet for Backyard Solutions:

<table>
<thead>
<tr>
<th>Backyard Solutions—Year-End Balance Sheet (Projected)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Year</strong></td>
</tr>
<tr>
<td>Cash                                              $110,320</td>
</tr>
<tr>
<td>Accounts Receivable                                15,291</td>
</tr>
<tr>
<td>Inventory                                         5,352</td>
</tr>
<tr>
<td>Other current assets                               —</td>
</tr>
<tr>
<td><strong>Total current assets</strong>                           130,963</td>
</tr>
<tr>
<td>Net fixed assets                                   57,905</td>
</tr>
<tr>
<td><strong>Total assets</strong>                                   $188,868</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong>                      $8,428</td>
</tr>
<tr>
<td>Long-term debt                                    37,735</td>
</tr>
<tr>
<td><strong>Total liabilities</strong>                              46,163</td>
</tr>
<tr>
<td><strong>Total Equity</strong>                                   142,705</td>
</tr>
<tr>
<td><strong>Total liabilities &amp; equity</strong>                     $188,868</td>
</tr>
</tbody>
</table>

You have now been exposed to basic financial terms and the financial statements that will be an integral part of your business plan. As you proceed through the upcoming chapters, you will be creating projected financial statements for your own business. By projecting these financial statements for the first years of the business, you can determine the feasibility and viability of your business concept.

**from real entrepreneurs**

Rita, owner of a mid-town flower shop, never understood the financial statements that her accountant sent her each month. When money got tight, she decided it was time to learn more. A financial seminar, held by a local accountant, really opened her eyes to accounting concepts. After several meetings with the seminar leader, Rita realized that understanding financial statements wasn’t that difficult after all. She also recognized that even though she had an accountant keep her financial records, it was critical that she understood them.

**Tip**

Entrepreneurs don’t need to become accountants to effectively run their business. But they do need to be able to read and understand financial statements to make financial decisions.

**More Info**


Financial Statements—The SBA guide to the Income Statement and Balance sheet. [sba.gov/content/financial-statements](http://sba.gov/content/financial-statements)
11.1.2 Profitability and Cash Flow

In addition to understanding basic financial statements and terms, entrepreneurs also need to understand the related concepts of profitability and cash flow, two critical financial objectives which are critical to the long-term survival of any business. Profitability is the company’s ability to generate income. Cash flow is the company’s ability to pay obligations as they become due and to accumulate cash for future growth. By studying the projected financial statements, entrepreneurs are able to determine the ability of a company to achieve these two objectives.

from real entrepreneurs

With a mark-up of 100% over costs, Bryan couldn’t understand why his small trailer manufacturing business was in such dire financial straits. He could barely make payroll for the three employees that worked for him and keeping the lights turned on was a challenge. Upon a careful analysis of how customers paid for their made-to-order custom trailers (a down-payment at the time the order was placed and the rest paid on delivery), Bryan realized he could double the down payment and still not hurt sales. His high-income customers, primarily race car owners, had the money for a heftier down payment and were willing to pay it for a quality, custom built trailer in which to transport their race cars. These changes meant survival to Bryan’s business.

Profitability

The entrepreneur may have enough money to get started in business, but ongoing profits are the key to long-lasting success. In the previous sections you reviewed an income statement for Backyard Solutions which indicated that they are off to a good start, showing a profit their first year in business. Adequate profits are necessary to repay debts, purchase inventory, and fund future growth.

What exactly are profits? Profits are determined by subtracting the expenses of a business from the revenues generated in the business. They are the excess of revenues over expenses in a given time period, which includes depreciation and other non-cash expenses. This is sometimes referred to as the Net Income Equation or Income Statement Equation.

Net Income Equation

\[
\text{Net Income} = \frac{\text{Sales/Revenues}}{\text{Cost of Goods Sold}} - \text{Total Expenses}
\]

Let’s take a closer look using the figures from the Income Statement for Backyard Solutions shown earlier. Using the formula above to calculate the net income for Backyard Solutions would show the following:

\[
\begin{align*}
\text{Net Sales/Revenues} &= \$775,177 \\
\text{Cost of goods sold} &= 542,623 \\
\text{Gross income} &= 232,554 \\
\text{Total expenses} &= 174,847 \\
\text{Net income} &= \$ 57,707
\end{align*}
\]

*Note: Total Expenses include Operating Expenses ($171,370) and Interest Expense ($3,477)
Now examine some of the figures in the Net Income Equation in more detail. Revenue is calculated by multiplying the total number of products/services sold at the price charged. When selling items of various prices, an average price can be used. The revenue equation is as follows:

Revenue = Units Sold x Price (per unit)

In our example above, the $775,177 revenue was generated through the sale of 386 storage sheds at an average price of $2008.23 per shed. The revenue equation would be: $775,177 = 386 sheds x $2008.23

The other major factor affecting net profit is expenses. As you saw in Backyard Solutions example, there were two main categories of expenses, cost of goods sold (or cost of product/service) and operating expenses. Businesses selling products have a cost of goods sold. Some service businesses do not. When the cost of the products/services is subtracted from sales, the result is the gross income, which is also called gross profit or gross margin.

\[
\text{Sales} - \text{Cost of products/services} = \text{Gross income}
\]

The gross income equation for the Backyard Solutions would be:

$775,177 – $542,623 = $232,554

Gross income is an important number to understand because it indicates how much money is available to cover the other costs of operating the business (operating expenses). These include overhead costs such as rent and administrative payroll, as well as marketing costs. In addition to operating costs, a business may have interest expense and taxes. After all expenses are covered, the amount remaining is the net income or profit. If expenses exceed revenue, a net loss occurs.

\[
\text{Sales} - \text{Cost of products/services} - \text{Expenses} = \text{Net income or loss}
\]

As stated earlier, the net income equation for the Backyard Solutions would be:

$775,177 – $542,623 – 174,847 = $57,707

Reality

The price charged often affects the number of products/services that can be sold. Most often, the lower the price, the more products/services sold. In some cases, however, increasing the price gives the customer the idea of increased value and more products/services are sold.

Sales – Cost of products/services = Gross income

Tip

Evaluating price, units sold, cost of products/services, and operating expenses, allows you to make changes to improve overall profitability.
In retail stores, the markup on merchandise is often 100 percent. For example, an item that costs a store $15 is marked up 100 percent to sell for $30 to a customer. This markup means that every time a retail store sells something, up to 50 percent of the money collected is used to cover the actual costs of the item. The remaining 50 percent covers operating expenses and provides a profit.

A projected income statement (also called the Profit & Loss or P&L statement) is a tool for entrepreneurs to forecast the profitability of the company. It shows how much profit a company made or lost during a given period of time (Revenues – Expenses = Net profit or Net loss). In your business plan, you will generate both monthly and annual income statements.

**Cash Flow**

Cash flow is exactly what the name implies. It shows cash as it flows into and out of a company. You need to analyze your cash flow because of the delay that usually occurs between the time you pay cash out to generate sales and the time you actually receive cash in from those sales. This is called the cash cycle. Since typical sales transactions have a cash cycle of days, weeks, or months, you will need to locate funds to keep the business running while waiting for the cycle to be completed. Only cash transactions are included in this analysis. Non-cash items such as depreciation do not appear on the cash flow statement.

An example of a cash flow statement for Backyard Solutions was included in section 11.1.1 of this chapter. The example showed a positive cash flow for months 1 and 2, based on the assumptions provided.

A monthly cash flow statement is one of the most important planning and reporting tools you will use during the start-up phase of the business. A projected cash flow statement will show the ability of your company to pay its obligations as they become due and to build cash for future growth. It can help with your daily budgeting and alert you to potential cash shortages.

**Tip**

Growing companies have a high cash burn rate—the rate that a company uses up cash. The cash burn rate is usually calculated as your average monthly costs. In the company’s early stages, you will likely be spending more money than you bring in, or running at a loss, before emerging into profitability and positive cash flows.

**from real entrepreneurs**

Duane Johnson had a three-year-old company that specialized in commercial embroidery. Each year Duane’s sales grew and by the third year, sales had reached over $300,000. Duane’s background in sales helped stimulate this growth. Even though the company was growing, there seemed to be a consistent and growing need for cash. Halfway through the third year Duane realized that he needed help. He hired an accountant, for the first time, and had extensive work done to analyze his financial position. The accountant recommended a working capital loan to compensate for the increasingly tight cash flow. According to his projections, Duane’s company would have been bankrupt within a year because of its lack of cash to pay for ongoing expenses and financial obligations. Duane closely analyzes his financial statements now, especially the projected cash flow statement.
Profits and Cash Flow

The income statement reflects the profitability of the business, yet net profit does not always result in a positive cash flow. A prime example is when customers do not pay at the time of the sale. This is often the case when customers are sent an invoice and given 30 days to pay their bill. This might also occur if customers do not pay on time. The revenue is recorded on the income statement, but the cash has not been received.

The monthly cash flow statement reflects a company’s cash on hand at a given time. In the situation described earlier, the sale has been made but the cash from the sale would not be reflected in the cash flow statement because the money has not yet been received. If this is the case for enough customers, a profitable business may be unable to pay its bills unless cash shortages that result from the sales cycle are anticipated and addressed.

Consider the following to be an Income Statement for Backyard Solutions for the month of June – their first month in business. After subtracting all expenses from sales, the statement shows a net income or profit of $3091. The owner would consider this a profitable month.

### Backyard Solutions—Monthly Income Statement

<table>
<thead>
<tr>
<th></th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>$50,200</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>$35,140</td>
</tr>
<tr>
<td><strong>= Gross income</strong></td>
<td><strong>$15,060</strong></td>
</tr>
<tr>
<td>Operating expenses</td>
<td>$11,680</td>
</tr>
<tr>
<td><strong>= Operating income</strong></td>
<td><strong>$ 3,380</strong></td>
</tr>
<tr>
<td>Interest expense</td>
<td>289</td>
</tr>
<tr>
<td><strong>= Net income</strong></td>
<td><strong>$ 3,091</strong></td>
</tr>
</tbody>
</table>

Now, let’s take a look at the cash flow statement for the same month, but change one of the assumptions made in the previous Cash Flow Statement. Let’s assume that rather than paying for inventory the following month, Backyard Solutions has to pay for inventory in cash because they are a start-up business without a credit history. In the earlier cash flow statement, it was assumed Backyard Solutions could purchase on credit and pay within 30 days. The Cash Flow Statement which follows reflects how a change in this one assumption creates cash flow problems for the business.
Their cash flow statement would now appear as follows:

<table>
<thead>
<tr>
<th>Cash Flow Statement (Projected)</th>
<th>Month 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Cash Balance</td>
<td>$10,000</td>
</tr>
<tr>
<td>Cash In</td>
<td></td>
</tr>
<tr>
<td>Cash Sales</td>
<td>$25,100</td>
</tr>
<tr>
<td>Received on Acct (AR)</td>
<td>$25,100</td>
</tr>
<tr>
<td>Total Cash In</td>
<td>$25,100</td>
</tr>
<tr>
<td>Total Cash Available</td>
<td>$35,100</td>
</tr>
<tr>
<td>Cash Out</td>
<td></td>
</tr>
<tr>
<td>Inventory Expenditures</td>
<td>$35,140</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>$11,680</td>
</tr>
<tr>
<td>Interest</td>
<td>289</td>
</tr>
<tr>
<td>Total Cash Out</td>
<td>$47,109</td>
</tr>
<tr>
<td>Monthly Cash Flow</td>
<td>$(22,009)</td>
</tr>
<tr>
<td>Ending Cash Balance</td>
<td>$(12,009)</td>
</tr>
<tr>
<td>(Beg Cash Bal +/- Monthly Cash Flow)</td>
<td></td>
</tr>
</tbody>
</table>

Based on the current assumptions, even though Backyard Solutions was profitable their first month in business, they ran out of cash with which to operate the business. Like many start-up companies, they were not able to establish payment terms and, therefore, had to pay for their inventory with cash. Yet, they extended terms to their own customers. Advance planning would have helped them realize that they were not in a position to do so.

There are numerous factors that might contribute to negative cash flow. Projected cash flow statements can help entrepreneurs identify these factors and plan accordingly.

**Tip**

Profitability is needed to ensure the long-term survival of a business.

Cash is needed to ensure the short-term survival of a business.

The cash flow statement is by far the most important document in the business plan for a venture. It is also the most important tool that management has for contemplating and controlling the financial affairs of the enterprise.

**Tip**

A business can operate for a long time at a loss—many do—but no company can operate without cash. No cash…no business!

**More Info**

How to Better Manage Your Cash Flow, These four steps will help you keep track of the money coming in and out of your growing company. [entrepreneur.com/money/moneymanagement/managingcashflow/article66008.html](https://entrepreneur.com/money/moneymanagement/managingcashflow/article66008.html)
11.1.3 Finding Financial Information

The first place entrepreneurs look for financial information is within the industry. Many trade associations provide information about sales and expenses that can be built into assumptions. Additional industry information can be found by utilizing the databases of business magazines and journals available through most libraries. Under the industry classification code, SIC or NAICS, articles about existing businesses may mention information about profits, expenses, or other financial data.

From Real Entrepreneurs

To build financial assumptions about her specialty retail store, Korah Alma utilized the contacts she made within her industry's trade association to gather information. By talking with other retail store owners in the association, she found that the average sale per customer was $45. She combined this information with local zip code data and traffic counts to begin estimating her expected sales.

Studies of financial statements may also provide valuable information. Several publishers collect information directly from companies and compile it by industry. If resources require a subscription to access their materials, check with your local business library to see if they are subscribers. Many libraries make this information available to their patrons free of charge.

By using the industry classification code, entrepreneurs can review the financial information of competitors within their industry. Information is organized by the size of the company and includes data concerning sales, COGS, expenses, assets, liabilities, and financial ratios. These financial statement studies are also available at most libraries. Benchmarking your company's data against the reported data of others in the industry is an excellent way to get started.

More Info

BizStats by BizMiner—Free business statistics and financial ratios.
bizstats.com/corporation-industry-financials/

RMA Annual Statement Studies—Includes 17 sections arranged by primary industry code. They contain composite company financial data supplied by Risk Management Associates’ member institutions. Available in most business libraries. Publisher’s website: rmahq.org/RMA/

Industry Norms and Key Business Ratios, Dun and Bradstreet—Financial information based on financial statements of various companies arranged by industry code. Available in most business libraries. Publisher’s website: dnb.com

Almanac of Business and Financial Ratios, Leo Troy, Ph.D.—Financial information from IRS data on millions of companies. Available in most business libraries.
11.1.4 Financial Planning Outcomes

The financial plan focuses on three primary outcomes:

- Profitability—Entrepreneurs must know that their ventures will be profitable.
- Cash flow—Entrepreneurs must understand the cash needs of the ventures and have adequate sources to meet those needs.
- Financial performance—Entrepreneurs want to know that their businesses are projected to perform financially as well as, or better than others in the industry.

These three outcomes should be supported by written assumptions related to the basic components of each. To thoroughly plan for these, entrepreneurs need to project expectations in the following financial categories:

- Start-up costs
- Operating expenses
- Sales
- Inventory costs
- Capital budget—money needed for purchases of assets and distributions to owners/investors
- Equity and Debt—money sources

When projecting financial information, entrepreneurs will develop the following financial statements. These financial statements will help answer questions about profitability, cash flow, and financial performance:

- Monthly Cash Flow Statement
- Year-End Income Statement
- Year-End Balance Sheet
- Financial Analysis/Ratios

**Tip**

Using the financial template provided in this course will save you hours of work in producing projected financial statements for your business plan. The template will automatically generate these financial statements as you enter financial information.

11.1.5 Financial Template: Using Technology to Assist in Financial Planning

A Microsoft Excel financial template, included with this course, is provided to save hours of time in producing the projected financial statements needed for the business plan. The template consists of worksheets for entering data and projecting financial statements as well as a ratio analysis. The projected financial statements and ratio analysis should be included as part of the financial section of the business plan. Worksheets should be included in the appendix of the plan.
The financial template consists of the following interactive worksheets:

- The Introduction provides valuable information on the features of the financial template.
- The Set-Up provides areas to enter company information.
- The Start-Up worksheet should be used to compile the costs involved in starting the business.
- The Operating Expenses, Sales, Inventory, Capital Budget, and Equity & Debt worksheets ask for budget decisions for the next three years. Changes on these worksheets will automatically be carried forward to the following financial projections:
  - Monthly Cash Flow Statement
  - Monthly + Year-End Income Statement
  - Year-End Balance Sheet
  - Financial Analysis/Ratios
- Two additional functions are provided on worksheets for added convenience:
  - The Amortization Schedule determines principal and interest payments on loans.
  - Print Options allows users, with one click, to print out instructions, worksheets or financial projections.

Note: The financial template is not designed for columns or rows to be added or deleted. Doing so may cause data to be lost or corrupted.

The following steps provide an overall guide to using the financial template:

Step 1 Save the template.

- Open the Financial Template.
- From the File menu, select Save As
- Save the document as MyFinancials.xls on your own flash or hard drive.
- Continue to save the document as changes are made. Store a backup copy in a safe place.

Step 2 Complete Set-Up worksheet.

Step 3 Complete the Start-Up worksheet.

Step 4 Enter other budget information on Operating Expenses, Sales, Inventory, Capital Budget, Equity and Debt worksheets.

Step 5 Print the financial projections.

Note: In this chapter, you will complete Steps 1-3. The Inventory, Operating Expenses, Capital Budget, and Equity and Debt worksheets in Step 4 and Step 5 will be completed in subsequent financial chapters.

More Info

Using the Business Planning Financial Template—Detailed instructions on how to use this helpful planning tool created by the Ewing Marion Kauffman Foundation.
More Info 11a: Using the Business Planning Financial Template

Financial Template Overview

A Microsoft Excel workbook is provided to save hours of time when projecting financial statements for your Business Plan. When you initially access the file, Excel may prompt you to “Enable Macros.” There may be a security warning at the top of the page indicating that Macros have been disabled. You must enable the macros to use the printing options within the financial templates.

The template consists of worksheets (where you enter data) and projected financial statements as well as ratio analysis. The financial statements and ratio analysis are part of the financial section of the business plan. Include the worksheets in the appendix of your 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 workbook 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 (Set-up Worksheet).

Many features have been built into the template to make it easy to use. For example,

- 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.
- Tips/comments are included throughout the workbook to provide additional information on the template or the financial projection process. Placing your cursor on any cell that has a red triangle will access these tips/comments.
- Printing instructions, worksheets, and financial information is easy with the print buttons that are provided on each sheet. There is also a Print Options Worksheet that lists all printing options included within the workbook. You “Enable Macros” upon entering the workbook to use the print buttons.

The financial template consists of the following interactive worksheets:

- Introduction—provides valuable information on features of the financial template.
- Set Up—asks you to set up your company information and record your company’s current financial position.
- Start-Up—allows you to compile the costs involved in starting your business.
- Operating Expenses, Sales, Inventory, Capital Budget, Equity & Debt—ask you to record budget decisions for the next three years. Changes on these worksheets will automatically be updated on the following financial projections:
  - Monthly Income Statement
  - Break-even Analysis
  - Monthly Cash Flow Statement
  - Year-End Income Statement
  - Year-End Balance Sheet
  - Financial Analysis/Ratios
Two additional functions are provided on worksheets for your convenience:

- Amortization Schedule—figure your principal and interest payments on your loans
- Print Options—with one click, print out your choice of instructions, worksheets or financial projections

**Steps in Using the Financial Template**

**Step 1: Save the template**

- 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.

When you begin entering your own information into the financial template, we recommend giving the file another name. This will allow you to keep a fresh version of the template if you want to create another plan.

**Step 2: Set Up**

The second sheet in the financial template—Set Up—asks you to set up your workbook with the name of your company, the year you wish to designate as year one, and your estimated effective tax rate. Detailed instructions are provided for each step of Set Up. Start-up businesses will skip Step 3. Businesses already in operation will complete Step 3—Historical Balance Sheet.

**EXISTING BUSINESSES**

If you have an existing business, you will be asked to enter your company’s current financial position using information from the company’s most current balance sheet. The workbook adds the current financial information to the projections to create projected balances for assets, liabilities, and equity.

The balance sheet includes:

- **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, and 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.
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.

Accounts Payable (Suppliers)—Enter the amount of accounts payable 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.

Owners 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.

Existing businesses may need to complete a payoff schedule located at the bottom of the 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.

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 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. 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. 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. Payments on your Line of Credit, Long-term or Real Estate Loans should NOT be entered in the pay off schedule. Use the Equity & Debt Worksheet to record payment of principal and interest relating to these loans.

Step 3: Start-Up

If your company is a start-up, you will use this worksheet—Start-Up—to compile the cost associated with starting your business. The start-up expenditures will be automatically carried forward in the financial projections. Do Not enter these costs in month one of the business unless they occur again during month one. Detailed instructions will direct you through the process of entering start-up estimates.
Step 4: Enter Your Budget Information

The next five sheets—Operating Expenses, Sales, Inventory, 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.

TWO ADDITIONAL WORKSHEETS ARE PROVIDED FOR YOUR CONVENIENCE:

- Amortization Schedule—calculate your principal and interest payments on your loans
- Print Options—with one click, print out your choice of instructions, worksheets or financial projections

Operating Expenses Projections

This worksheet reports the expenses that you expect to incur just to operate your business—your overhead costs. On this worksheet you will enter the monthly amount you expect to pay for operating expenses, such as payroll, marketing and rent expenses. Be sure to enter expenses in the month(s) they will be paid. Some expenses such as rent will be paid each month. However, an expense such as membership in an organization is probably paid once a year. Enter it in the month it is paid. Do not divide the amount into monthly payments, unless of course, it will actually be paid in that manner.

For each expense projected, 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. This information will help you remember the details supporting the numbers and will help readers of your plan understand the basis for your estimates. 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.

Sales Projections

On this worksheet you will record the amount of sales revenue you expect to receive for the first three years in the planning period. To get an accurate picture of your sales projections 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)?

You will be asked to enter your monthly estimated sales for each year in the planning period. Customize the worksheet by entering the product/service categories in the areas provided and then start entering sales in the first month that you expect to receive sales. Be sure to reflect sales fluctuations based on start-up, seasonality, peak sales months, and growth over time.

In addition to monthly sales, you may receive money from activities unrelated to your primary business. The template provides a place for you to enter these amounts, as well.
Inventory Projections
This worksheet is for businesses that have direct costs of goods sold, such as retailers and manufacturers. If you do not purchase any inventory or materials for resale, you do not need to complete this worksheet. To accurately project inventory needs, you will be asked these questions:

1. Does your business provide services along with products?
2. What percentage of sales is the average cost of goods sold (COGS) for your products?
3. How much inventory or raw materials will you be purchasing? Will you be buying some of this on credit? What are 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?

For each inventory or raw material amount projected, you will write an assumption about how that estimate was determined.

Capital Budget Projections
The different sections of this worksheet will guide you through the process of recording your capital budget. The instructions for each section will help you determine which sections pertain to your business. Through this process you will identify:

1. Depreciation on existing capital assets (equipment, furniture, vehicles, etc.).
2. Future capital purchases and the depreciation on these purchases.
3. Other capital expenditures (owner draws, dividend payments, etc.).

Equity & Debt Worksheet
This worksheet is divided into several sections that represent the type of funding you plan to include in your business plan. The funding you receive may include both equity (money provided by owners of the company) and debt (money loaned to the company by outside sources). Questions will prompt you in each section to determine if that form of funding is to be added to the plan. 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, etc.) 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 section is provided that shows the current cash balances based on all the projections for spending and sales as well as borrowing and equity investments you have made 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 if you still find yourself needing additional cash to support business operations.

**Step 5: Print the Financial Projections**

Congratulations! You have completed the financial projection process. Now, print out the statements you need for your business plan. Use the Print Options Worksheet to print the Financial Statements to include in the business plan:

- Monthly Income Statement
- Break-even Analysis
- Monthly Cash Flow Statement
- 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 the business plan.

- Historical Balance Sheet
- Start-Up Funding & Expenditures
- Sales Projections
- Inventory Projections
- Operating Expenses Projections
- Capital Budget Projections
- Equity & Debt Worksheet
- Amortization Schedule
Assignment 11a: Financial Template—Set-Up Worksheet

The assignments in chapters 11 through 14 will help you create a professional financial plan. In Assignment 11a you will learn how to use the financial planning template and set up your financial plan. With the help of the financial template, it will be easier than it first appears to build your financial plan. If you collected information on the Financial Assumptions worksheets as you wrote the earlier sections of the plan, you should have most of the financial data you need. It will now be a matter of entering that data; the actual formatting and calculations will be done for you.

Tip

Familiarize yourself with the template so you can use it easily in this and subsequent assignments. The time you spend now will make it easier to complete your financial plan.

You will use this same Microsoft Excel-based financial template throughout the financial chapters. The template consists of eight worksheets, which are linked to five financial statements – monthly income statements, cash flow statements, year-end income statements, balance sheet and ratio analysis. The financial statements become part of the financial section of the business plan. Include the worksheets in the appendix of the business plan.

Worksheets

1. Set-Up
2. Start-Up
3. Operating Expenses
4. Sales
5. Inventory
6. Capital Budget
   Section A—Depreciation (existing capital assets)
   Section B—Capital Asset Purchases and Depreciation
   Section C—Other Capital Expenditures
7. Equity & Debt
   Section A—Cash Position
   Section B—Real Estate Loans
   Section C—Traditional Business Loan and/or other Long-term Loans
   Section D—Line of Credit
   Section E—Equity Investment
8. Amortization Schedule

Financial Statements

Monthly Income Statement
Break-even Analysis
Monthly Cash Flow Statement
Year-End Income Statement
Year-End Balance Sheet
Financial Analysis/Ratios
If you would like to print out the instructions, worksheets, or financial statements, you can print them directly from the sheets in the template or you can go to the last sheet of the template, which is the print options page.

After thoroughly reading the introduction on the first sheet of the template, follow the instructions to complete the Set-up Worksheet. You will need the name of your business and the year the plan starts. Follow the instructions in Step 2 to estimate the income tax rate for the business.

If your company is a start-up, the Historical Balance Sheet and Pay Off Schedule do not apply. Complete the Set Up and proceed directly to the Start-Up worksheet.

If you have an ongoing business, you will continue your work in the Set-Up worksheet by completing the following:

- **Historical Balance Sheet**
- **Pay Off Schedule**, if appropriate.

If yours is a start-up business, the **Historical Balance Sheet and Pay Off Schedule do not apply. Complete the Set Up and proceed directly to the Start-Up worksheet.**
11.2 Determining Start-Up Costs

11.2.1 Start-Up Costs

Business concepts must match the personal visions of entrepreneurs as well as their bank accounts. Problems like running out of money can be avoided by accurately estimating start-up costs and preparing an initial start-up budget. When developing a list of start-up costs, entrepreneurs should keep their personal vision in mind. This will help them remember what they originally wanted to accomplish through their business.

One method of determining how much money a venture will need at start-up is to create a mental image of what the business will look like. Answering the following questions will assist you in visualizing your business and identifying start-up costs:

- Where will the business be located?
- What size will it be initially?
- What will the office or retail space look like?
- What type of furniture and fixtures will it have?
- What equipment will be needed, such as computers, copiers and fax machines?
- What signage will be required?
- How much opening inventory will the business need?
- How will the inventory be paid for?
- What deposits will be required? For example, how much will deposits cost for telephone, utilities, and first and last month’s rent?
- What city codes must be complied with, and what are the costs involved?
- What governmental (local, state, federal) business licenses will be required, and which have fees associated with them?
- What supplies will be needed for cleaning, office correspondence, shipping, and boxes?
- What marketing costs will be incurred before opening the business for items such as brochures, advertising, stationery, and business cards?
- What are potential costs for recruiting and hiring initial staff?
- Will staff training be necessary before opening?

Tip
Talk with other business owners to get a realistic idea of what it may cost to start your business.

Reality
The difference in recording expenditures and expenses has implications that can affect a business’ financial position and tax liability.
When estimating start-up costs, entrepreneurs must be as realistic and accurate as possible. Some entrepreneurs try to force the budget process to match the amount of money they have available and as a result underestimate their actual start-up costs. Instead of looking at available funds, entrepreneurs should determine how much money the business concept needs at start-up and then look at available funding.

Entrepreneurs should also avoid the trap of projecting a lower start-up amount than needed with the idea that it will help them get a loan from a bank. It is better to redefine the concept than to start a business with too little money. If costs of starting the business under the current business model are too high, the entrepreneur should consider scaling the business or selecting another type of business. The entrepreneur should alter the start-up plans, not the start-up costs.

from real entrepreneurs

One island-based entrepreneur wanted to launch a touring business. His first idea, providing underwater ocean tours, seemed feasible since he found two submersible vehicles for sale. After estimating a start-up budget, the entrepreneur discovered that about $1.2 million was needed for to launch this venture. The entrepreneur could only raise $100,000. This reality brought the entrepreneur back to evaluate his initial vision—a touring business. He altered his business plan to reflect the available money and started a very successful land-based touring company.

More Info

10 Reasons for a Bare Bones Business Start-Up—Staying “lean and mean” should be the bootstrapper’s mantra, according to tech entrepreneur Jeff Hester. In this blog post, he shares his advice and insights into protecting and growing your business during the early years. bootstrapme.com/50226711/10_reasons_for_a_bare_bones_business_startup.php.

Reality ✓
When estimating start-up expenses, be as realistic and accurate as possible. Entrepreneurs always discover unplanned hidden costs after start-up.

Reality ✓
Don’t start a business unless adequate funding is available. Starting without enough money is a sure way to fail.

Identifying the start-up costs for a venture helps the entrepreneur understand the amount of money needed to open the business’ doors. Start-up costs include both capital expenditures (generally, one-time costs) and operating expenses (generally, ongoing costs). Understanding the difference between expenditures and expenses is important because each is treated differently from an accounting standpoint.
11.2.2 Start-Up Expenditures

When items are purchased that retain some value, they are referred to as assets. The acquisition of assets is considered a capital expenditure. Capital expenditures include items purchased to operate the business (such as a computer) or to generate revenue (such as printing equipment for a print shop).

Tip
Capital expenditures can be sold to recapture some of the cash that you spent to buy them. Because they have value, capital expenditures are recorded as an asset on the balance sheet.

Expenditures can also include upfront payments for security deposits required by utility companies or landlords. These deposits will be recorded as assets on the Balance Sheet because as long as you perform all the requirements of your agreement, you expect to receive the money back. The cost of purchasing your opening inventory to sell to customers is another type of start-up expenditure.

Examples of possible expenditures include:

<table>
<thead>
<tr>
<th>Capital Expenditures</th>
<th>Security Deposits</th>
<th>Other Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>Rent Deposit</td>
<td>Inventory</td>
</tr>
<tr>
<td>Furniture</td>
<td>Telephone</td>
<td>Deposit</td>
</tr>
<tr>
<td>Leasehold improvements</td>
<td>Utility</td>
<td></td>
</tr>
<tr>
<td>Vehicles</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

11.2.3 Start-Up Expenses

When you pay out cash during the start-up phase for costs to operate your business and those purchases do not retain value, they are start-up expenses. These expenses include the costs of running the business. Keep in mind that you are currently only concerned about those costs occurring while the business is in the start-up phase. Most expenses will continue throughout the life of the business. For now, focus on the expenses you expect to have during the length of time it takes you to complete the start-up phase.

Examples of possible start-up expenses include:

- Rent
- Accounting fees
- Salaries & wages—training/setup
- Benefits & taxes—training/setup
- Office supplies
- Business supplies
- Printing—business cards, stationery, brochures
- Pre-opening advertising

from real entrepreneurs

When Danny O’Neill decided to launch The Roasterie, he took a leave of absence from his corporate job and spent nearly seven months investigating the specialty coffee business and determining his start-up costs.

O’Neill approached this research like a full-time job. “I was relentless,” he admits, noting that fear was a key driver. “I was afraid that I might fail and have to go back to my corporate job. But instead of being paralyzed by fear, I let it motivate me.”

One of O’Neill’s first moves was to join a specialty coffee association, which proved to be his single biggest source of information. The association pointed him to a number of industry experts—and the right questions to ask.
Traveling across the United States and to Costa Rica, O’Neill visited coffee growers, exporters, brokers and other industry players. He also called on potential customers in his own backyard to find out what kind of coffee they currently bought, how much they spent, and if they would be willing to upscale.

As a result of O’Neill’s extensive research, he confronted no real surprises in terms of start-up costs. In fact, as he gathered information, O’Neill was able to significantly reduce costs and fund the company entirely on personal savings—with his largest expenditure being a $12,000 roaster.

The most dramatic savings came from a decision to start the business in his home instead of commercial space. Then O’Neill sliced infrastructure costs even further. He needed to retrofit his basement into a “cleanable, washable” environment that would pass governmental codes, and contractors had estimated the remodeling job would cost between $10,000 and $20,000. Yet with a little creativity—and a lot of sweat equity—O’Neill did the work himself for $800. “My goal was to save as much money as possible and eke out an existence until I could get cash flow coming in,” he explains.

“Many entrepreneurs lose their shirts because they haven’t spent enough time researching costs and putting a good plan in place,” says O’Neill, who believes in leaving no stone unturned. “Most people are glad to help, and if they don’t know the answers to your questions, they’ll usually refer you to someone else. But it’s strange how often leads drop in entrepreneurs’ laps and they don’t pursue them.”

### Scenario 11.2.3

**Run KC – Start-up Costs**

**Learning Objective**
- Determine the start-up costs for a given company.

**Overview**

Identifying all the start-up costs necessary to get a business going can be difficult. One way to do it is to think through the start-up process. Entrepreneurs should envision their business as it will look and identify all the resources, supplies, and equipment that will be needed. A list of typical start-up costs, such as the items included on the financial template worksheet, can also be helpful in bringing to mind expenses and expenditures. When estimating costs, it is better to be conservative and estimate the figures high. It is also likely that some necessary costs will be overlooked initially.

**Scenario**

Run KC will be established as a limited liability company, LLC, in the state of Kansas. A retail location will be established in a 2100 foot square space in the Parkway Plaza shopping center in southeast Johnson County, Kansas. The business which occupied the space prior to Run KC was a coffee shop. Signage will be provided by the property manager, but paid for by Run KC.

The store’s inventory will include seven brands of running shoes along with apparel and accessories. Retail prices for running shoes will range from $70 - $140; apparel will range from $15 - $120; accessories will range from $3.50 - $300. Cost of Goods Sold for athletic footwear is 55% and for athletic clothing and accessories, it is 50%. The product breakdown in specialty running stores is typically 70% shoes, 16% apparel and 14% accessories. Attached is a proposed start-up shoe inventory.

During the six weeks prior to opening, facilities will be set up and fixtures will be installed. The company’s accountant will set up the point of sale system as well as the company books. Staff will be hired and trained and a web page will be developed and launched.

A grand opening event will be held in partnership with Run KC’s vendors – major shoe manufacturers. The event will be promoted through ads in a local running, biking, and triathlon magazine, *Midland Events*, as well as through ads in the newsletters of local running clubs, and through social media.
| Shoe Inventory List | W's denotes women's sizes | 5 | 5.5 | 6 | 6.5 | 7 | 7.5 | 8 | 8.5 | 9 | 9.5 | 10 | 10.5 | 11 | 11.5 | 12 | 12.5 | 13 | 14 | 15 | Total | $ |
|---------------------|--------------------------|---|-----|---|-----|---|-----|---|-----|---|-----|----|------|---|------|---|------|---|-----|---|-----|---|-----|---|-----|---|
| 100 SuperNova Glide | 1 1 1 1 2 2 2 2 1 1 1 | 15 | 825.00 |
| 100 W's SuperNova Glide | 1 1 2 2 2 1 1 1 1 1 1 | 15 | 825.00 |
| 120 AdiStar Solution | 1 1 1 1 1 1 1 1 1 1 | 9 | 594.00 |
| 120 W's AdiStar Solution | 1 1 2 2 1 1 1 1 | 11 | 726.00 |
| 100 SuperNova Sequence | 1 1 2 2 2 1 1 1 1 | 16 | 880.00 |
| 100 W's SuperNova Sequence | 1 2 2 2 1 1 1 1 | 14 | 770.00 |
| 140 AdiStar Salvation | 1 1 1 1 1 1 1 1 1 1 | 8 | 616.00 |
| 140 W's AdiStar Salvation | 1 1 2 2 1 1 1 1 | 11 | 847.00 |
| 100 Cumulus | 1 1 1 1 2 2 2 2 1 1 1 | 18 | 990.00 |
| 100 W's Cumulus | 1 1 2 2 2 2 2 2 1 1 | 23 | 1,265.00 |
| 125 Nimbus | 1 1 1 1 2 3 3 3 2 2 2 1 1 1 | 15 | 1,031.25 |
| 125 W's Nimbus | 1 1 2 2 2 2 2 2 1 1 | 15 | 1,031.25 |
| 100 2150 | 1 1 1 1 2 3 3 3 2 2 2 1 1 | 24 | 1,320.00 |
| 100 W's 2150 | 1 1 2 2 2 2 2 2 1 1 | 24 | 1,320.00 |
| 140 Kayano | 1 1 1 2 2 2 2 2 1 1 1 1 | 16 | 880.00 |
| 140 W's Kayano | 1 1 2 2 2 2 2 2 1 1 | 16 | 880.00 |
| 100 Cumulus | 1 1 1 1 2 2 2 2 1 1 1 | 18 | 990.00 |
| 100 W's Cumulus | 1 1 2 2 2 2 2 2 1 1 | 23 | 1,265.00 |
| 125 Nimbus | 1 1 1 1 2 3 3 3 2 2 2 1 1 1 | 15 | 1,031.25 |
| 125 W's Nimbus | 1 1 2 2 2 2 2 2 1 1 | 15 | 1,031.25 |
| 100 2150 | 1 1 1 1 2 3 3 3 2 2 2 1 1 | 24 | 1,320.00 |
| 100 W's 2150 | 1 1 2 2 2 2 2 2 1 1 | 24 | 1,320.00 |
| 140 Kayano | 1 1 1 2 2 2 2 2 1 1 1 1 | 16 | 880.00 |
| 140 W's Kayano | 1 1 2 2 2 2 2 2 1 1 | 16 | 880.00 |
| 100 2150 | 1 1 1 1 2 3 3 3 2 2 2 1 1 | 24 | 1,320.00 |
| 100 W's 2150 | 1 1 2 2 2 2 2 2 1 1 | 24 | 1,320.00 |
**Step 1**

In groups or individually, identify potential start-up items for Run KC (both expenses and expenditures). Estimate the amount of money needed for each item as well as a grand total. While exact amounts cannot be determined without research, for this activity, estimates are fine. In the column labeled Source of Info, indicate where you could find this information.

<table>
<thead>
<tr>
<th>Start-Up Item</th>
<th>Cost Estimate</th>
<th>Source of info?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Example: Equipment</td>
<td>$15,000.00</td>
<td>Vendor catalog</td>
</tr>
<tr>
<td>$</td>
<td>$</td>
<td>$</td>
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<td>$</td>
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<td>$</td>
</tr>
<tr>
<td>Total</td>
<td>$</td>
<td></td>
</tr>
</tbody>
</table>

**Step 2**

In a large group setting, each group should share their start-up item list, cost estimates, grand total, and the sources of information they would rely on. Compare estimates among the groups. Discuss why they vary.
Assignment 11b: Financial Template—Start-Up worksheet

The Start-Up Worksheet includes items needed to start your business. Begin the Start-Up Cash section of the worksheet by entering any money you or your investors plan to initially put into the venture under the category Equity Investments. If you will be purchasing Real Estate, enter the loan amount required in that category. You will come back to revisit Loan Proceeds when you have completed your financials and are in a position to determine the funds needed. At that time, you may need to revisit the Equity Investment category as well.

Next, you will identify start-up costs by these three categories: Start-Up Expenditures, such as security deposits, Capital Expenditures, such as furniture and equipment, and Start-Up expenses, such as rent and utilities. The notes you made earlier on the Financial Assumptions worksheets will be helpful as you complete this section. Remember, at this point you should be documenting start-up expenses only. Ongoing operating expenses will be addressed in the next section.

Tip

This is the second assignment using the financial template. If you have not already completed the Set-up worksheet, please go to Assignment 11a. It is important to read the template introduction before using the financial template.

After you enter your start-up information, you may want to view other sheets in the financial template to see how the numbers from the Start-Up Worksheet link to these financial statements: Monthly Income Statement, Monthly Cash Flow Statement, Year-End Income Statement, and Year-End Balance Sheet. If you make a change in your start-up funding or expenditures, each of these sheets will change accordingly.
# START-UP FUNDING & EXPENDITURES

## Start-Up Cash
- Equity Investments
- Loan Proceeds
- Real-Estate Loans

**Total Start-Up Cash**

## Start-Up Expenditures

### Security Deposits
- Rent (last month’s)
- Telephone Deposit
- Utilities Deposit
- Other Deposits

**Total Security Deposits**

### Start-Up Expenses
- Accounting Fees
- Insurance
- Legal & Consulting Fees
- Licensing and Registration
- Meals & Entertainment
- Office Supplies
- Payroll Expenses (training/setup)
  - Salaries & Wages
  - Payroll Taxes
  - Benefits
- Pre-opening advertising
- Printing (cards, stationery, brochures)
- Sales Tax Permit
- Web Page
- Other Start-Up Expenses

**Total Start-Up Expenses**

## Other Costs
- Opening Inventory

## Capital Expenditures
- Computer Equipment
- Equipment & Machinery
- Furniture & Fixtures
- Vehicles
- Leasehold Improvements
- Buildings
- Land

**Total Start-Up Capital Expenditures**

**Total Start-Up Expenditures**

---

Notes:
Summary

This chapter outlined the basic aspects of financial planning. It identified the main financial concepts that entrepreneurs use to plan a financially successful business. This chapter also focused on estimating start-up costs.

- An entrepreneur needs to understand the basic concepts represented by three key financial statements, the Income Statement, Cash Flow Statement and Balance Sheet along with their related terminology to effectively plan and manage the financial aspects of their business.
- A cash flow statement reflects cash flowing into and out of the business, similar to a check register.
- An income statement shows the net income or loss the business has experienced over a period of time.
- A balance sheet reports what the company owns (assets), what it owes (liabilities), and the net worth that remains for the owners of the business at a specific point in time.
- The income statement reflects the profitability of the business, yet net profit does not always result in a positive cash flow.
- Entrepreneurs need to understand the related concepts of profitability and cash flow, two financial objectives which are critical to the long-term survival of any business.
- Accurately projected start-up costs can help an entrepreneur plan cash flow needs to avoid facing negative cash flow and financial difficulties.
Overview
This chapter expands upon the financial concepts entrepreneurs use to plan successful ventures. These concepts require an understanding of key financial terms, the projection of accurate financial statements, and financial ratios.

In this chapter, you will continue building the financial statements (income statement, cash flow statement and balance sheet) by estimating operating expenses, sales and inventory. The financial template will be used to enter this information and build the necessary statements.

This chapter builds on the financial knowledge you have already developed. As you progress through these financial chapters, you will continue to analyze the profitability of your venture.

Objectives
In this chapter, you will learn to:

- Understand key financial concepts.
- Develop accurate financial projections.
- Estimate the on-going costs of operating the business.
- Calculate research-based sales projections.
- Develop accurate inventory estimates.
- Write effective assumptions for operating expenses, sales and inventory.
- Understand break-even analysis.
### 12.1 Projecting Operating Expenses
#### 12.1.1 Projecting Operating Expenses

In addition to start-up costs, businesses have on-going operating expenses. Sometimes called overhead, these expenses are necessary to support the sales, administration, and general operations of the business. They are the final component of the Net Income Equation used to determine profitability and are subtracted from the gross margin to determine net income.

\[
\text{Sales} - \text{Cost of Product/Service} = \text{Gross Margin} - \text{Operating Expenses} = \text{Net Income}
\]

One way to determine operating expenses is to research the monthly costs associated with operating the business. For cash flow purposes keep in mind that it is critical to determine the actual costs for each specific month. Do not determine monthly expenses simply by dividing annual expenses by 12, a practice called straight-lining. For example, if insurance costs are $1200 per year, do not simply divide by 12 and enter $100 each month in the insurance category – unless that is how you will pay it. If you will pay insurance quarterly, enter $300 in each month that it is actually paid. In reality, operating costs may differ greatly from month to month.

As you completed the first three sections of the business plan, you used the Financial Assumptions worksheets to make note of any expenses you encountered. Take time now to research any estimates you are missing. The right-hand column of the Financial Assumptions worksheet provides guidance for researching those costs.

---

**from real entrepreneurs**

Representatives from Backyard Solutions attend a national gardening trade show each winter. Considerable money is spent to prepare for this trade show throughout the winter months. Since most garden sheds are sold in the summer months, tight cash flow is experienced during the winter months. If Backyard Solutions allocated these trade show costs in twelve even amounts throughout the year, the projected cash flow statement would provide no assistance in preparing for the winter shortage of cash.
12.1.2 Selling and Administrative Expenses

Some of the operating expenses of the venture are necessary to generate sales, such as wages for sales employees, advertising, marketing and promotions, and meals and entertainment (which are generally associated with marketing efforts to attract and retain customers). These expenses are called selling expenses.

Forecasts of major categories of selling expenditures should be backed by researching actual costs. Heavy marketing efforts related to the sales cycle or seasonal events may result in considerable expense fluctuations from month to month. Selling expenses alone can provide a good indication of how much it will cost to generate revenue.

From Real Entrepreneurs

On average, it costs Backyard Solutions $45 in selling expenses for each Yard Closet. This figure includes the costs for the direct sales personnel, sales brochures, direct mailings, and so on. Last year, Backyard Solutions considered adding print advertising in several large distribution garden magazines. However, this cost raised the average selling expenses for each garden shed to over $90. Because of this increase, Backyard Solutions decided to stick with its existing marketing strategy of direct sales.

Some costs are necessary to support the overall operations of the company but cannot be linked directly to generating sales. These include costs associated with support employees, dues and subscriptions, legal fees, telephone, outside services, office supplies and insurance. These expenses are referred to as general or administrative expenses.

Industry norms for selling and general or administrative expenses may be identified through trade associations and resources such as Dun & Bradstreet’s Industry Norms & Key Business Ratios and RMA Annual Statement Studies by Risk Management Association (ask a librarian for assistance locating these resources, if needed). Inquires made to suppliers and service providers are also helpful.

Once the business has a financial history, entrepreneurs can review these expenses and compare them to industry norms to assess the efficiency of their business operations.

Backyard Solutions has several support employees including a receptionist, administrative assistant and bookkeeper. On average, it costs Backyard Solutions $372 per Yard Closet for administrative and general expenses.

By identifying which components of operating expenses are related to sales and which are related to general administrative costs, entrepreneurs can get a better handle on costs when evaluating the profitability of a venture.

The following shows a breakdown of the total costs of Backyard Solution’s lowest priced wooden shed as well as the net profit on the sale of one unit.

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw Materials</td>
<td>$ 730</td>
</tr>
<tr>
<td>Production Costs</td>
<td>344</td>
</tr>
<tr>
<td>Selling Expenses</td>
<td>45</td>
</tr>
<tr>
<td>Administrative/General Expenses</td>
<td>372</td>
</tr>
<tr>
<td>Total Costs</td>
<td>$1,491</td>
</tr>
<tr>
<td>Selling Price</td>
<td>$1,535</td>
</tr>
<tr>
<td>Profit</td>
<td>$ 44</td>
</tr>
</tbody>
</table>

Since Backyard Solutions only makes $44 per shed with a selling price $1535, its profit margin appears to be inadequate. Taking the time to understand all the costs that go into the production and sale of each wooden shed provides the information they need to evaluate their pricing structure.
12.1.3 Expense Assumptions

Operating expenses should be estimated based on facts uncovered about the business concept and industry. When you completed your Financial Assumptions worksheets, you made notes regarding the estimates you documented. These notes or facts should be used to write the assumption statements in the operating expense section of the financial template for your business.

The operating expense assumptions should explain how each expense category was estimated. You should also explain the variances between each month (for example, number of days in the month, promotions and events, utilities variances, seasonality, new product/service releases, and expansion activities). The assumptions should substantiate expense estimates by including facts and figures.

The assumptions provide information to readers of the plan to help them understand the financial information. The assumptions also serve as a useful reminder to the entrepreneur about the facts used as a basis for the projections.

from real entrepreneurs

Following are the list of assumptions Nick Thomas developed for his residential construction business, Thomas Custom Builders.

<table>
<thead>
<tr>
<th>Expense Assumptions Year 1</th>
<th>Thomas Custom Builders—Residential Construction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td>Newspaper and magazine advertising in local publications at strategic market cycles (prior to home shows and Tour of Homes).</td>
</tr>
<tr>
<td>Dues and Subscriptions</td>
<td>Annual dues to the USA Association of Architects and the Residential Builders Association.</td>
</tr>
<tr>
<td>Insurance</td>
<td>General business liability (builder’s risk is part of COGS) as quoted by Insurance for Builders of America.</td>
</tr>
<tr>
<td>Licenses and Fees</td>
<td>City taxes and business licenses as quoted by city hall.</td>
</tr>
<tr>
<td>Marketing and Promotion</td>
<td>Web site development and maintenance by WebsAmerica, brochures by Thomas &amp; Julico, trade shows, graphic design.</td>
</tr>
<tr>
<td>Meals and Entertainment</td>
<td>Little time is required for entertaining. The budgeted amount covers special events with lenders, vendors, and real estate professionals.</td>
</tr>
<tr>
<td>Office Expenses (Postage)</td>
<td>Postage budget for direct mail for tradeshow invitations, and year-round administrative postage.</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>Drafting supplies and general office supplies budget.</td>
</tr>
<tr>
<td>Professional Fees</td>
<td>Outside accounting assistance to include quarterly tax preparation and yearly tax prep and counseling, architectural licensing fees.</td>
</tr>
<tr>
<td>Telephone</td>
<td>One cell phone with unlimited use and one office line with cable modem access.</td>
</tr>
<tr>
<td>Vehicle</td>
<td>Truck lease payments for one truck, insurance as quoted by IBA, maintenance and fuel.</td>
</tr>
</tbody>
</table>
Projecting Operating Expenses
Assignment 12a: Financial Template—Operating Expenses Worksheet

For this assignment, you will determine all the expenses required to operate your business on an ongoing basis. You will include the expenses that support the sales, administration, and general operations of the business on the Financial Template under Operating Expenses. The categories on the Operating Expense projections list common types of operating expenses. If you have expenses that do not fit the listed categories, you can rename the “other” categories at the end of the list.

The information you gathered for the Financial Assumptions Worksheets will be helpful in completing this worksheet. Because it is easy to overlook some expenses, it is a good idea to have other people review your list and identify anything missing for your business.

Remember, payments for expenses that are paid quarterly, semiannually, and yearly should be reflected in the month in which they are paid. This results in a more accurate cash flow statement, which enables entrepreneurs to anticipate and prepare for fluctuations in monthly expenditures. Expenses should not be straightlined—the same amount shown each month—unless they are, indeed, constant.

For each expense, include an assumption that explains the basis for the estimate. 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.”

After you enter your operating expenses, you may want to view other sheets in the financial template to see how the Operating Expenses flow through to the financial statements. If you change your operating expense projections, your financial statements will change. Include the operating expense projections in the appendix of your business plan.

Tip

When working on your financial projections, do not list the same expense on more than one worksheet. For example, an expense listed as a start-up cost on the Start-Up Worksheet should not be listed as the first month’s operating expense on the Operating Expense Worksheet.
### Operating Expense Projections

**My Company**

<table>
<thead>
<tr>
<th>Year 1</th>
<th>JAN</th>
<th>FEB</th>
<th>MAR</th>
<th>APR</th>
<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><strong>Operating Expenses</strong></td>
<td></td>
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<tr>
<td>Advertising</td>
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<tr>
<td>Bank Charges</td>
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</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
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<td>-</td>
<td>-</td>
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</tr>
<tr>
<td>Insurance</td>
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</tr>
<tr>
<td>Licenses &amp; Fees</td>
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</tr>
<tr>
<td>Marketing &amp; Promotion</td>
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<td>-</td>
</tr>
<tr>
<td>Meals &amp; Entertainment</td>
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<td>Miscellaneous</td>
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<td>Office Expense (postage)</td>
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<td>Payroll Expenses</td>
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<td>Salaries &amp; Wages</td>
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<td>Vehicle</td>
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<td>Other</td>
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<tr>
<td><strong>Total Operating Expenses</strong></td>
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</tbody>
</table>

### Assumptions - Year 1

- Advertising
- Bank Charges
- Dues & Subscriptions
- Insurance
- Licenses & Fees
- Marketing & Promotion
- Meals & Entertainment
- Miscellaneous
- Office Expense (postage)
- Office Supplies
- Outside Services
- Payroll Expenses
- Salaries & Wages
- Payroll Taxes
- Benefits
- Professional Fees
- Property Taxes
- Rent
- Repairs & Maintenance
- Shipping & Delivery
- Telephone
- Training & Development
- Travel
- Utilities
- Vehicle
- Other
- Other
12.2 Projecting Sales
12.2.1 Projecting Operating Expenses

It would be nice if you could look into a crystal ball and see what the future holds when you project sales for your business. Since you can’t, projecting sales requires looking at a variety of perspectives and determining how each might impact the sales and profitability of your business. Because of the importance and complexity of projecting this very critical component of profitability, many entrepreneurs use a multifaceted approach to projecting sales.

Three common ways to project sales include the comparative sales approach, the average sales approach, and the bottom-up sales approach. Comparing sales estimates made through these three different approaches gives entrepreneurs a clearer perspective of what is realistic for their business.

Comparative Sales Approach

This approach, sometimes called the top-down method of projecting sales, uses research conducted on competitors and the industry. Through research, you should be able to produce estimates of sales based on competitors’ annual sales and the rate of sales expected in your industry.

For example, an entrepreneur in the sports memorabilia business found industry data indicating that the average annual sales for that business are $500,000. After more research, he found that a competitor sells approximately $5000 each week during the off peak season and $15,000 during the peak season totaling $360,000 in sales annually. The range of $360,000 to $500,000 provided a starting point for his sales projections.

After you have analyzed all of your competitor and industry data, you can use that data to identify a range of projected sales estimates for your business. Keep in mind that if your competitors have been in business for a while, your first-year sales may be significantly less. Be ready to make adjustments based on the reality of your situation. You should research as many competitors and industry sources as possible. The more competitor and industry data you include in your calculations, the more accurate you can expect your sales projections to be. When formulating the final range, you should also consider possible variables that might affect sales, such as the location of your business, its maturity, the expertise of the owner and other factors. When your sales estimates, using the comparative approach, seem reasonable, you’re ready to look at the next perspective – the average approach.

Average Sales Approach

To project sales using the average sales method, you will need to count the number of sales transactions you expect over a specific period. For example, a restaurant may expect sixty customers on an average day. The restaurant owner figures the average price of each meal sold. If the owner expects the average price per meal to be $15, then the annual sales volume is $328,500 (60 customers x $15 X 365 days). For a more accurate estimate, the restaurateur should take into consideration the number of lunch customers versus dinner customers and increases in customer counts on weekends. The restaurant might also see a significant swing in the number of customer during different times in the year. Or, the restaurant may not be open every day of the week or every week of the year. All these variations affect the final estimate.

You should calculate the price of an average sale for your business and then project your sales like the restaurateur did in the example. When documenting sales on the sales worksheet, be sure they reflect growth over time as well as fluctuations due to factors such as seasonal variations or major events that affect sales. After you have calculated sales for three years, you’ll want to check your projections again to see if they seem reasonable.
Bottom-Up Approach

The bottom-up approach is more mathematical than visionary. In order to prepare this projection, you’ll need to estimate your annual costs of goods sold and all of the expenses you expect in your business. These total costs plus the amount of desired profit represent your projected annual sales. The goal is to cover costs and profit.

For example, a courier service business estimates all of the cost of sales and expenses expected in each of the first three years of business. Then, the business owner identifies the amount of profit she wants to generate each year. Using the bottom-up approach, the projected sales for this business equal the total costs of the business (cost of sales and expenses) plus the amount of profit expected. Since covering costs and generating profits is essential to every business, this approach is a good way to check the reasonableness of the other two methods. If your bottom-up approach leaves you with a projected sales number much higher than the other two approaches, you need to seriously consider the ability of the business to achieve that level of sales and profitability.

Use the Sales Projection Template to develop sales projections for your business. Using all three approaches to projecting sales can increase your confidence in the reliability of your sales goals. You can look at the sales figures you projected using each approach and ask yourself: Which one relies on the most accurate information? Which one seems the most reasonable? Which one seems the most attainable?

In all likelihood, your actual sales will probably rest somewhere in the middle of these three estimates. Projecting sales near the low end is more conservative and will probably be more acceptable to a lender. Projecting sales at the high end is risky because the amount will be difficult to attain. Select the sales figure that seems most realistic for your business, and be prepared to support your decision through detailed sales assumptions.

It is critical to recognize that there is a direct relationship between the level of sales projected and expenses. When you feel that you have sales numbers that seem realistic and attainable, revisit your Operating Expense Worksheet. Check to see that your operating expenses are in line with the level of sales you have projected. Have you budgeted enough advertising and marketing dollars to generate this level of sales? Do you have enough sales people to accommodate customers? Your selling and operating expenses should be able to support your projected sales.

from real entrepreneurs

After considerable research, Tom found that sales for a particular type of business in his industry rarely reached $80,000 the first year. Even though he thought he could sell $150,000, it did not seem reasonable to estimate sales over the industry amount. In reality, Tom was able to do more than the industry number, but only by $8,000.

More Info: Sales Projection Template—Excel-based spreadsheet to help estimate sales projections using top-down, bottom-up, and average sales approaches. Use the More Info link in the online course to download the file. In addition, a hard copy follows this section for your reference.
More Info—Sales Projections

**Average Sale Approach**

*Project sales using the average sale approach.* Count the number of sales transactions you expect your business to have over each of the first four quarters of its first year. Then calculate the total sales dollars those transactions will generate to project sales using the average sale approach.

<table>
<thead>
<tr>
<th>Product/Service 1</th>
<th>Quarter 1</th>
<th>Quarter 2</th>
<th>Quarter 3</th>
<th>Quarter 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of products/services sold:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average price per product/service:</td>
<td></td>
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<tr>
<td>Total sales for product/service 1:</td>
<td></td>
<td></td>
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</tbody>
</table>

Assumptions: Note the sales variations that you would expect with this product:

<table>
<thead>
<tr>
<th>Product/Service 2</th>
<th>Quarter 1</th>
<th>Quarter 2</th>
<th>Quarter 3</th>
<th>Quarter 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of products/services sold:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average price per product/service:</td>
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<tr>
<td>Total sales for product/service 2:</td>
<td></td>
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</tr>
</tbody>
</table>

Assumptions: Note the sales variations that you would expect with this product:

<table>
<thead>
<tr>
<th>Product/Service 3</th>
<th>Quarter 1</th>
<th>Quarter 2</th>
<th>Quarter 3</th>
<th>Quarter 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of products/services sold:</td>
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<tr>
<td>Average price per product/service:</td>
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<tr>
<td>Total sales for product/service 3:</td>
<td></td>
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</tbody>
</table>

Assumptions: Note the sales variations that you would expect with this product:

<table>
<thead>
<tr>
<th>Product/Service 4</th>
<th>Quarter 1</th>
<th>Quarter 2</th>
<th>Quarter 3</th>
<th>Quarter 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of products/services sold:</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Average price per product/service:</td>
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<tr>
<td>Total sales for product/service 4:</td>
<td></td>
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</tbody>
</table>

Assumptions: Note the sales variations that you would expect with this product:

**Calculate total yearly sales**

- Product/Service 1
- Product/Service 2
- Product/Service 3
- Product/Service 4
- Total Yearly Sales
Bottom-Up Approach

**Project sales using the bottom-up approach.** Enter the appropriate amounts in the chart below to project sales for your company using the bottom-up approach.

<table>
<thead>
<tr>
<th>Question</th>
<th>Formula</th>
<th>Enter Amount</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>What are your estimated monthly operating expenses (excluding owner salaries)?</td>
<td>Yearly operating expenses = Monthly operating expenses x 12</td>
<td>$</td>
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</tr>
<tr>
<td>How much salary per year do you (and any other owners) want to make? Your salary will be increased by 12% for employer payroll taxes.</td>
<td>$</td>
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<tr>
<td>How much pre-tax profit do you want to make in dollars?</td>
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</tr>
<tr>
<td>What is your sales price per unit? (If multiple products/services are sold, use a weighted average.)</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>What is your cost of product/service per unit? (Be sure not to include this cost category if they were already entered above.)</td>
<td>$</td>
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<tr>
<td>What is your gross margin in dollars per product/service?</td>
<td>$</td>
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</tr>
<tr>
<td>This is your bottom-up sales projection or the amount of sales needed to cover your cost of sales, operating expenses, and profit expectations.</td>
<td>Number of units/hours sold x selling price</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>This is the number of units/hours you must sell to cover your cost of sales, operating expenses, and profit expectations.</td>
<td>(Yearly operating expenses + salary + pre-tax profit) / gross margin per unit</td>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>
**Comparative Sales Approach**

**Project sales using the comparative sales approach.** Enter the appropriate amounts in the following chart to project sales for your company using the comparative sales approach.

<table>
<thead>
<tr>
<th>Industry Research</th>
<th>High</th>
<th>Low</th>
<th>First-Year Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Range of sales in region</td>
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<tr>
<td>Range of sales of similar-sized companies</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Competitor Research</th>
<th>High</th>
<th>Low</th>
<th>First-Year Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitor A</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Competitor B</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Competitor C</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Competitor D</td>
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<tr>
<td>Competitor E</td>
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<td>Competitor F</td>
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<tr>
<td>Competitor G</td>
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</tbody>
</table>
Exercise 12.2.1: Forecasting Sales

Learning Objectives

• To take a closer look at forecasting sales using the Average Sales Approach.
• To understand factors which influence sales fluctuations.

Overview

Unfortunately, no crystal ball can show the future of a business. Projecting future sales requires looking at the issue from a variety of perspectives and determining what each might mean for the business.

Three common ways to project sales include the comparative sales approach, the average sales approach, and the bottom-up sales approach. Comparing sales estimates made through these three different approaches gives entrepreneurs a clearer perspective of what is realistic for their business. In this exercise, you will take a look at the Average Sales Approach.

To project sales using the average sales method, you will need to count the number of sales transactions you expect over a specific period of time and multiply that by the price of the average sale for your business. For example, if a restaurant owner expects the average price per meal to be $15 and anticipates serving 60 customers a day for 30 days in June, monthly sales would be projected as $27,000 ($15 x 60 customers x 30 days). As he proceeds to project sales for the remaining months of the year, he will adjust the number of days in each month accordingly. Other factors which he might also need consider include the fluctuations in sales each month based on seasonal factors and demand and the breakdown in sales for each category of products or services.

Step 1

You have been provided with monthly sales projections for year one for Maggie’s Coffee Café. Use these projections to answer the following:

1. Based on the sales projections for Maggie’s Coffee Café determine:
   - Sales per day for the first month they are open (January) ____________
   - Sales per day for the 6th month they are open (June) ____________
   - Sales per day for the 12th month they are open (December) ____________
   (assume the business is open 7 days/week; Jan and Dec have 31 days; June has 30)

2. Which month has the highest sales? Which month has the lowest sales?
   Why do you think this is so?

   _________________________________________________________________

3. Where do you see fluctuations in sales? How would you explain these fluctuations?

   _________________________________________________________________

4. In a business such as Maggie’s Coffee Café, would it be possible for the owner to estimate an average amount spent by each customer per visit while still in the planning stage? _____yes _____no ___ If so, how could this be determined?
5. Assuming that the average customer ticket is $6, determine:
   Number of customers per day the first month they are open (January) ________
   Number of customers per day the 6th month they are open (June) __________
   Number of customers per day the 12th month they are open (December)_____

Step 2
For your own business:

6. Estimate the average amount spent by each customer per visit.

7. Calculate your average daily revenue:
   What would be a reasonable figure for sales per day at start-up?
   \[
   \frac{\text{average sale/customer}}{\text{# of customers/day}} \times \text{# of customers/day} = \text{revenue per day}
   \]

   What would be a reasonable figure for sales per day month 6?
   \[
   \frac{\text{average sale/customer}}{\text{# of customers/day}} \times \text{# of customers/day} = \text{revenue per day}
   \]

   Note: For some businesses, sales per week or per month may be a more logical number to establish and use.
   For example, a web page designer might calculate the average cost per web page X the number of web pages
   per month. If that is the case in your business, change the word day above to read either week or month.

8. Calculate your monthly revenue:
   What would be a reasonable figure for sales per month at start-up?
   \[
   \frac{\text{revenue per day}}{\text{# day per month}} \times \text{# day per month} = \text{revenue per month}
   \]

   What would be a reasonable figure for sales per month for month 6?
   \[
   \frac{\text{revenue per day}}{\text{# day per month}} \times \text{# day per month} = \text{revenue per month}
   \]

9. For your own business, what factors will affect demand/sales?

10. Below, mark the months you expect your highest sales with an H and the months you expect your lowest sales with an L.
    _____January_____February_____March_____April_____May_____July_____June
    _____August_____September_____October_____November_____December

11. Maggie’s Coffee Café has categorized sales for their business as hot beverages, cold beverages, food items, coffee and tea – bulk; and gift cards. What categories will you use to organize sales in your business?
# Step 3

Use the figures you have determined above to help project sales for your business. Don't forget to consider factors such as seasonality and fluctuations in demand.

## 12.2.2 Sales Assumptions

Sales projections should be based on the facts uncovered about the business venture and industry. These facts should be written into assumption statements that support the financial projections. Assumption statements accomplish the following:

- Builds confidence on the part of the reader that projections are not just guesses.
- Helps readers understand the sources of information for the financial projections.
- Reminds the entrepreneur of the facts used as the basis for projections.

The assumptions should explain how sales forecasts are developed and how growth is predicted. Projected variances during the year should also be explained. These include seasonal variations, the number of sales days in a month, heavy marketing efforts, repeat business, new product/service releases, and expansion plans. The assumptions substantiate sales forecasts by including facts and figures.

---

## Sales Budget

<table>
<thead>
<tr>
<th></th>
<th>JAN</th>
<th>FEB</th>
<th>MAR</th>
<th>APR</th>
<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>Hot Beverages</td>
<td>12,400</td>
<td>14,000</td>
<td>17,360</td>
<td>18,000</td>
<td>18,000</td>
<td>17,360</td>
<td>18,000</td>
<td>21,700</td>
<td>23,560</td>
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<td>24,800</td>
<td>228,380</td>
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<tr>
<td>Cold Beverages</td>
<td>3,100</td>
<td>3,528</td>
<td>4,350</td>
<td>4,500</td>
<td>5,300</td>
<td>10,500</td>
<td>15,750</td>
<td>18,000</td>
<td>15,750</td>
<td>18,810</td>
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<tr>
<td>Food Items</td>
<td>3,000</td>
<td>3,720</td>
<td>4,340</td>
<td>5,000</td>
<td>9,300</td>
<td>9,000</td>
<td>8,680</td>
<td>10,540</td>
<td>11,400</td>
<td>11,780</td>
<td>13,200</td>
<td>16,120</td>
<td>110,080</td>
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<tr>
<td>Coffee and Tea - bulk</td>
<td>1,116</td>
<td>1,260</td>
<td>1,674</td>
<td>1,755</td>
<td>1,953</td>
<td>2,295</td>
<td>2,511</td>
<td>2,650</td>
<td>2,700</td>
<td>2,930</td>
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<td>Gift Cards</td>
<td>310</td>
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<td>1,240</td>
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<td>775</td>
<td>900</td>
<td>900</td>
<td>1,600</td>
<td>2,100</td>
<td>11,130</td>
</tr>
</tbody>
</table>

### Assumptions - Year 1

- **Sales (cash)**
  - Hot Beverages: Coffee, latte, cappuccino, chai tea - Average price $4
  - Cold Beverages: Pastries, bagels, desserts - Average price $4 for individual/$15 for whole desserts
  - Food Items: Coffee by the pound, tea bags and loose tea - Average price $9 per pound
  - Coffee and Tea - bulk: Available in any amount
  - Gift Cards: No additional cost
- **Sales (credit)**
- **Bad Debt Expense - Accrued**
- **Received on Account**
- **Bad Debt - Cash Flow**

### Credit Management

- **Sales (credit)**
- **Bad Debt Expense - Accrued**
- **Received on Account**
- **Bad Debt - Cash Flow**

### Gross Sales

- **Less: Returns & Allowances**

### Net Sales

- **Other Income**

### Total Income

- **Other Income**

---

Tip

In the financial template that is provided, assumptions must be condensed to fit on one line. Any detailed information should be included in the appendix.
from real entrepreneurs

Following are sales assumptions for Thomas Custom Builders, a residential construction company:

- The initial projection is to build six homes by the end of the first fiscal year, of which three units are projected to sell at an estimated sales price of $437,500 (including an average lot price of $87,500). One model home and two speculative homes will remain in inventory entering year two.

- Year two will produce six homes of which six units will be sold (at the same estimated price of $437,500) and three will again remain in inventory entering year three.

- In year three, TCB will produce 12 homes of which eight units will be sold (at the same estimated price of $437,500), four will be works in progress, and three completed homes will remain in inventory entering year four.

- In keeping with the projected leveling-off of the market (as projected by Home Builders Association of America Building Journal Today) the company will continue, as the market dictates, to produce and sell 12 homes annually.

Assignment 12b: Financial Template—Sales Worksheet

In this assignment, you will use the Sales Worksheet to estimate your monthly sales for three years. To accurately complete this worksheet, you will need to understand the potential demand for your products/services as well as the purchasing habits of your customers. For example, what percent of your sales will be cash versus credit? How long will credit customers take to pay? What percent will be uncollectible?

If you plan to sell many types of products or services, group them into categories for your sales estimates. The worksheet allows up to seven categories. As you detail each projection, consider all the factors that will affect your sales. These factors include such things as your production capacity, advertising, competitors, seasonality, and economic conditions.

An important part of this worksheet is the section for your assumptions. For each sales estimate, briefly explain the basis for the estimate. For example, an assumption for Returns and Allowances might read, “Estimated at 25 percent based on industry averages for boutique operations.” The source of the industry statistic could be included directly after the assumption.

After you enter your sales information, you may want to view other sheets in the financial template to see how the data for the Sale Worksheet impacts the financial statements. If you change your sales estimates, these sheets will change accordingly. The sales projections will be included in the appendix of your business plan.

Tip

The assumptions should explain to the reader why the sales forecast is accurate. These assumptions are just as important as the actual sales estimates.

Reality

It is difficult to determine demand for a product/service before a business opens. The accuracy of your sales estimates reflects the quality of your research on the industry and the market.
### 12.3 Projecting Inventory

#### 12.3.1 Manufacturing vs. Merchandising

When a business venture includes the selling of products, the entrepreneur needs to understand how inventory will affect the business. Manufacturers and retailers sell products. Some businesses, such as a cleaning company, might only sell services. Some businesses sell both products and services, such as a computer training company that also sells training materials and learning aids.

Inventory is the term accountants use to describe the goods that are available to be sold. Inventory is an asset because it maintains value. It is recorded on the Balance Sheet. At any given time, inventory can be sold for cash, assuming a customer wants it. In a manufacturing company, inventory goes through several stages before it is ready to be sold. It begins as raw materials and is fashioned into work-in-progress before it is considered a finished good. Once inventory is sold, the costs of the items are transferred to the Income Statement as Cost of Goods Sold.

---

**Backyard Solutions** is a manufacturing business. It produces and sells wooden garden sheds called Yard Closets. Every month, Backyard Solutions purchases raw materials. These include wood, metal hardware (such as hinges, door handles, and hooks), and production supplies (nails, screws, and glue). While the raw materials is being built into Yard Closets the inventory is called work-in-progress. The completed garden shed is called finished goods inventory. Because of the time needed to produce the sheds, accept orders, ship the products, bill customers, and receive final payments, Backyard Solutions has to pay for raw materials five months prior to receiving cash from sales of the sheds. This time lapse drains cash flow.
With proper planning, however, Backyard Solutions has enough cash reserves to cover the delay. The company also has to control the costs of producing each shed. The price of the shed must cover the direct cost of production plus the operating expenses of the company and also provide an acceptable profit.

Many product businesses resell goods that have already been produced. This practice is called merchandising. Merchandise inventory is the stock of goods that the business has on hand at any given time. The purchase price of the merchandise is the cost of goods sold. Whether a company has manufactured inventory or merchandise inventory, planning for these inventory costs is critical to cash flow.

### 12.3. Manufacturing Inventory

In a manufacturing company, inventory goes through stages before it is ready to sell. Entrepreneurs must carefully analyze and estimate the costs at each stage to produce accurate projections of the cost of goods sold and to monitor the inventory production process in the future.

Manufacturing inventory costs include the following:

- **Raw materials**—If entrepreneurs are going to manufacture or assemble products to sell, they must plan for raw materials inventory. This task can be difficult. To simplify the process, entrepreneurs should answer the following questions.
  - How many types of raw materials does the product use? If many types of raw materials are used, the costs to store or warehouse those materials grow.
  - How much raw material needs to be on hand? Purchasing larger quantities to lower costs can help increase profits, but it can also reduce cash flow.
  - How quickly can raw materials be turned into finished goods ready to sell? Entrepreneurs should consider ways to streamline the production process. This efficiency allows inventory to be sold more quickly, which can bring cash into the business faster.

**from real entrepreneurs**

Backyard Solutions needs to purchase many types of raw materials in order to produce each Yard Closet. These raw materials have value, so they are assets, but cannot be sold yet as a garden shed. Backyard Solutions purchases large quantities of materials to obtain quantity discounts. Because several employees work on different stages of the process at different times, however, it takes approximately one to two weeks before the garden shed is finished and ready to ship. Therefore, Backyard Solutions has lots of work-in-progress inventory sitting around tying up cash.

Production expenses—In addition to the cost of raw materials, the process of producing the finished goods usually costs money. These production expenses become part of the total cost of goods.

Following are some common production expenses entrepreneurs may incur:

- **Freight-in and trucking/shipping costs**—Represents the direct cost of having raw materials for production or products for resale.

**Tip**

Adding the raw materials cost and production cost together defines the total cost of sales (or cost of goods sold). This figure is critical to overall profitability.
• Insurance—Only include if the insurance applies to the production facilities.
• Payroll expenses—May be the highest production cost. All personnel who play a direct role in producing inventory or supervising the production process should be included. Payroll expenses include salaries, benefits, and employer-paid payroll taxes.
• Rent and utilities—Only include the costs of the production facilities, which could also be a major portion of the production expenses. If the production area is shared with office or retail space, the amount used directly for production should be considered. The rest will be included in the operating expenses.
• Repairs and maintenance—Should be taken into account if production equipment must be periodically repaired or maintained.
• Rework—This should be considered if manufactured products must be reworked from time to time. This figure should include the costs invested to make products salable.
• Subcontracting—Occurs in companies that subcontract out a portion of the production process.

Businesses that have an inventory of products or raw materials have different challenges than a service business without inventory. Careful management of the inventory can add dollars to gross margin. Poor management of inventory may add unnecessary costs.

from real entrepreneurs

Each of their lowest priced wooden Yard Closets costs Backyard Solutions $1,074 in materials and production costs. The average cost for raw materials for each wooden shed (when purchasing materials in large quantities) is $730. The average production costs (for production employees and manufacturing overhead) for each wooden shed us $344.

12.3.3 Cost of Goods Sold

When a product/service is sold to a customer, some costs are usually associated with it. This is called the cost of goods sold (also called cost of sales and direct cost). As a component of profitability, cost of goods sold plays a huge role in determining gross margin and net income. It is deducted from revenue to reveal gross margin. Gross margin reflects the amount available to cover the operating expenses of the business.

The following Net Income Equation illustrates the impact of the cost of product/service on net income:

\[
\text{Sales} - \text{Cost of Goods Sold/Direct Cost} = \text{Gross Margin} - \text{Operating Expenses} = \text{Net Income}
\]

The cost of product/service includes both inventory and production expenses. It is determined by researching material and expense costs.
Entrepreneurs need to take this one step further and convert each line of their Net Income Equation to a percentage of sales. This is done by dividing each line by total sales. Following is an example of the Net Income Equation with percentages for a restaurant called Cassy’s Corner.

<table>
<thead>
<tr>
<th>Dollars</th>
<th>Percentages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales $335,200</td>
<td>100 %</td>
</tr>
<tr>
<td>– Cost of Goods Sold/Direct Cost $113,600</td>
<td>34 %</td>
</tr>
<tr>
<td>= Gross Margin $221,600</td>
<td>66 %</td>
</tr>
<tr>
<td>– Operating Expenses $196,000</td>
<td>58 %</td>
</tr>
<tr>
<td>= Net Income $25,600</td>
<td>8 %</td>
</tr>
</tbody>
</table>

In this example, Cost of Goods Sold is 34% which was determined by dividing the COGS by total sales or $113,600/$335,200.

Another approach is to research industry averages and use them to calculate the cost of goods sold, sales, and other business costs. If Cassy’s Corner restaurant had used this approach and found that the industry norm for COGS was 34%, they could use their projected sales estimate to determine their COGS based on industry averages. In this case, they would multiply sales by 34% to calculate their costs of goods sold as $113,600.

Estimating costs of goods sold using both methods is likely to yield the most reliable results. In Step 2 of the Inventory Worksheet, you are asked for the COGS percentage of sales for your business. Identifying an industry norm for COGS for your type of business and comparing it with your calculation will give you greater confidence in your forecast. Your entry in Step 2 will be used to automatically calculate your COGS in your financial projections. It is important that you provide an accurate estimate by researching the industry norm.

It is easier to track the cost of goods sold in a product-based company than in a service-based one. Some service-based businesses are able to identify the costs associated with a service. For example, a cleaning company might be able to identify the cost of cleaning products used on each job. This is called the direct cost of sales. Some service business cannot identify costs associated with specific sales in a cost-effective manner.

**Consider the following businesses and the associated cost of sales.**

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Example of Cost of Product/Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restaurant</td>
<td>Food, beverages, cooks</td>
</tr>
<tr>
<td>Residential construction</td>
<td>Materials, construction workers</td>
</tr>
<tr>
<td>Computer repair</td>
<td>Parts, technicians</td>
</tr>
<tr>
<td>Bagel shop</td>
<td>Food, cooks</td>
</tr>
<tr>
<td>Gas station</td>
<td>Fuel, retail goods</td>
</tr>
<tr>
<td>Internet service provider</td>
<td>Direct costs of bandwidth, technicians</td>
</tr>
<tr>
<td>Retail store</td>
<td>Retail goods</td>
</tr>
<tr>
<td>Landscaping</td>
<td>Trees, shrubs, flowers, landscaping labor</td>
</tr>
<tr>
<td>Produce grower</td>
<td>Seeds, fertilizer, production labor</td>
</tr>
<tr>
<td>Boat manufacturer</td>
<td>Materials, production workers</td>
</tr>
<tr>
<td>Bookstore</td>
<td>Books, video, cards</td>
</tr>
</tbody>
</table>
Accounting for cost of goods sold can be very complex. Here are three basic ways to figure the cost of a product/service. An accountant can provide more detailed calculations for a specific industry.

1. Manufacturer: Determine the total dollar amount spent to buy materials and parts, as well as costs associated with making the product (production expenses). Production expenses include labor and overhead directly related to the production process.

   **Example:** Cabinet Shop
   
   Cost of Materials and Parts
   + Production Expenses
   = Cost of Product/Service

2. Retail Store: Determine the total dollar amount spent for merchandise resold to customers.

   **Example:** Clothing Boutique
   
   Merchandise purchases
   = Cost of Product

3. Service Business: Determine the total dollar amount spent for labor and supplies directly used to make the product/service available to customers.

   **Example:** Commercial Cleaning
   
   Labor
   + Cost of Direct Supplies
   = Cost of Product/Service

Cost of goods sold is subtracted from inventory to calculate your inventory balance as shown.

   Beginning Inventory
   + Inventory Purchases
   + Inventory Production (Production Expenses)
   - Cost of Goods Sold
   = Ending Inventory

Reality
Benchmarking costs of goods sold against industry norms is essential for running a successful product-based business. The COGS for a service business is sometimes zero percent. What is the COGS industry norm for your type of business.
Assignment 12c: Financial Template—Inventory Worksheet

The Inventory Worksheet takes you through the process of building your inventory projections. All product-based businesses should complete this assignment since they will have costs of goods sold. Service businesses that also sell products should complete it as well. If you are a service provider and do not sell any products, skip this assignment.

On the inventory worksheet, you will think through the various expenses associated with your inventory requirements. The information you gathered on your Financial Assumptions Worksheet will be helpful in completing this assignment. Begin by answering the questions in Steps 1-3. Your answers will impact how inventories are calculated and expensed.

**Step 1 asks:** What percent of your sales comes from products? To determine this, you need to review your sales worksheet. If all sales are for products, you should insert 100% in Step 1. If a portion of your sales comes from product and a portion comes from services, refer to the total column at year's end on your sales worksheet. Add together the total sales for all categories that relate to product sales and then divide that amount by the overall total sales for the year. This provides you with the percent of your sales that comes from products versus services. Check to see if Years 2 and 3 follow the same pattern. Enter the resulting percentage in Step 1.

**Step 2 asks:** What percentage of sales is the average cost of goods sold (COGS) for your products? Section 12.1.3 provided instructions for determining this figure for your industry.

**Step 3 asks:** What percent of your inventory or raw materials will be purchased with cash? It is assumed that the rest will be purchased on credit. If you will be purchasing on credit, enter the time (in months) that you are allowed before payment is due. This information will be used to determine the timing of cash flowing in and out of the business.

Next, under Inventory Projections go to line 54 - Inventory Purchases. This is the line you will use to enter the amount of inventory you plan to purchase each month. If you entered an opening inventory on the start-up sheet and projected sales on the sales sheet, your ending inventory balance is shown on line 81. The spreadsheet automatically calculates ending inventory based on projected sales and COGS. Determine the level of inventory you wish to maintain and replenish your inventory by entering monthly inventory purchases on line 54 for Year 1 and then proceed to Years 2 and 3.

You need to complete the Production Expense section (rows 60-71) ONLY if you produce inventory in your own plant. In those rows, you will allocate the portion of those costs that relate directly to production. Administrative and other overhead costs are entered on the Operating Expense worksheet. Important note: If you do not produce your own inventory, you will not use the Production Expense section (rows 60-71). This section will remain blank.

In the assumptions section, explain the basis for your numbers. For example, the inventory/raw material purchases of $12,000 for a winery may include the assumption, “Grapes at $800 per ton.”

After you enter your inventory information, you may want to view other sheets in the financial template to see how the data from the Inventory Worksheet links to the financial statements. If you change your inventory projections, your financial statements will change. Include the inventory projections in the appendix of your business plan.

**Tip**

Using financial tools such as the inventory worksheet can help you track and manage inventory costs. The costs associated with excess inventory must be balanced with the costs of not having inventory to meet customer demand.
### INVENTORY PROJECTIONS

**My Company**

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<th>Year 1</th>
<th>JAN</th>
<th>FEB</th>
<th>MAR</th>
<th>APR</th>
<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>
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<td>Inventory Purchases</td>
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<tr>
<td>Inventory/ Raw Material Purchases (Cash)</td>
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<td>Inventory Production Expenses</td>
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<td>Inventory Balance</td>
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<tr>
<td>(Cost of Goods Sold)</td>
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<tr>
<td>Ending Inventory Balance</td>
<td>-</td>
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</tr>
</tbody>
</table>

#### Financial Planning: Operating Expenses, Sales & Inventory

12

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12.4 Break-Even
12.4.1 Break-Even Analysis

Entrepreneurs use break-even analysis to determine how much of their product/service they must sell at a specific price to meet all costs. Break-even analysis is a mathematical formula that is used to determine how much output must be sold at a certain price for the business to break even. Simply put, break-even is the point at which costs or expenses and revenue are equal: there is no gain or loss as one has just “broken even.” It is a rather comfortable feeling to learn the level of activity at which the enterprise is no longer losing money, but rather is beginning to make money.

Breakeven can be calculated in terms of units or sales amount. The break-even point represents the number of units that need to be sold at a certain price to cover all costs, both fixed and variable. Or, it can be the sales revenue that must be generated to cover all costs. Fixed costs remain relatively constant no matter how many products/services are produced or sold. These costs typically include rent, insurance, interest charges, and executive salaries. Variable costs fluctuate directly with the production and sales levels, such as manufacturing labor, materials used in production, and sales costs.

Break-even analysis not only aids the entrepreneur in making pricing judgments, but it also helps the entrepreneur decide whether to start a venture.

Now that you have finished your financial statements, it is possible to determine a break-even for your business. After a break-even analysis has been completed, you can compare that to your initial sales and pricing to validate your numbers.

from real entrepreneurs

When starting his manufacturing company, Ralph used break-even analysis to determine prices. The fixed costs of the company were estimated at $50,000. The variable costs were $.20 per unit with a $1 retail selling price per unit. Based on those figures, the break-even point would be 62,500 units.

The formula for Break-Even Point is:

\[
\text{Fixed costs} / (\text{Sales price per unit} - \text{Variable costs per unit}) = \text{Break-even point}
\]

In our example:

- Fixed costs = $50,000
- Sales price/unit = $1.00
- Variable costs per unit = $.20

The break even formula is 

\[
50,000 / (1.00 - .20) = 50,000 / .80 = 62,500
\]

This got Ralph to thinking, “Can I sell 62,500 units? What would happen if the price were increased to $2 retail with the same variable cost per unit of $.20?”

So, he recalculated as follows: 

\[
50,000 / (2.00 - .20) = 50,000 / 1.80 = 27,778
\]

Then Ralph thought, "Would it be easier to sell 27,778 units for $2 or 62,500 units for $1?" Going through this evaluation several times helped Ralph consider an appropriate range of prices for his products.
Sometimes it is helpful to chart the break-even relationships. The chart shows visually what happens to profits as prices and volumes are changed.

**Break-Even Point**

At $2 sales price
break-even = 27,778

At $1 sales price
break-even = 62,500

Variable costs = $.20/unit

Fixed costs = $50,000
Exercise 12.4.1: Calculate the Break-Even Point

Learning Objective

- Understand how break-even is calculated.

Overview

Entrepreneurs use break-even analysis to decide whether to start a venture and to aid in setting prices. The break-even point is the point at which the company’s revenue equals its costs. At this point, the money coming in must equal the money going out. The break-even point in units is the number of units that need to be sold to cover all costs, both fixed and variable. The difference between the product’s marginal revenue (the dollars obtained through the sale of one additional unit) and its marginal costs (the costs incurred through the production of one additional unit) goes into profit once the break-even point is reached.

Tools

Calculator

Step 1

**Read the following information.**

Riley is interested in buying a local coffee shop and wants to determine its profitability potential. To do so, his first step is to calculate the break-even point. This will tell Riley at what level of sales he will start to make a profit. The current business owner provided the following information:

<table>
<thead>
<tr>
<th>INCOME STATEMENT</th>
<th>Total Per</th>
<th>Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units</td>
<td>44,000</td>
<td>1</td>
</tr>
<tr>
<td>Sales</td>
<td>$220,000</td>
<td>$5.00</td>
</tr>
<tr>
<td>Cost of Sales (variable expenses)</td>
<td>88,000</td>
<td>2.00</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>132,000</td>
<td>3.00</td>
</tr>
<tr>
<td>Operating Costs (fixed expenses)</td>
<td>125,500</td>
<td>2.85</td>
</tr>
<tr>
<td>Net Profit</td>
<td>6,500</td>
<td>.15</td>
</tr>
</tbody>
</table>

Step 2

**Calculate break-even based on units.** Using the information from the income statement provided, calculate number of units which must be sold to break-even.

\[
\text{Fixed costs/ (Sales price per unit – Variable costs per unit) = Break-even in units}
\]
Step 3

Calculate break-even based on Total Sales. Using the information from the income statement provided, calculate total sales dollars needed to break-even.

\[
\text{Gross Margin/Sales} = \text{Gross Margin} \%
\]

\[
\text{Fixed Expenses/Gross Margin} \% = \text{Break-Even in total sales dollars}
\]

Step 4

Discuss answers to the following questions. In small groups, or with a partner, answer the questions below. Be prepared to discuss your answers with the class.

1. Based on the average sale of $5, how many units need to be sold to break even?
   - In a year?
   - In a month?
   - In a day?
   
   Note: Use an average of 30 day/month.

2. What research could Riley do to determine whether this is reasonable?

3. What are some changes Riley could make to improve his profitability?
Step 5

Now do this activity a second time with a higher selling price. Calculate break-even at a $7.00 selling price. Using the information from the above income statement, calculate the break-even per unit, the gross margin percent, and the break-even total sales.

Calculate break-even based on units.
Fixed costs/ (Sales price per unit – Variable costs per unit) = Break-even in units

Calculate break-even based on Total Sales.
Gross Margin/Sales = Gross Margin %

Fixed Expenses/Gross Margin % = Break-Even in total sales dollars

Step 6

Discuss answers to the following questions. In small groups, or with a partner, answer the questions below. Be prepared to discuss your answers with the class.

1. Based on the average sale of $7, how many units need to be sold to break even?
   In a year?
   In a month?
   In a day?
   Note: Use an average of 30 day/month.

2. What impact did changing the selling price from $5 to $7 have on the break-even point?

3. What impact will the increase in selling price likely have on number of units sold? What, if anything, could be done to lessen the impact of the change in price?
Scenario 12.4.1

Run KC—Understanding Financial Statements

Learning Objective
- To compare the cash flow and income statements and examine what each disclose about the financial state of a business.

Overview
Decisions made regarding income and expense projections for a business will determine the expected profitability and cash flow for that business. Profitability is the company’s ability to generate income and is revealed in the Income Statement. The Cash Flow Statement reflects the company’s ability to pay obligations as they become due and to accumulate cash for future growth. Analyzing these two financial statements during the planning stage will help the entrepreneur determine viability and/or changes which need to be made to ensure long-term survival.

Scenario—Tim’s business during his college years, prior to Run KC
During Tim’s college years, he developed a plan to start his first entrepreneurial venture selling running socks to schools, running clubs/teams, and organizations. The socks were a basic style which was personalized with the school or organization’s name or logo. The price point was low, making it possible to include the item in a race entry fee or as a promotional giveaway.

Tim located a sock supplier in Boston where he was attending school. It was not necessary for Tim to carry inventory since all socks were stamped with the school or organization’s name or logo when the order was placed. Once Tim placed an order, the socks would be ready for pick-up within 48 hours. Since he was a start-up business without a credit history, the supplier required that he pay cash for each order at the time of pick-up.

Tim had no vehicle but needed one for pick-ups and deliveries. He planned to purchase a car that needed some work and to invest money in the vehicle monthly to make the needed repairs.

Tim planned to establish this company as a sole proprietorship and employ his roommate to answer the phone, take orders, and help when needed. Through his contacts in the running world, he was able to finalize a significant number of contracts prior to starting the business. These contracts would provide him with ongoing sales for 5K races and marathons throughout the first year.

All customers would be invoiced when the socks were delivered and payment would be due in 30 days.
Financial Information for start-up and first three months would be as follows:

Tim’s Initial Investment: $8,000

Start up Expenses:
- Licenses $50
- Marketing $1,000 – includes sample socks for demonstration/giveaways
- Office Supplies $100
- Telephone (cell) $150
- Vehicle $4,000
- Web page $1,000

Monthly Expenses:
- Insurance $125 – every six months
- Marketing $100, $100, $200 – Months 1, 2, 3 – booth fees at running events
- Miscellaneous $75
- Payroll $400
- Payroll Taxes $50
- Telephone $125 – cell phone
- Vehicle $350 – repairs and gas
- Web Hosting $10

Owner’s Draw: $1,000/month

Pricing: $4.00/pair retail to schools, organizations and running clubs/teams

COGS: $1.50/pair

Sales to schools, organizations, and running clubs/teams:

<table>
<thead>
<tr>
<th></th>
<th>Month 1</th>
<th>Month 2</th>
<th>Month 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$4,000</td>
<td>$4,800</td>
<td>$6,000</td>
</tr>
<tr>
<td>COGs</td>
<td>$1,500</td>
<td>$1,800</td>
<td>$2,250</td>
</tr>
</tbody>
</table>
### Step 1

Using the below Income Statement format and the information provided, develop a projected monthly income statement for the first three months of business for Tim’s sock business.

**Income Statement**

<table>
<thead>
<tr>
<th></th>
<th>Month 1</th>
<th>Month 2</th>
<th>Month 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net 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 Income</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Expenses</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>Dues and Subscriptions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Licenses and Fees</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketing and 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></td>
<td></td>
<td></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 and Wages</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td></td>
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</tr>
<tr>
<td>Benefits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Professional Fees</td>
<td></td>
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<tr>
<td>Property Taxes</td>
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<td></td>
</tr>
<tr>
<td>Rent</td>
<td></td>
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<tr>
<td>Repairs and Maintenance</td>
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<tr>
<td>Shipping and Delivery</td>
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<tr>
<td>Telephone</td>
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<tr>
<td>Training and Development</td>
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<tr>
<td>Travel</td>
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<td></td>
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<tr>
<td>Utilities</td>
<td></td>
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<td></td>
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<tr>
<td>Vehicle</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income before Taxes</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Based on the income statement you developed, answer the following:

1. According to Tim’s projections, will the sock business be profitable? Explain your answer.

2. If you were Tim, how would you feel about the outlook for the business?
Step 2

Using the below Cash Flow Statement format and the information provided, develop a projected monthly cash flow statement for the first three months of business for Tim's sock business.

### Cash Flow Statement

<table>
<thead>
<tr>
<th></th>
<th>Start-up</th>
<th>Month 1</th>
<th>Month 2</th>
<th>Month 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Beginning Cash</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>CASH IN:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collections from</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Accounts Receivable</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Loan</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Cash In</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Cash Available</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>CASH OUT:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Licenses</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Insurance</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Marketing</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Miscellaneous</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Supplies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telephone</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vehicle</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other: Web Page</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Capital Purchases</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td></td>
<td></td>
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<tr>
<td>Vehicle</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Owner’s Draw</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Total Cash Out</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Ending Cash</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Based on the Cash Flow Statement you developed, answer the following:

1. Do Tim’s projections indicate that the sock business will “cash flow”? Explain your answer.

2. If you were Tim, how would you feel about the outlook for the business?

3. Since Tim developed his financial projections prior to starting the business, he has the opportunity to make adjustments while still in the planning phase. In small groups or individually (depending on instructions provided by your professor), brainstorm all the ways that Tim could alter his financial plans so he does not run out of cash.
Summary

This chapter outlined the basic aspects of financial planning that began in Chapter 11, concentrating on estimating inventory and operating expenses. The chapter included the following concepts:

- Businesses have on-going operating expenses. These expenses are necessary to support the sales, administration, and general operations of the business.
- Determining the projected operational costs for the business is important to accurately estimate how much money is needed to cover expenses.
- Operating expenses should be estimated based on facts uncovered about the business concept and industry.
- There are three common approaches to developing sales projections. Comparing sales estimates made through these three different approaches gives entrepreneurs a clearer perspective of what is realistic for their business.
- Effective sales assumptions include information which justifies the estimates.
- Inventory is the term accountants use to describe product available to be sold. Estimating inventory is an important step in the financial planning of a business.
- Product based business have a cost of goods sold; many service based businesses do not.
- Entrepreneurs use break-even analysis to determine how much of their product/service they must sell at a specific price to meet all costs.
Financial Planning: Cash Outlays & Sources

Overview
This chapter expands on the financial concepts entrepreneurs use to plan a financially successful venture. These concepts include understanding and projecting accurate financial statements, determining cash needs, and evaluating cash sources.

Every business must have cash to start and grow its operations. Throughout the stages of business, money is sought from various debt and equity sources. This chapter will help you determine the amount of money needed to start and sustain your business throughout the first few years. You will also be given many ideas for sources of cash.

Your ability to obtain funds to start and grow a business varies greatly depending on your situation. This chapter will give you the information you need to evaluate different sources of money and the appropriateness of each for your business.

Objectives
In this chapter, you will learn to:

• Identify capital expenditures for starting your business.
• Understand the concepts of depreciation and amortization and how they affect the balance sheet.
• Develop accurate financial projections.
• Identify all types of cash outlays for your business.
• Develop knowledge about debt and equity sources of money.
• Identify sources of money that you may be able to access.
13.1 Projecting Other Cash Outlays

13.1.1 Introduction

Cash supports the operations of a business in a variety of ways. One way is through cash outlays to cover the initial costs of products/services so that the business has something to sell. Another way is through cash outlays that go to support the operating expenses of the business. In addition to these primary cash outlays, there are other activities that use up a business’s cash, such as the purchase of additional equipment and owners’ draws.

In the financial template you estimated the cash needed for start-up expenses, the cost of products/services and operating expenses. Additional cash outlays for capital expenditures, security deposits, land, and payouts to owners and investors will be entered on the Capital Budget Worksheet. It is important to estimate these numbers carefully so that cash flow projections will be correct.

13.1.2 What Are Capital Expenditures?

Capital expenditures are assets purchased by the company. These assets may be used to generate revenue, such as sound system equipment for a disc jockey service, or to organize and operate the company, such as a computer and customized software for a photography business. A capital expenditure is considered an asset, regardless of its intended use.

You entered initial capital expenditures on the Start-up Funding and Expenditures Worksheet when you estimated costs for start-up purchases. This might have included items such as computer equipment, furniture, machinery, and vehicles. Capital expenditure purchases are not one-time events. You will now begin planning for capital expenditures to be made in the first three years of business operations.

As the business becomes operational and grows, additional capital purchases may be required. These purchases are recorded as assets on the balance sheet. An asset is an item that retains value. Assets can be sold to recapture some of the cash spent to obtain them. Following are several examples of capital expenditures:

- Equipment
- Furniture
- Leasehold improvements
- Vehicles
- Buildings
from real entrepreneurs

When Jacob Johansen started his mobile auto repair and detail business, he needed lots of equipment. First, he identified the capital equipment that would assist him in generating revenue - touchup and repair systems, detailing systems, carpet and upholstery cleaning, etc. He purchased these systems new because he felt it afforded him the best opportunity to acquire state-of-the-art equipment that would last him many years. Then he determined the equipment that would help him organize and run the business - computer, cell phone, desk and filing system, etc. He purchased these systems used or at discounts since their primary function was to keep him organized. This strategy helped saved thousands of start-up dollars.

Capital expenditures (assets) are always recorded in the company records at the purchase price. This amount represents the book value of the asset. The book value is important because it helps the entrepreneur determine how much cash has been invested in the business. The book value, however, does not indicate the real value, or market value, of an asset. The market value is the amount that someone outside the company will pay for the asset.

13.1.3 Understanding Depreciation

Depreciation is an accounting method used in creating financial statements. It adjusts the original value (book value) of an asset to more accurately reflect its current value (depreciated value). Depreciation reduces the value reported for each asset on a yearly basis.

When an asset is purchased, its book value is determined by how much it costs the business. This book value does not change. However, the actual value of an asset generally declines every year that the asset is owned or used. This annual decline occurs because the asset's usable life has been reduced by one year. The depreciated value (book value minus accumulated depreciation) reflects this decrease in usable life.

Another important reason for depreciation is called the matching principle. The matching principle says that the expenses involved in generating revenue must match (or be recorded in) the time period in which that revenue is realized. In other words, when a sale comes in, all expenses associated with that sale should be recorded (or expensed) at the same time. Another way of looking at this is that these assets are fully expensed during the period they are being used/consumed. Then, when its useful life is over, the asset will be fully depreciated and have a book value of $0.

from real entrepreneurs

Last year Backyard Solutions purchased a commercial-grade radial arm saw for $4,000. This capital expenditure is an asset because it retains value. The saw can be sold at any time to generate cash. Therefore, the $4,000 is recorded as an asset and can be found on the balance sheet of the company. This saw will last several years while it helps produce Yard Closets and generate revenue.
Depreciation reduces the book value of the saw each year. This calculation accomplishes two things. First, the original $4,000 book value is reduced every year to more accurately reflect the usability of the equipment. Second, as the book value is reduced, the amount of the reduction is recorded as an expense against the revenue of the company. Therefore, the revenue generated by the sale of Yard Closets made with this saw will be recorded in the same period as the expenses (depreciation) for this saw. Straight-line depreciation—a simple form of depreciation—works in the following way:

<table>
<thead>
<tr>
<th>Asset or book value as seen on the balance sheet</th>
<th>Depreciation amount that is expensed, reducing the value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Price $4,000</td>
<td></td>
</tr>
<tr>
<td>Year 1 3,200</td>
<td>800</td>
</tr>
<tr>
<td>Year 2 2,400</td>
<td>800</td>
</tr>
<tr>
<td>Year 3 1,600</td>
<td>800</td>
</tr>
<tr>
<td>Year 4 800</td>
<td>800</td>
</tr>
<tr>
<td>Year 5 0</td>
<td>800</td>
</tr>
</tbody>
</table>

Assuming that the piece of equipment will retain some value for five years, the book value of the asset is divided evenly among those years. Each year, 1/5 of the book value is recorded as an expense against revenue (on the income statement) and the book value is reduced (on the balance sheet). After the fifth year, the balance sheet will show the asset as having no value. It may indeed have market value. For example, it may still be sold to obtain some cash, but it has no book value.

Asset depreciation methods vary. The objective is to match depreciation expenses with the revenue generated by the use of the asset. For planning purposes, straight-line depreciation is most common. It is easy to calculate—the value of the asset is evenly distributed over its useful life. Some assets are depreciated according to a pre-set industry standard of “usefulness.” For example, computers are generally depreciated over no less than three and no more than five years. You may keep your computer longer, but most accountants will depreciate a new computer according to a standard rate of depreciation. You should use a reasonable estimate or talk with your accountant to determine the appropriate number of years commonly used for an asset. The Financial Template uses the following life expectancies.

<table>
<thead>
<tr>
<th>Asset</th>
<th>Estimated Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer Equipment</td>
<td>3</td>
</tr>
<tr>
<td>Equipment &amp; Machinery</td>
<td>7</td>
</tr>
<tr>
<td>Furniture &amp; Fixtures</td>
<td>7</td>
</tr>
<tr>
<td>Vehicles</td>
<td>5</td>
</tr>
<tr>
<td>Leasehold Improvements</td>
<td>5</td>
</tr>
<tr>
<td>Building</td>
<td>20</td>
</tr>
</tbody>
</table>

13.1.4 Understanding 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.

The value recorded on the Balance Sheet for these assets represents the cost of obtaining them. They should be amortized over their expected lifetimes on a straight-line basis. The amortization process occurs in a similar manner as the depreciation process illustrated in the Backyard Solutions example. The only difference is the types of asset being amortized and the term amortization itself. If you cannot tell whether an asset should be depreciated or amortized, talk with your accountant.
13.1.5 Other Capital Expenditures

Common expenditures (assets) are furniture, equipment, and inventory. Money can be spent on other types of assets as well. Consider the following:

**Prepaid Expenses**—Some business expenses must be prepaid. This occurs when the money must be spent before the service can be received. Insurance is a common example of a prepaid expense and is categorized as an asset. Items of value, assets, are shown on the balance sheet. Prepaid expenses are shown as assets on the balance sheet and are expensed as the value diminishes.

**Security Deposits**—Sometimes a security deposit must be paid to a company, such as a utility company or a property manager. These security deposits are usually held in an escrow account and are returned in the future. Therefore, they maintain value as an asset even though they are intangible.

**Land**—Land is a unique asset because it tends to appreciate in value rather than depreciate. Therefore, it is treated differently than other capital expenditures that are depreciated.

**from real entrepreneurs**

Ramirez Roofing pays for an insurance policy that covers the business for a six month period of time. If the policy were cancelled, a portion of the premiums would be returned; therefore, it has value as an asset.

13.1.6 Payouts to Owners and Investors

In corporations and in limited liability companies that elect to be treated as corporations, the amount paid to the owner(s) for working in the business is treated as compensation and is processed through the company’s payroll system. This should have already been accounted for in operating expenses or in production expenses under Inventory.

Other cash payouts include money paid to investors and owners as a return for their investment in the company. This payment can take many forms and is determined by the company’s legal structure.

In a sole proprietorship or partnership, owners can receive a check at any time for compensation. The owners are not on a regular salary. This is referred to as an owner’s draw because money is drawn out from the business. This amount is not an expense. It is considered a reduction in equity. In the case of a limited liability company, unless an election was made to be treated as a corporation, the owner(s) would also take an owner’s draw.

In addition to salaries, the board of directors of a corporation has the authority to declare a dividend, a payout to stockholders for all or part of its actual or anticipated profits. This payment is generally given based on some given dollar amount per issued and outstanding share of stock.
Assignment 13a: Financial Template—Capital Budget Worksheet

On the Capital Budget Worksheet, you will record the purchase of capital assets as well as money paid to owners and investors during the first three years of business operations. Begin by entering the capital asset purchases you expect to make during the first three years. Do not repeat those you already entered in start-up. Depreciation of most assets will be calculated for you based on a standard depreciation schedule.

Read each step carefully as some assets, such as land, require special attention. Record information for the categories that apply to your business.

Remember, if your business is structured as a corporation or a limited liability company taxed as a corporation and you will be paying yourself a salary, that figure belongs in the Operating Expense Worksheet or in production expenses under Inventory rather than on this worksheet. However, if you will be withdrawing funds for yourself that are not a salary, they will be listed as owner’s draw in the Capital Budget.

Include assumptions when appropriate. After you complete the Capital Budget Worksheet, you may want to view other sheets in the financial template to see how the data links to the other worksheets and the financial statements. Include the capital budget projections in the appendix of your business plan.

<table>
<thead>
<tr>
<th>Capital Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use this worksheet to record depreciation on existing capital assets (equipment, furniture, vehicles, etc.), future capital purchases, applicable depreciation, and other capital expenditures (owner draws, dividend payments, etc.). Read through the instructions for each section to determine which sections pertain to your business. Repeat each step for Years 2 and 3.</td>
</tr>
</tbody>
</table>

| Section A — Depreciation (Existing Capital Assets) |
| Did you enter capital assets (Computer Equipment, Equipment/Machinery, Furniture & Fixtures, Leasehold Improvements, Vehicles, or Building) in either the Set-Up or Start-Up Funding & Expenditures Worksheet? If the answer is yes, complete this section. If not, go to Section B. |

**Step 1:** For Existing Companies

The capital asset balance from the Set-Up Worksheet is…………………………………………………………………………………

If you do not fill out the details in this table, this balance will automatically be depreciated over the next five years. If you would like a more accurate and detailed estimate of depreciation, fill out the following table. To use the table, first enter the balance net of accumulated depreciation for each category of capital asset. Then, enter the useful life in years that remains to be depreciated. The total of all the capital assets must equal the capital asset balance in cell H16, from the Set-Up Worksheet. If the totals do not match, the balance in cell H16 will be depreciated over five years. Do not include land values in this table. For land, see Section C, Step 5.

**Capital Asset** | **Balance** | **Useful Life** | **Annual Depreciation Year 1** | **Annual Depreciation Year 2** | **Annual Depreciation Year 3**
--- | --- | --- | --- | --- | ---
Computer Equipment | - | 3 | - | - | -
Equipment/Machinery | - | 7 | - | - | -
Furniture & Fixtures | - | 7 | - | - | -
Vehicles | - | 5 | - | - | -
Leasehold Improvements | - | 5 | - | - | -
Building | - | 20 | - | - | -

**Step 2:** For Start-Up Companies

The capital asset balances from the Start-Up Funding & Expenditures Worksheet are in the table below. They will be depreciated according to the useful life shown starting in January of Year 1. You may change the useful life if you know your depreciation schedule will differ from the standard.

**Capital Asset** | **Balance** | **Useful Life** | **Annual Depreciation Year 1** | **Annual Depreciation Year 2** | **Annual Depreciation Year 3**
--- | --- | --- | --- | --- | ---
Computer Equipment | - | 3 | - | - | -
Equipment/Machinery | - | 7 | - | - | -
Furniture & Fixtures | - | 7 | - | - | -
Vehicles | - | 5 | - | - | -
Leasehold Improvements | - | 5 | - | - | -
Building | - | 20 | - | - | -

**Step 3:** Proceed to Section B.

---

**Tip**

Working on your Capital Budget Projections is a good time to ask yourself: Is each capital expenditure important to the success of my business? Which do I need to purchase before I open for business and which should be purchased later.
13.2 Determining Funding Needs

13.2.1 Match with Stage of Growth

A business’ need for capital varies with its stage of development. The sources of funds available to the business also vary with the stage of development. Stages include: conception and start-up, early operating, growth and rapid-growth, and maturing.

from real entrepreneurs

A young graduate of a famous business school put together a business plan for a custom touring bicycle manufacturing business that required $250,000 of initial financing. After much effort contacting many venture capitalists and wealthy investors without success, the graduate was facing ruin. This entrepreneur had proceeded with the venture, assuming that he would have no problem raising the money. Faced with failure, the entrepreneur examined the major financial planning tool—the cash flow plan—more closely and figured out that only $100,000 was really needed to do the job. The rest was for non-essentials and padding for peace of mind. With a smaller amount of money to raise, the entrepreneur divided it into units of $10,000 each and sold them to friends. The fund raising was successful.

Tip

When entrepreneurs finance operations without seeking outside money, life is much simpler and nights will be more restful. The decision to go after other people's money is a serious one loaded with implications and responsibilities.

Tip

Your emphasis should be on the amount of money you need, not the amount you want.

Conception and Start-Up Stages

Most entrepreneurs must rely on their own money sources when first starting a business. Even financial institutions in business to loan money are reluctant to lend to start-ups. This position isn't personal; it is based on the high risk of business start-ups. Generally banks will only lend money to start-ups if the borrower has a good credit history, can provide solid collateral to secure the loan, and will personally guarantee the loan. Be prepared to look at your personal financial situation to identify sources of start-up funding, such as personal savings or a home equity loan. If your own personal financial situation doesn't reveal funding sources, then consider whether you might have any friends or family who would be interested in making an initial investment in your business. Many entrepreneurs start their business on the side while they are still employed. Keep this in mind if you are having difficulty finding other start-up funding.
from real entrepreneurs

In the marketplace today, many ventures have a long lead time before they can reach a cash break-even point and eventually make profits. Amazon.com required massive investments in brand development and infrastructure before it made money. Biotech firms endure long lead times for research and development and Food and Drug Administration trial costs before making profits.

Be creative when looking for start-up money. Many entrepreneurs get started in business by thinking of non-traditional ways to cover their costs. Consider buying used equipment, seeking customers that will make deposits, and lowering the costs of start-up.

Early Operating Stage

The early operating stage can put a great deal of stress on a business’s daily cash flow balance. Many entrepreneurs will seek lines of credit to give them the flexibility of having the funds available when they need them. Banks are more interested in lending to businesses with an operational track record, so obtaining loans for purchases of equipment and other large items is generally easier at this stage than at start-up. Keep in mind that in the early operating stage, friends and family might also become more interested in investing.

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 be aware of customers, suppliers, or even competitors who could become a source of cash flow through joint-venture arrangements or other agreements.

Tip

Even though they meticulously planned for start-up funding, entrepreneurs can fail because they do not adequately plan the amount.
Growth and Rapid Growth Stages

Growth may mean expanding the number of locations, adding a new production facility, or just kicking up operations to accommodate new markets. Increasing levels of payroll, purchasing more inventory, and buying new equipment generally take a lot of cash flow. All of these expenditures are expected of a business in the growth stage. Because they are expected, funding is somewhat easier to obtain. 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.

Maturing Stage

When the revenues of the business begin to plateau, the business is moving out of the growth stages and into a mature operating stage. At this stage, companies usually remain somewhat stable as long as they continue to respond to market needs.

The funding during this stage is similar to the early operating stage. Since these businesses have already established relationships with lending institutions, 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 to avoid a decline in future sales, so they will be keeping a close watch on the business.

More Info

Capital Needs for Growth—From The Entrepreneurial Revolution with Bill Reisler, Partner, KC Venture Partners; Mark Beckloff and Dan Dye, co-founders of Three Dog Bakery. Access this video with the 13.2.5 More Info link in the online course.

13.2.2 Comparing Equity and Debt

**Equity**

Equity means ownership, as in the owner’s equity in the business. Equity capital is the money invested in a business by its owner(s). Equity also includes everything left over after suppliers, employees, the bank, the government, and everyone else is paid. Of course, entrepreneurs plan to have plenty left over.

Equity holders have the rights to control income and assets. An entrepreneur who is the only equity holder clearly holds all the rights to the business. As additional equity holders are added—stockholders, investors, venture capitalists—rights become much more diffused and difficult to manage.

Examples of equity include:

- Entrepreneur contributions
- Private investments
- Initial public stock offering
- Earnings retained in the business

**Debt**

Debt essentially means that the borrower must repay the funds along with agreed upon service charges, such as interest, and loan origination fees. If the money is not repaid as promised, the lender can start collection proceedings. This process can result in a loss of the business and any non-business assets that the entrepreneur pledged to secure the loan.

Borrowing money should not be done lightly. When borrowing money, the entrepreneur assumes a serious obligation. The money should not be borrowed unless those funds will earn in excess of their cost.

Examples of debt include:

- Borrowing from family and friends
- Bank financing
- Real estate loans
- Long-term loans
- Lines of credit
- Small Business Administration-backed loans

### Tip

Borrowing money is like placing a bet. The entrepreneur uses the company to bet with the lender that he will be able to perform according to plans. If the plans are wrong, an entrepreneur can lose his company and anything else he has invested.

13.2.3 Evaluating Cash Sources

Raising money is an art. Fortunately, it is an art that can be learned. All entrepreneurs should become experts at raising money. The entrepreneur needs to know about sources of money, how to find them, and how to relate to them. Even if outside funding is not needed in the seed or start-up stage, most entrepreneurs will discover a time when outside money is necessary. Whether they can get the money will depend on what they have done long before the money is needed and how they deal with the money sources.
All money is not the same. When providing money, investors and lenders have specific goals they intend to accomplish. It is fairly easy to find out what they are. The key question is whether the entrepreneur’s goals are compatible with those of the investor or lender. Six major considerations in determining this are: time, amount, use of funds, cost, control, and consequences.

**Time**—Seeking outside money sources may take months of almost full-time effort. If an enterprise is in its early stages of development, that time is usually taken at the expense of other critical activities. Time may also be an issue for the lender or investor. They may have to wait for the business to reach a certain stage, be acquired by another business, receive another round of funding, or go public before they receive their return on investment.

**Amount**—The amount of money needed to finance the company has a bearing on available sources. Funding sources have minimum and maximum amounts that characterize their participation in a business. The needs of the entrepreneur must match the parameters of the funding source.

**Use of funds**—Entrepreneurs need to match the term of the lending with the use of the funds. Using short-term debt to finance long-term fixed assets is a common mistake made by entrepreneurs. Short-term loans should be used to finance seasonal inventory and accounts receivable. Long-term loans finance equipment and other long-lasting investments.

**Cost**—Borrowing money is expensive. It is important to consider the associated costs. Private investors, investment bankers, or venture capitalists will expect a 25 to 100 percent return per year for their funds. One of the reasons that banks are so popular is that they are usually the least expensive source of money.

### from real entrepreneurs

A private investor in a computer manufacturing company invested $50,000 and was bought out three years later for $350,000, which is a high rate of return. Most investors demand a highly profitable venture before investing to counter the higher risk they are taking.

**Control**—The main reason many entrepreneurs start a business is to control their own destiny. Using outside money can negate that goal since investors may control the future of the enterprise.

**Consequences**—Anyone who has ever borrowed money and then not been able to repay it knows that lenders are likely to do things to force borrowers to pay. These consequences may result in closing the doors of the business. Or, in an investment situation, failure to provide investors adequate returns may result in loss of control of the business.

Some entrepreneurs prefer to raise capital through investors who take an equity position in the business. Others prefer to borrow from a lender. Some do both.

### from real entrepreneurs

Gene Amdahl, founder of Amdahl Corporation, was left with only three percent of his computer business after several fund-raising stages. Why bother getting the money if the enterprise is lost in doing so? The old cliche, “It is better to have 10 percent of something than 100 percent of nothing,” is little consolation to an entrepreneur who began his own business in order to control his own destiny.
13.3 Locating Funding Sources
13.3.1 Introduction

Entrepreneurs should become proficient at raising money as they will likely need to do so many times in the life of the business. Fortunately, raising money is a skill that most people can learn.

Entrepreneurs need to know about sources of money, how to find them, and how to relate to the sources. Even if outside funding is not needed in the conception and start-up stages, most entrepreneurs will reach a point when raising money is necessary. Their ability to acquire money will depend on the historical performance of the company and how they deal with money sources.

It is interesting to note that the majority of financing for entrepreneurial ventures comes from personal resources, including that of family and friends. The Federal Reserve 2010 Survey of Consumer Finances reported that for businesses of under 500 employees, more than 70% were initiated using personal savings or assets, about 6 percent were initiated using personal loans from banks or savings institutions, about 3 percent were initiated using personal or business credit cards, and just 3 percent were initiated using a business loan from a bank or savings institution.

More Info
Borrowing Money—An SBA overview on borrowing money.
sba.gov/content/borrowing-money

Deciding Whom To Ask for Money, Asheesh Advani. Tips to help you develop a list of prospects to approach when seeking business capital. entrepreneur.com/money/financing/startupfinancingcolumnistasheeshadvani/article83792.html

How Start-up Capital Works, Lee Ann Obringer—A series of articles on various types of financing and how they work. money.howstuffworks.com/startup-capital.htm

Small Business Credit Availability—Report from the Federal Reserve on the small business lending market. federalreserve.gov/newsevents/speech/duke20110414a.htm

Federal Reserve’s 2010 Survey of Consumer Finances federalreserve.gov/newsevents/speech/duke20110414a.htm

Tip
Begin building relationships early for future fund raising. When you are asking for money, it should not be the first time a potential investor or lender has heard about your business.
13.3.2 Self Financing

Entrepreneurs who do not need outside investors enjoy many advantages. The venture may not grow as quickly as ventures with more financial support, but many entrepreneurs feel the trade-off of maintaining more control is worth it and allows them to sleep better at night.

Borrowing money from relatives and friends is also considered self-financing when the money is provided with better terms and conditions than could be found through traditional funding sources. Entrepreneurs, however, should be careful when using money from family and friends. Even the best relationships can become strained when money is involved.

**Tip**

Consider using your own savings to start a business if you want to:

- Maintain total control of the business.
- Use the cheapest source of money.

**from real entrepreneurs**

One recent college graduate wanted to start a tent production business with a friend and needed $20,000 for his share of the venture. The only people he knew he might be able to approach to raise this kind of money were his parents.

He struck the following deal with his mother and father. First, they would loan him the $20,000 at 8 percent interest. To insure payback of the loan in case something happened to him, he would obtain a $20,000 term life insurance policy naming his parents as the beneficiaries. He would pay principle plus interest monthly to his parents. If the business declared bankruptcy, he would still be required to make payments until the loan plus interest was repaid.

Self financing also includes the following options; some are safer than others to use:

**Current Employment**—Probably the most risk-free approach to starting a business is to stay employed either full-time or part-time. This approach allows you to use earnings from your current employer to fund your business during the start-up stage. Generally, this approach will last as long as it takes to get the business up-and-running and able to pay you a salary. Although the benefits of starting your business without having to borrow or bring in investors are many—you’re in control at no cost—be sure to understand the limitations this approach will have on your current employment, your ability to get your business started, and your personal life.

**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 effortless and 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? This issue may be less urgent if you are single without the responsibility of any dependents. Even so, what impact could losing this money have on your future?

One reason not to personally finance your business is that for your business to develop a credit history, it will need to borrow money. As you develop a relationship with a bank or lending company and repay the loan, your business is creating a credit record. This record is tracked by the financial institution that lent the money, as well as other companies that track credit ratings.
Friends and Family—Money borrowed from relatives and friends can sometimes be another easy source of funding. Although this source of funding may be external to the business and its owners, it is an internal source because it is obtained solely through close, personal relationships. Generally these sources will not require completed applications or 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 funding source. Take into consideration the potential fallout (loss of friendships or uneasy family gatherings) if something goes wrong. You should establish a clear understanding of the risk associated with the investment, as well as repayment expectations for loans that include interest rate, term life insurance to pay your debt in case something happens to you, and contingencies for not being able to repay the loan.

Credit Cards—Many entrepreneurs use credit cards as a means to jump start a business. One reason is that they can get money quickly with little, if any, application process. Credit card debt should only be used 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 for 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.

Current Earnings (Profits)—Existing 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 until a business becomes profitable, in most cases it is paying out more in expenses than it is receiving in sales. After it reaches profitability, the cash it generates can be used to pay back loans, finance growth, or to pay dividends to the owners.

In the marketplace today, many ventures have a long lead time before they can reach a cash break-even point and eventually receive profits. Amazon.com® had massive investments in brand development and infrastructure while it still lost money. Biotech firms also endure long lead times for research and development and Food and Drug Administration trial costs before making profits.

You should consider all the options of internal funding sources and weigh their advantages in speed and cost against the advantages of external sources of funding.
External cash sources may help you build a credit history or develop your network of advisers and business associates in ways that internal sources cannot.

### from real entrepreneurs

A financial background did not preclude Isabella from making some financial decisions that she wished she had not. Isabella is still challenged by the credit card debt she incurred to purchase inventory for her business today, several years later. Isabella felt that credit cards were her only financing option, albeit not a good one, with little start-up capital and no bank financing—a common problem for new businesses. Now she cautions others to learn from her experience and start out with more working capital.

**More Info**

- How to Keep Family and Friends Loans Strictly Business, How to make sure all parties and relationships are protected. [entrepreneur.com/article/printthis/24380.html](entrepreneur.com/article/printthis/24380.html)
- Bootstrapping to Extend Cash Flow, William H. Payne The author discusses how bootstrapping can be used to extend cash and postpone the need to raise money. [entrepreneurship.org/en/resource-center/bootstrapping-to-extend-cash-flow.aspx](entrepreneurship.org/en/resource-center/bootstrapping-to-extend-cash-flow.aspx)
- Raising Money in Tough Times: An Entrepreneur’s Guide to Bootstrapping, Andrew J. Sherman. Examples of well known entrepreneurs such as Ernest and Julio Gallo are highlighted in this article which helps business owners think through the question “What were we actually going to do with the money, and are there other ways to obtain these resources? [entrepreneurship.org/en/resource-center/raising-money-in-tough-times-an-entrepreneurs-guide-to-bootstrapping.aspx](entrepreneurship.org/en/resource-center/raising-money-in-tough-times-an-entrepreneurs-guide-to-bootstrapping.aspx)

#### 13.3.3 Traditional Debt Sources

Debt is money loaned to the company by outside sources. Obtaining financing from an outside lender can be difficult. The process is easier when the entrepreneur understands the lender’s concerns. Lenders prefer businesses that pose little risk. In addition, the ability of a bank to lend money to a start-up business varies and depends on the number of current loan requests and the existing loan commitments of the bank.

Successful banking relationships are built on the personal relationship entrepreneurs develop with their bankers. Entrepreneurs should start early to develop these relationships as doing so takes time.

The entrepreneur and the lender should work together to match the need for money with the proper type of loan. Several types of loans are available:

- **Short-term loans**
- **Long-term loans**
- **SBA backed loans**
- **Microloans**
- **Lines of credit**

**Tip**

Finding the right bank and loan officer can be difficult.

Here are some tips:

- 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 governmental lending programs.
- Ask about the banking services you want for your business.
More Info

How to Improve Your Chances of Getting a Loan—Knowing your banker and how decisions are made can improve your chances of getting a loan.

entrepreneur.com/article/printthis/217382.html

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. While your new business may not qualify for a line of credit from a bank, you might have success obtaining a one-time, short-term loan to finance temporary working capital needs. If you have established a good banking relationship with a banker, he or she might be willing to provide a short-term note for one order, for seasonal inventory, or for accounts receivable buildup.

Depending on 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 courts to take possession of whatever asset you pledged as collateral and sell it. The proceeds 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 typically 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 longer.

You will find that the interest rates, loan origination fees and terms on long-terms 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.

Reality

Even when entrepreneurs establish their companies as corporations, banks often require corporate officers to sign the note to personally guarantee that the loan will be repaid.

from real entrepreneurs

One entrepreneur borrowed $20,000 from the bank, using his company’s injection-molding machine for security. After several months, the entrepreneur realized that he couldn’t repay the amount borrowed, so he stopped making payments to the bank. The bank went to court and proved that the note was legal and that the entrepreneur was in default. The bank received a legal document from the court that allowed the sheriff to take possession of the molding machine. When the molding machine was sold, it only brought $5,000, some of which went to the lender and some to the attorney. The entrepreneur still owes the lender $15,000, interest, legal fees, and court costs. This costly loan could have been avoided if the entrepreneur had done cash flow projections to determine the business’ ability to repay the loan.
SBA Backed Loans. The Small Business Administration (SBA) is not a lender, so it does not provide loans directly to businesses. Instead it has several programs that may help entrepreneurs secure loans with reasonable terms. The 7(A) and 504 Loan Guaranty Programs are the primary ones. Through these programs, entrepreneurs can receive small business loans through normal lending channels such as a bank. These loans are then guaranteed by the SBA.

from real entrepreneurs

Nancy wanted to start a retail store selling and renting snow ski gear. Her husband was supportive but unwilling to allow the house to be used as collateral for the business loan. Several banks turned down Nancy's request for traditional financing. Then, she went to a bank that was an SBA-preferred lender. Apparently, they had made so many loans with the SBA backing that they had achieved this preferred status. Nancy's credit rating was exemplary, and her business plan showed a consistent cash flow to pay back the loan. Because of her careful planning, the bank accepted Nancy's loan request, and the SBA guaranteed her loan without collateral. The SBA-backed loan cost Nancy a little extra since it included a guarantee fee and a slightly higher interest rate than the average loan. Still, without the SBA backing, Nancy feels she would never have gotten her business off the ground.

Lending institutions familiar with SBA loan programs can provide information and assistance throughout the SBA loan application process. The advantage of this program for the bank is 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 entrepreneurs is that they may be able to get a loan through these programs that they would not otherwise be able to obtain through traditional loans.

Here are some smart tips for obtaining an SBA-backed loan:

- Establish a banking relationship with a full-service bank that participates in SBA lending programs.
- Develop a business plan that contains proper financial projections, including a Three-Year Monthly Cash Flow Report, a Three-Year Income Statement, and a Three-Year Balance Sheet.
- Prepare a current, personal financial statement for any principals involved in the venture.
- List the collateral to be offered as security, including an estimate of the present market value of each item.
- Identify the amount of the loan request and the purpose for which the funds will be used.
- Make an appointment with your loan officer and request a loan.

The SBA evaluates the loan application by reviewing the following:

- Repayment ability from the cash flow of the business—The cash flow statement must show that the business can repay the loan.
- Character of the management team—From a banker's perspective, the entrepreneur's character and that of the management team reflects their willingness to repay loans. The entrepreneur's personal credit history will be used to assess character.
- Business plan—The plan provides information on the business and demonstrates the entrepreneur's seriousness and planning skills.
• Collateral available—Bankers often require some alternative means of recovering their funds if the business fails.
• Owner’s equity contribution—Entrepreneurs should have at least as much at risk as the bank and other investors.
• Condition—Lenders’ decisions will factor in the economy and its impact on the business.

More Info
Loans, Grants and Funding—The SBA guide to financing a small business.  
sba.gov/category/navigation-structure/starting-managing-business/starting-business/loans-grants-funding
SBA Loans: A Primer—The SBA has loan programs to match every stage of business.  
entrepreneur.com/article/217372
SBA Loans—Link to SBA loans and Loan Application Checklist  
sba.gov/category/navigation-structure/starting-managing-business/starting-business/loans-grants-funding/loans
Lending Partners—SBA 504 Loan and SBA 7a Loan comparison.  
cdcloans.com/lending_partners/sba-504_sba-7a_comparison.shtml

Microloan Programs.  Essentially, microloans are small business loans that help entrepreneurs start or expand businesses. Some loans are for as little as a few hundred dollars and go up to about $50,000. Some lenders even go up to about $75,000 for these loans. A number of institutions are beginning to make these types of loans, since the higher interest rates can be profitable. The Small Business Administration also funds microlending programs.

Microloans are typically made for purchasing inventory and other working capital needs. Some microlenders charge interest rates roughly comparable with those on consumer credit cards, while nonprofit lenders tend to charge a couple of points lower and extend credit for longer periods of time than traditional lenders. Microlenders usually require less collateral than conventional business lenders. They recognize that borrowers are just beginning to establish credit.

More Info
US Microenterprise Directory—A directory of microenterprise organization searchable by state.  
fieldus.org/Publications/2008/index.html
Microloan Program—An overview of the SBA Microloan program and listing of program affiliates.  
sba.gov/content/microloan-program
How to Use Kickstarter to Launch a Business, Christine Lagorio How a young couple used Kickstarter, an online community designed to help artists, musicians, athletes, inventors, and filmmakers raise small amounts of money from a large number of people, to launch a beverage company.  
inc.com/guides/2010/04/using-kickstarter-for-business.html

Lines of Credit. When a line of credit is awarded to a business, the entrepreneur can draw upon the approved funds, to a maximum level, whenever needed. This type of funding is appropriate to cover seasonal fluctuations in sales or regular cash shortages.
The amount and terms of the line of credit are determined in advance based on the needs of the business and the policies of the lending institution.

In most cases, lines of credit are due to be paid within a year. Other policies may be imposed on the business, such as not using the line of credit for two months after the balance has been paid. The rate on the line of credit will vary based on the institution and the business. In general, the rate is often one-two points over prime (the interest rate that commercial banks charge their most credit-worthy customers) for established companies and slightly higher for new businesses.

**Tip**

Be sure you understand all the terms and conditions of the line of credit. Some banks require that the line of credit balance be paid down to zero at least once each year. Other banks will keep renewing the note.

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**from real entrepreneurs**

One entrepreneur started a snowboard manufacturing business. The challenge with operating this type of seasonal venture was that the owner hired temporary workers, paid them after the work was completed, and then sold the product later. This practice resulted in a serious cash flow problem. Some companies paid within 10 days, while others paid within 30 days.

This entrepreneur was looking for a way to finance the cash shortages. The entrepreneur’s banker, however, turned down a request for a line of credit. The entrepreneur was forced to use personal credit cards to cover temporary cash shortages.

The company continued to grow, and the business expanded. The entrepreneur needed more financing to support the growth. This time, the banker realized the strength and opportunity of the company and readily agreed to the line of credit.

**13.3.4 Traditional Equity Sources**

**Angel Investors**

Equity capital is money invested in a business. Providing equity establishes an ownership position in the company.

Angels are private investors who provide equity funding to start-up stage entrepreneurs. These investors are typically high net worth former business owners who have successfully exited their businesses and seek to invest both time and money in early stage ventures. Angels invest from their personal accounts.

Funding start-up companies is high risk; consequently, these investors seek high-growth opportunities in which to invest both their cash and their time. Typically, they seek companies with potential to grow between 10-30 times their value in five years. Most of the return on investment to angels comes from 10 to 15 percent of invested companies.

Angels typically invest in rounds of $250,000 to $1 million with several angels investing $25,000 to $100,000 each. Although many angel investments are made in the technology and medical fields, investments have also been made to a wide variety of business sectors. Frequently angels are drawn to a venture because they have an interest in that particular industry or in the entrepreneur. Look for angels who can bring substantial value to your business, both industry experience and general management skills. Since angels are experienced business persons, they expect to be engaged in the business as mentors, advisers, or directors.
Angels do not publicize themselves as investors, therefore, they can be difficult to find. They frequently attend events where entrepreneurs gather to informally see what might be of interest to them. They usually do not disclose their investor status until they have already become interested in a business. In the past decade, however, angel investors have formed and joined together into groups called Angel Networks. There are now over 300 angel organizations in the United States. Angels join these organizations to gain exposure to more deals and to take advantage of efficient deal processing that organizations have adopted. Like solo investors, angel organizations tend to invest close to home.

**Tip**

Angel investors can be hard to find. Look for them by contacting:
- Industry trade associations.
- Local economic development governmental agencies.
- Advisors to angels (bankers, financial consultants, attorneys, etc.).
- Angel Networks.
- US Investor Network (usinvestor.com).

**More Info**

Angel Capital Association—Link to the webpage for the Angel Capital Association which includes FAQs about angel capital as well as links to member groups.
[angelcapitalassociation.org/entrepreneurs/](angelcapitalassociation.org/entrepreneurs/)

A Guide to Angel Investors—What it means to work with an Angel Investor
[entrepreneur.com/money/howtoguide/article52742.html](entrepreneur.com/money/howtoguide/article52742.html)

**Venture Capitalists**

While angel investors primarily fund start-up and early stage businesses, venture capital investors seek later stage companies with phenomenal growth potential—those who need several million dollars to achieve success. Very few companies (fewer than 2,000 in the United States) are successful in attracting first-time venture investment each year. Like Angel Investors, Venture Capital Investors take an equity (ownership) position in the company in return for capital. Their goal is to cash out of the business in five to seven years with a significant return on their investment.

Venture capitalists usually specialize by industry and stage but, in general venture capitalists work in all growth industries. When thinking about contacting a venture capital firm, entrepreneurs should consider the following:

**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.

**Minimum investments**—Most venture capital deals range between $7 and $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. Sometimes early stage businesses will have multiple rounds of venture capital financing. The earlier the stage, the riskier the investment—and these risk must be mitigated by a highly attractive business opportunity.

**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.

**Management participation**—Most venture capitalists play active roles in the firms in which they invest. In a very real sense when an entrepreneur takes a venture capitalist’s money, that VC becomes a partner in the operations of the business. VCs usually place representatives on the board of directors and may even insist on selecting their own CEO.
Types of investments—For the most part, venture capitalists are interested in life sciences and technology-based high-growth ventures. They want developmental technology on proven products with proven markets. They are generally interested in second and subsequent rounds of financing.

Cost of investment—Venture capitalists invest with the expectation of cashing out the investment within five years for a return of at least five times their investment and often much more. This exit is usually achieved through a sale or merger of the company or through an IPO.

You must carefully plan communication with venture capitalists. Seek venture capitalists who invest in your industry and business stage. Few entrepreneurs find money by blanket e-mailing their business plans to all venture capital firms they can find. The old adage is true, “It’s not what you know, but who you know.” The best way to get your business plan noticed is through a referral from an attorney, board member, angel investor, entrepreneurship center, trade organization, or other personal contact.

More Info
How to Pick a Startup Funding Strategy, Grasshopper Group. Chart which outlines the pros and cons of several types of funding strategies.
grasshoppergroup.com/how-to-pick-a-startup-funding-strategy-infographic/

Private Placements
A private placement is a way of raising capital through the sale of securities to a small number of select investors. 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.

It may cost anywhere from $3,000 to $20,000 or more to prepare a private placement memo, depending on the complexity of the venture. Private placements can be done by the entrepreneur directly, but more commonly investment bankers, financial packagers, or venture capital organizations handle these matters much as they would handle other types of financing. It depends on how much money is being sought and from whom it is being solicited. A knowledgeable investment lawyer or accountant should be consulted before attempting a private placement offer.

Initial Public Offering
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. Although this option is very unlikely for start-up ventures, (fewer than 200 venture companies go public annually in the United States), public markets are excellent sources of large amounts of money to fund company 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.
13.3.5 Alternative Sources

Business owners will also want to examine any of the following money sources that are viable options for their type of businesses:

- Customers
- Factoring
- Joint Ventures/Strategic Alliances
- Suppliers
- Employees
- Professional Advisors, Business Acquaintances
- Leasing Companies
- Sale of Distribution Rights

**Tip**

To find alternative sources of financing, look for people who could benefit from what your company offers. These people, often termed stakeholders, are the ones most interested in seeing your company succeed. They have a stake in your success. In other words, when you win, they win. Stakeholders might include employees, suppliers, the landlord, and 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.

**Customers**

In some instances customers want products or services so badly they are willing to put down significant deposits with their orders or supply the money an entrepreneur needs to get the job done. Customers can be an inexpensive source of money. Even if they must be given a discount for paying COD, the entrepreneur may be ahead financially.

**from real entrepreneurs**

An entrepreneur in eastern Colorado spotted an opportunity when he recognized a problem affecting home builders. Environmentalists and government regulators complained that the increase in home building had a negative effect on wildlife such as the prairie dog. Capturing the animals and moving them to uninhabited areas resulted in higher costs to the developers and presented potential dangers such as bites and the spread of infectious diseases.

The entrepreneur obtained agreements from developers and contractors to pay him in advance to remove and relocate the prairie dogs. He reengineered the large compressor on an old wheat truck to pull air in instead of blowing it out and added a hose large enough in diameter to pull a prairie dog through it and into a cage. With the customers in hand, Dog Gone Inc. removed the prairie dogs effectively and efficiently. The ride made the little animals dizzy, but they quickly recovered unharmed. Customers (the developers) needed this service so badly that they paid in advance to schedule Dog Gone Inc.

**Factoring**

If a company has accounts receivable, they can short-term finance by selling accounts receivable to a commercial financing company called a factor. Accounts receivable are sold directly to the factoring company at a discounted value. Customers are then notified that their accounts are owned by and payable to the factor. Factors do all of the collection work, which includes mailing invoices and doing the bookkeeping. Since factoring requires accounts receivable, it is usually not an option for financing the start-up business.
Joint Ventures/Strategic Alliances

Sometimes other firms that have an interest in what an entrepreneur is trying to do will form a strategic partnership with them to help the entrepreneur accomplish their goals. The firm wants to benefit from the entrepreneur's work.

from real entrepreneurs

An entrepreneur working on a new toxic waste disposal system was looking for a strategic alliance. He found a waste management firm that wanted to finance the work in exchange for the right to exclusively license the resulting technology from the entrepreneur.

In other cases, entrepreneurs can use a joint-venture arrangement to help finance their operations. Two or more firms can share the same assets, such as the plant, offices, and people, thus lowering their capital needs.

New venture incubators are a type of strategic alliance. Incubators offering shared rental space for start-up businesses are often found on university campuses and industrial parks. Incubators nurture young companies by offering work space at low rent, business services at low cost, and opportunities for consultation with business experts.

Suppliers

If an entrepreneur does not pay for purchased items when they are received, then vendors, in essence, are helping to finance the operation. The longer one can delay paying vendors, the more the venture is being financed by the suppliers’ money. This practice is called extended terms, and the vendor must agree to them. Thus, suppliers become a source of money.

The cost of the money may be another matter. If a business must forgo pay-early discounts, the financing may be costly. Choosing to extend terms rather than take a 2/10, Net 30-day discount, costs 36 percent annually. Taking the discount can save 2 percent each month by paying the invoice within 10 days rather than taking the full 30 days to pay.

from real entrepreneurs

One Generation X entrepreneur developed several different accessories to be used with a variety of Jet Skis, including a workbench, trailer, storage rack, and display fixtures. All of these products required a supplier who specialized in bending metal tubing. The entrepreneur located several suppliers and found an expert in metal tubing. The tubing owner was excited about the products, and negotiated the following business agreement during the next two weeks.

The metal shop would build the prototypes at no charge but required the entrepreneur to sign a manufacturing agreement that the metal shop be the sole supplier for the accessories at a preset price. The entrepreneur would be primarily responsible for marketing the products to potential buyers. The entrepreneur attended industry trade shows and convinced Yamaha to purchase the accessories and sell them through its dealers.

This business venture was started with the tubing supplier furnishing the start-up capital, manufacturing the prototype, and producing the Jet Ski accessories. The founder did not have to pay the supplier until Yamaha paid for the products. The owner of the metal shop was interested in this deal because of an upswing in the Jet-Ski industry. The tubing owner saw an opportunity to be the sole supplier of these accessories and create another income stream. Currently, this business is a multimillion-dollar Jet Ski accessory business.
Employees

Employees—past, present, or prospective—are often a good source of financing. Current or past employees are familiar with the business, its goals and future earnings’ potential. Prospective employees may be interested in an opportunity to “buy” a job and, therefore, invest in the company in exchange for the opportunity to work there.

from real entrepreneurs

Worker-owned cooperative plywood plants in the Pacific Northwest were financed when each of the approximately 100 employees needed bought a working share for $20,000. The working share entitled the person to a job in the plant. Naturally, another set of problems arises when employees are also owners, but they can be handled in a variety of ways.

Professional Advisors, Business Acquaintances

Lawyers, CPAs, other business professionals, and business acquaintances have been known to invest in enterprises if the prospects look bright. After all, they are often looking for a good investment.

Sometimes a business acquaintance has other contacts. These contacts may make additional resources available that can nurture the new firm. This type of investor is often strongly motivated to help the firm prosper.

Leasing Companies

Leasing is becoming a popular financing strategy. Equipment/asset leasing, including the sale and lease back of an asset, is a major source of capital for entrepreneurs.

Generally, lease payments cost less than loan payments on equipment. Leasing, however, requires analysis of tax, accounting, and financial situations.

Tip

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 less time. The lessor accepts this risk. Many lessors provide takeouts, rollovers, or upgrades for technological changes so that a business can have state-of-the-art equipment.

More Info

Equipment Leasing—How leasing works and how it might fit into your business plans. [entrepreneur.com/money/howtoguide/article52720.html](http://entrepreneur.com/money/howtoguide/article52720.html)

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, entrepreneurs must be prepared to give a lot in return. The person may ask for the distribution rights for a large area, such as everything east of the Mississippi. Before selling such rights, the entrepreneur should analyze the situation carefully; many times performance guarantees may be needed.
Choosing the Source

Determining which funding sources to use is an important and often complex decision. Following are factors to consider in choosing sources:

1. Does the funder’s capacity fit the size/needs of your business?
2. Does the funder have an understanding of your industry?
3. Will the funder help manage the financial aspects of your company?
4. Will the funder take an active role in the management overall?

As you think about your business’s future funding needs and review the information you’ve just read, you can use the chart on the following page to help you remember which types of funding are most commonly utilized during the various stages of business. The checkmarks indicate the funding stage at which each source is generally used. This chart will help you focus your fund-raising energies where they will be most effective.

<table>
<thead>
<tr>
<th>Type of Funding</th>
<th>Conception and Start-Up</th>
<th>Early and Mature Operations</th>
<th>Growth and Rapid Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Employment</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Personal Savings and Home Equity Loans</td>
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<td></td>
</tr>
<tr>
<td>Friends and Family</td>
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<td>x</td>
<td></td>
</tr>
<tr>
<td>Credit Cards</td>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Earnings</td>
<td>x</td>
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<td>x</td>
</tr>
<tr>
<td>Customers</td>
<td>x</td>
<td></td>
<td></td>
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<tr>
<td>Suppliers</td>
<td>x</td>
<td></td>
<td></td>
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<tr>
<td>Professional Advisers or Business Acquaintances</td>
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<td>x</td>
<td></td>
</tr>
<tr>
<td>Leasing Companies</td>
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</tr>
<tr>
<td>Microloan Program</td>
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<td>x</td>
<td></td>
</tr>
<tr>
<td>Bank Loans</td>
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</tr>
<tr>
<td>Angel Investors</td>
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<td></td>
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<tr>
<td>Venture Capital Investors</td>
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<td></td>
<td></td>
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<tr>
<td>Private Placements</td>
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<tr>
<td>Initial Public Offering</td>
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<td></td>
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<tr>
<td>Factoring</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Joint Ventures / Strategic Alliance</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Sale of Distribution Rights</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>
Scenario 13.3.5

**Run KC – Funding Sources**

**Learning Objective**
- Evaluate the cash sources available during the different stages of business.

**Overview**
Every business must have cash to start and grow its operations. Throughout the stages of business, money is sought from many sources. The funding requirements stipulated by these sources, such as amount, cost, and control, need to match the business’s financial goals. Not all funding sources will be available or appropriate for every business.

As an entrepreneur begins to identify the cash needs of their business, they should keep in mind the different phases of business growth. Each stage has its own funding needs and options. As a business progresses through different stages, the entrepreneur should have a plan in place to provide the cash needed.

**Scenario**
Tim has been preparing to start Run KC for a number of years and has planned his personal finances with that goal in mind. His wife has a full time job with benefits and plans to remain employed. Her salary is sufficient to cover their living expenses. They have saved enough money to comfortably invest $50,000 of their own money in the business. Tim’s financial projections indicate that he will need a total of $200,000 at start-up.

In five years, Tim pictures himself as the owner of a successful store that can operate without him. At that time, he plans to develop detailed plans for expansion. He expects that by year 10, he will have two to three successful locations.

**Step 1**
**Cash sources at start-up.** Run KC is in the start-up stage of business. List as many options as you can think of that might be sources of money for this start-up business. Then, compare your list with another.
Step 2

**Evaluate cash sources.** Which of the sources identified in Step 1 would be the easiest for Tim to get money from? Which would be the cheapest source of money? Which would leave Tim with the most control?

**Easiest:**

**Cheapest:**

**Leave Tim with control:**

---

Step 3

**Identify advantages/disadvantages of cash sources.** The owner of Runner’s Resource, the Boston based specialty running store where Tim worked for five years, is interested in investing in Run KC. What would be the advantages and disadvantages to this arrangement?

**Advantages:**

**Disadvantages:**

---

Step 4

**Cash sources for growth.** How might funding options change when the business expands in five years? Why do the options differ?
Assignment 13b: Financial Template—Equity & Debt Worksheet

The Equity and Debt Worksheet will help you determine how much money you will need to operate the business. When you originally completed the Start-up Worksheet, you were instructed to enter any money you plan to invest to start the business under the category Start-up Cash – Equity Investments. Equity is money provided by the owners of the company. You may have also entered a Real Estate Loan. To determine the additional funding required, follow these steps.

1. **Review the Equity and Debt Worksheet, Section A - Cash Position.** This provides you with the ending cash balance each month for the first three years in business. If all numbers are positive, you may have enough money for the start-up phase of your business – that is, if your projections are accurate and you have enough “cushion” for any variations from these projections. Most entrepreneurs will find negative numbers in this section indicating the need for additional funding.

2. **Determine the amount of additional funding you need at start-up.** You have already entered the equity you plan to invest at start-up. You may have also entered a Real Estate Loan. Now determine the additional funding needed so that the cash position in the Equity and Debt Worksheet, Section A is never a negative number. Additional funding may include more equity and/or debt (money loaned to the company by outside sources) or through any of the options listed under Step 6, Section A on the Equity and Debt worksheet.

Remember, you need enough “cushion” to allow for variances from your projections. If your additional funding includes debt, you will also need to allow funds for the loan payment.

3. **Return to the Start-up Funding and Expenditure Worksheet.** Enter the additional funding determined above. Enter debt under Start-up Cash – Loan Proceeds. Adjust the Equity Investment at Start-up, if needed.

4. **Return to the Equity and Debt Worksheet and review Section B – Real Estate Loans and Section C – Traditional Business Loans.** If you have debt financing, you will find that the loan amount(s) entered in the Start-up Worksheet have been carried over to Existing Balance. Now, you must determine and enter the loan payment(s).

5. **Proceed to the Amortization Schedule Worksheet to determine your monthly payment.** To do so, you will enter the amount of the loan, the interest rate charged, and the term of the loan in months. The payment schedule will be calculated for you.

6. **Return to the Equity and Debt Worksheet.** Transfer the loan payment (principal and interest) from the Amortization Schedule to the appropriate repayment section. Since the projections are for three years, you will only enter the first three years of payments.

7. **Revisit the Equity and Debt Worksheet Section A-Cash Position.** Are there any months that are near or below $0? If so, consider the options listed in Step 6.
Financial Planning: Cash Outlays & Sources

Equity & Debt
Use this worksheet to record equity investments, to calculate payments for your existing loans, and to forecast any new borrowing for the planning period. Follow the steps in each section. Begin with Section A.

Section A — Cash Position - The chart below provides you with the ending cash balance each month for the first three years in business based on your projections for spending and sales as well as the equity investments you have made to this point. If all numbers are positive, you have enough money for the start-up phase of your business — that is, if your projections are accurate and you have enough “cushion” for any variations from these projections. Most entrepreneurs will find negative numbers in this section indicating the need for additional funding.

<table>
<thead>
<tr>
<th>Cash Balance</th>
<th>JUN</th>
<th>JUL</th>
<th>AUG</th>
<th>SEP</th>
<th>OCT</th>
<th>NOV</th>
<th>DEC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
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<td>Year 2</td>
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<tr>
<td>Year 3</td>
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</tbody>
</table>

To determine and document additional funding:

**Step 1:** Determine the amount of additional funding you need at start-up. You have already entered the equity you plan to invest at start-up. You may have also entered a Real Estate Loan. Now, determine the additional funding needed so that the cash position is never a negative number. Additional funding may include more equity and/or debt (money loaned to the company by outside sources) or any of the options listed in Step 6 below. Remember, you need enough “cushion” to allow for variances from your projections. If your additional funding includes debt, you will also need to allow funds for the loan payment.

**Step 2:** Return to the Start-up Funding and Expenditure Worksheet. Enter the additional funding determined in Step 1. Enter debt under Start-up Cash - Loan Proceeds. Adjust the Equity Investment Start-up, if needed.

**Step 3:** Return to the Equity and Debt Worksheet and review Section B - Real Estate Loans and Section C - Traditional Business Loans. If you have debt financing, you will find that the loan amount(s) entered in the Start-up Worksheet have been carried over to Existing Balance. Now, you must determine and enter the loan payments(s).

**Step 4:** Proceed to the Amortization Schedule Worksheet to determine your monthly payment. To do so, you will enter the amount of the loan, the interest rate charged and the term of the loan in months. The payment schedule will be calculated for you.

**Step 5:** Return to the Equity and Debt Worksheet. Transfer the loan payment (principal and interest) from the Amortization schedule to the appropriate repayment section. Since the projections are for three years, you will only enter the first three years of payments.

**Step 6:** Revisit the Equity and Debt Worksheet Section A-Cash Position. Are there any months that are near or below $0? If so, consider the options listed below:

1. **Option 1:** Revisit your projections for start-up, operating expenses and sales. Are they reasonable? Are there any expenses that could be adjusted? Could sales realistically be increased? Are there any other revenue streams which could be added?

2. **Option 2:** Owner Investment - The owner contributes additional cash in the form of an equity investment either at start-up or during the first three years. This is not a loan and will not be repaid. Enter contributions made after start-up in Section G of this worksheet.

3. **Option 3:** Additional Business Loan - Increase the amount of traditional business loans and/or other long-term loans. These funds are usually provided to support long-term operations and to purchase capital assets. If additional funds are added during the first three years, enter this additional financing and the associated loan repayment in Section C of this worksheet.

4. **Option 4:** Outside Investors - Cash may be available to you from outside investors (angel investors or venture capitalists). These funds may be made available to you in the form of a loan, but are most likely to be equity financing. In other words, the outside investors become part owners in your company. Enter this information in Section E of this worksheet for equity contributions. Enter any debt portions in Section C of this worksheet.

5. **Option 5:** Sine of Credit - Short-term financing to cover cash shortfalls as they occur. This type of financing is appropriate to cover seasonal and periodic cash shortages. Enter this financing in Section D of this worksheet.

**Step 7:** After adjusting loan and equity cash infusions, review your cash balances again. Are the cash balances sufficient to support start-up, operations and growth? If yes, you are finished with this worksheet. If no, repeat Step 6.

**Step 8:** If you have completed this worksheet, you are ready to look at the financial output sheets (Cash Flow, Year-End Income Statement, Balance Sheet and Ratio Analysis). You may go to the Print Options worksheet to print any combination of worksheets and financial statements you need.
Summary

This chapter continued the basic aspects of financial planning. It identified the main financial concepts that entrepreneurs use to plan a financially successful venture relating to cash needs and identifying sources of cash.

- Cash is paid out of the business in the form of expenses, capital expenditures, prepaid expenses, and owner payouts.
- Money is needed to successfully complete each stage of business—conception and start-up, early operating, growth and rapid-growth, and maturing.
- Different money sources are available at the different stages of a business.
- Most businesses are started with the entrepreneur’s own money.
- The following variables should be closely studied before selecting a source of money:
  - How much time will it take to secure the money?
  - How much money is needed?
  - How will the funds be used?
  - What will it cost to secure and pay back the cash?
  - What control is lost by using this money?
  - What are the consequences of using this funding source?
Overview

This chapter expands on the financial concepts introduced earlier. These concepts include understanding key financial terms, understanding and projecting accurate financial statements, determining an exit strategy, and calculating financial ratios.

Financial statements are essential tools for an entrepreneur. The statements show expected as well as unexpected outcomes of decisions. This chapter offers insight into using these tools to manage a business.

Understanding financial ratios is also a valuable skill for entrepreneurs. Financial ratios can help entrepreneurs set financial goals that encompass numerous variables. They provide a concrete way of assessing an entrepreneur’s business against industry standards. Ratios can also identify financial trends within the company that the entrepreneur needs to evaluate. Finally, ratios are a common way for outsiders to review the financial position of a company.

Objectives

In this chapter, you will learn to:

- Read and understand critical information found on financial statements.
- Calculate and understand financial ratios.
- Compare your business’ financial information to industry standards.
- Identify a specific exit strategy.
14.1 Utilizing Financial Statements
14.1.1 Introduction

According to the U.S. Census Bureau’s Business Information Tracking Series, one third of venture start-ups close before the end of the second year in business. After the sixth year in business, over 60 percent of business start-ups are closed. The reasons for closure are many. Sometimes the entrepreneur shuts down the business by choice. All too often the business fails and the entrepreneur is forced to close the doors.

Thousands of articles, research studies, and books have been written about the reasons for failure and how to avoid them. Whatever source you review, it will probably include most, if not all, of these top ten reasons businesses fail.

1. Lack of experience
2. Insufficient money
3. Ignoring the competition
4. Poor inventory management
5. Uncontrolled or unexpected growth
6. Poor location
7. Over-investment in fixed assets
8. Poor credit arrangements
9. Low sales
10. Lack of proper planning.

Of these reasons for business failure, six are directed related to the entrepreneur’s financial plans. Some relate to profitability, but most relate to having the right amount of cash when cash is needed.

How can you avoid these fatal errors? The best way is by diving into the financial planning process and utilizing the financial tools the process provides to start and manage your business.

14.1.2 The Accounting System

The development of accounting statements starts with the occurrence of a financial transaction. 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. They must be recorded in a way that easily provides the information an entrepreneur needs to make good financial decisions.

An accounting system provides this organization. First, a transaction takes place—sale, bill payment, or equipment purchase. Second, a document is processed—receipt, invoice, or check. Third, the transaction is entered into an account, such as Utility Expense, Consulting Revenue, Bank Loan. The accounting system then categorizes accounts as shown:

<table>
<thead>
<tr>
<th>Balance Sheet Categories</th>
<th>Income Statement Categories</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>Revenue</td>
</tr>
<tr>
<td>Liabilities</td>
<td>Expenses</td>
</tr>
<tr>
<td>Equity</td>
<td></td>
</tr>
</tbody>
</table>

These accounts are arranged into several reports, mainly the Income Statement, the Balance Sheet, and the Cash Flow Statement.
More Info

Small Time Operator — This book and software system provides a basic understanding of how accounting works. Especially good for those who fear the financial aspects of the business. bellsprings.com/STOSoftware.htm

Quickbooks—Offers several software programs for small business owners. When set up properly, these programs will generate financial statements needed to manage the business. intuit.com

Accounting Software Review—A review of nine accounting software programs. accounting-software-review.toptenreviews.com

Business Is Done through Transactions

1. A deal takes place—sales, bill payment, or purchase.
2. A document is processed—receipts, invoices, or checks.
3. The transaction is entered into an accounting system.

In the car buying process, paperwork is done in each step of the way. The paperwork is recorded into a record keeping system that sorts the information and generates reports. Dealerships use the reports to judge how profitable they are.

14.1.3 The Accounting Equation

The accounting equation that you reviewed in Chapter 11 provides the basis for accounting procedures. It states that the value of the 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.

\[ A = L + E \]

Each time a transaction is posted into the accounting system, it affects at least two accounts. When transactions are done properly, the accounting equation stays in balance.
14.1.4 Tools for Understanding Finances

Every day business decisions are made that will have an immediate or eventual impact on the financials of the business. Financial statements should be utilized by management when these decisions are being made.

Financial statements are as essential to business management as wrenches are to a machinist. Does a machinist only have one wrench? Do all the wrenches work the same way? No, because different jobs require different tools as well as the knowledge to choose the right tool for each job.

Financial statements provide the tools for company managers to examine and forecast the ability of a company to achieve its financial goals. The income statement reflects the profitability of a company, and the balance sheet reflects its solvency. The cash flow statement indicates if there is enough cash on hand to pay the expenses.

When reviewing or comparing financial documents and statements, it is important to remember that different businesses and industries may use different terms to describe the same types of accounts. Entrepreneurs should know what the accounts represent and where they come from, regardless of what they are called.

from real entrepreneurs

Southside Electronics Company found a new vendor that could supply an essential part for 50 percent less per piece than the previous supplier did. But after a few months, the company discovered that payroll expenses (in the form of overtime) were increasing. Why? The new piece had a failure rate 25 percent higher than the last one. That meant more rework. This discovery required the management to decide which cost the company more, the item or the labor expense.

14.1.5 Income Statement

The income statement is based on the Net Income Equation (Revenue-Expenses = Net Income) as discussed in Chapter 11. The income statement shows how much money a company made or lost during a given period of time. In other words, it shows the company’s performance. This is called net profit or net loss. The income statement reflects how the business performed in terms of the amount of revenues (sales) that were earned and the expenses that were incurred to generate those revenues. Simply stated, profits or losses equal the difference between revenues and expenses.

Tip

Your income statement can tell you how well your business performed compared to the budget, to last year’s figures, and to industry averages.

The income statement communicates how well business strategies are working. It is also used to identify tax liability, which is determined by the profit or loss indicated on the report.
Two categories of accounts are shown on the income statement—revenues and expenses. Cost of goods, one of the primary costs of a business, is the first expense to be deducted from revenues. Some service businesses do not have a costs of goods sold. The remaining balance is called gross income or gross profit. All other business expenses are deducted from gross income to identify the net profit or net loss of the business.

14.1.6 Balance Sheet

The formula for the balance sheet - Assets = Liabilities + Equity - is the same as the accounting equation. Since assets have value, this equation reflects the entities and individuals that have rights to those assets. Some rights go to people outside of the business (liabilities) and some rights go to people that own the company (equity).

The balance sheet is a reflection of how much the company owns, how much is owed to the company, and how much the company owes to both creditors and the owners. It shows the company's assets, the liabilities, and the owner’s equity.

On the balance sheet, assets are divided into current assets and fixed assets. Current assets include assets either currently in the form of cash or expected to be turned into cash within one year. Examples include cash, accounts receivable, and inventory. Fixed assets are not considered current because they are not expected to be converted into cash within a year. Fixed assets include buildings, equipment, and intangible assets, such as patents.

Liabilities are divided into current liabilities and long-term liabilities. Current liabilities are expected to be paid off within one year; long-term liabilities require a longer payoff time period. Equity is the difference between assets and liabilities, and represents the owners’ rights to the value of a business.

14.1.7 Monthly Cash Flow Statement

The monthly cash flow statement is a projection of how much cash will flow in and out of a business on a monthly basis. The projected monthly cash flow statement is by far the most important document for a start-up business. It helps with day-to-day cash budgeting. The need for cash flow analysis comes from the discrepancy that usually exists between the time cash is paid out to generate sales and the time it takes to actually receive cash from the sales—also called the cash cycle. The cash cycle takes time. Thus, additional funds are needed to keep the business running while waiting for the cycle to be completed.

Although cash flow planning is simple in concept, determining accurate 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 is included in this analysis. Non-cash accounting entries such as depreciation, amortization, and asset transfers are not included in the cash flow statement.

The cash flow statement starts with the cash balance at the beginning of the month. The expected cash received through sales, collections on account, loans, or equity
contributions are all added to the cash balance. This sum comprises the total cash available. All items paid for with cash in the month are deducted from the total cash available to identify the cash balance expected at the end of the month. This amount must always be above zero. In fact, it should have a healthy cushion to absorb variances in actual cash transactions.

### Tip

The concept of cash flow is similar to an individual’s checking account. In the checkbook you record money flowing into and out of your checking account.

### More Info

Financial Statements—This article discusses the relationship between the financial statements as well as how financial statements are developed.

[smallbusinessnotes.com/business-finances/financial-statements.html](http://smallbusinessnotes.com/business-finances/financial-statements.html)

### 14.1.8 Historic Cash Flow Statement

The historic cash flow statement is another type of cash flow statement that should be mentioned, even though it is not used as part of the financial projection process. While proforma cash flow statements look at anticipated cash flow, the historical cash flow statement looks at past cash flow. Sometimes called the accountant’s cash flow, this statement reports the changes in account balances that have ultimately affected the cash account. These changes are described as increases or decreases in each account. For example, if the money that was due to the company (accounts receivable) decreases over a certain period of time, it is assumed that some of the accounts receivable were paid resulting in an increase in cash. An increase in expenses would result in a decrease in the cash balance.

The goal of the historic cash flow statement is to identify how cash flowed through the company during the previous year. Since its purpose is to analyze historic use of cash, it is not used in this course. It is still a valuable financial statement for existing firms and may be required by external investors, accountants, and bankers.
14.2 Using Financial Ratios
14.2.1 Financial Ratios

Financial statements are projection and management reports. Ratios use information from these reports to reveal the financial status of the company to the entrepreneur. The four types of financial ratios are profitability, liquidity, risk, and efficiency. Ratios help entrepreneurs see relationships or correlations between financial items on the various financial statements.

Ratios allow the entrepreneur to evaluate the performance of the company over a period of time, to compare the business to similar businesses, and to plan for the future. Calculating financial ratios should become part of the regular financial monitoring and reporting process.

More Info
RMA Annual Statement Studies—Includes 17 sections arranged by NAICS code. They contain composite company financial data supplied by Risk Management Associates’ member institutions. Available in most business libraries. Publisher’s website: rmahq.org/RMA A sample set of industry ratios can be viewed at: rmahq.org/NR/rdownlyres/CC0A8EA6-ABB8-4EA6-B317-A75A269520E1/0/FRB_Sample_201011.pdf

Useful Business Statistics—Financial ratios and benchmarks by industry. bizstats.com

Industry Norms and Key Business Ratios, Dun and Bradstreet—Financial information based on financial statements of various companies. Available in most business libraries. Publisher’s website: dnb.com

Almanac of Business and Financial Ratios, Leo Troy, Ph.D.—Financial information from IRS data on 5.5 million companies. Available in most business libraries.

How to Track Your Company’s Critical Numbers, Darren Dahl—Guide to using the critical numbers you should know for your business. inc.com/guides/tracking-critical numbers.html

from real entrepreneurs

Will the costs of operating a plant that makes five million yo-yos a month be the same as the costs of a plant that only produces two million a month? Of course not. Still, financial ratios can be used to compare the profitability or liquidity of one company against another, or against the industry averages. For example, if the net profit margin for the yo-yo industry is normally six percent, then it should be about six percent no matter how many yo-yos a company produces.
### 14.2.2 Profitability Ratios

Profitability ratios help entrepreneurs evaluate the profitability of their business. By comparing certain numbers, these ratios can help identify elevated expenses, inefficient operations, and profitability margins. Although dozens of ratios exist, an understanding of a just a few simple profitability ratios will get the aspiring entrepreneur started.

**Profitability Ratios**

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Formula</th>
<th>What it measures</th>
<th>What it tells</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross Margin</strong></td>
<td>Gross income / Net sales</td>
<td>The profit a company makes on the goods it sells after direct costs are subtracted.</td>
<td>Gross margin shows how well a business is controlling direct costs. The higher the ratio, the more a company has left to spend on indirect costs such as sales, administration, and research and development.</td>
</tr>
<tr>
<td><strong>Operating Margin</strong></td>
<td>Operating income / Net sales</td>
<td>A company's operating profitability and efficiency.</td>
<td>Operating margins show how well a company is managing overhead costs. The higher the ratio, the more effective the company is in controlling these costs.</td>
</tr>
<tr>
<td><strong>Net Margin</strong></td>
<td>Net income / Net sales</td>
<td>Profitability.</td>
<td>The net margin shows how many cents on each dollar of sales are profit. The higher the ratio, the more profitable the business. A falling net margin may signal problems in controlling costs or setting prices.</td>
</tr>
<tr>
<td><strong>Return on assets (ROA)</strong></td>
<td>Net income / Total assets</td>
<td>How much profit a company generated for each dollar in assets.</td>
<td>Return on assets measure how efficiently the company uses its assets to generate a profit. ROA can be used to compare companies of different sizes. Assets remain fairly stable, so an increasing ROA indicates greater profitability while a decreasing ROA indicates less profitability.</td>
</tr>
<tr>
<td><strong>Return on equity (ROE)</strong></td>
<td>Net income / Total equity</td>
<td>The amount of net income returned as a percentage of equity.</td>
<td>How well a business uses invested funds to generate profits. This tells whether or not the company is a good investment. As ROE increases, generally the company becomes more attractive to potential investors.</td>
</tr>
</tbody>
</table>
from real entrepreneurs

When Roger and Jayne developed a business plan to start an auto racing memorabilia and toy store, they projected an income statement based on profitability ratios for the retail industry. This gave them a good starting point. During their first six months in business, they found the average sale per customer was considerably higher than the industry average they used. Now, they are developing their own track record of profitability ratios to use as a benchmark for future operations.

14.2.3 Liquidity Ratios

Liquidity ratios measure the amount of available cash, or the investments that can be converted to cash, to pay expenses and short-term debts. Liquidity ratios determine the entrepreneur’s ability to meet current liabilities. The two ratios that are most commonly used are the current ratio and the quick ratio. The current ratio compares all current assets to current liabilities. A 2:1 ratio is usually considered ideal. In other words, a business has twice as many current assets available as it has current liabilities. The quick ratio is the ratio of current assets (minus inventory) to current liabilities. This information determines if there are sufficient cash, receivables, and marketable securities available immediately to pay off current debts.

**Liquidity Ratios**

<table>
<thead>
<tr>
<th>Current ratio</th>
<th>How it is calculated</th>
<th>Total current assets / Total current liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>What it measures</td>
<td>Whether the company has enough liquidity to pay its short-term obligations.</td>
</tr>
<tr>
<td></td>
<td>What it tells</td>
<td>This tells whether there is enough cash available to pay the bills. Theoretically, a current ratio of 2.0 is preferred for most companies. It is important to watch this ratio closely. If it begins to go down, a company’s cash position may erode quickly. The quickest way to increase cash is to improve sales.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Quick ratio</th>
<th>How it is calculated</th>
<th>(Current assets – Inventory) / Current liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>What it measures</td>
<td>Whether the company’s assets minus inventory will provide enough liquidity to cover its short-term obligations.</td>
</tr>
<tr>
<td></td>
<td>What it tells</td>
<td>This is also referred to as the acid test. It shows whether the company has enough cash to meet its short-term obligations. A 1.0 ratio is usually preferred. If this number is going down, sales are not strong enough to meet daily cash obligations. Quick cash management intervention is required.</td>
</tr>
</tbody>
</table>
### 14.2.4 Other Ratios

Other types of financial ratios include risk ratios and efficiency ratios. Risk ratios measure the portion of the company that belongs to individuals outside the company and includes how much money the owners could lose to creditors.

Efficiency ratios tell how well business is being conducted. These ratios measure how quickly inventory moves, how efficiently the company collects its account receivables, and the sales generated by a company’s assets.

#### Risk Ratios

<table>
<thead>
<tr>
<th>Ratio</th>
<th>How it is calculated</th>
<th>What it measures</th>
<th>What it tells</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt ratio</td>
<td>Total liabilities / Total assets</td>
<td>The proportion of assets that are financed by creditors’ funds (debt).</td>
<td>A debt ratio of more than 1 means negative net worth. In other words, if a company could sell all of the assets for full value, it would still not have enough money to meet all its obligations.</td>
</tr>
<tr>
<td>Debt to equity ratio</td>
<td>Total liabilities / Total equity</td>
<td>How much the company relies on debt financing versus equity financing.</td>
<td>The higher the ratio, the more a company’s debt exceeds its net worth, and the less likely the company will be able to obtain debt financing. Additionally, the owner’s position is weakened. In instances of default on debt, those that own the debt (banks, large suppliers) can establish control of the company.</td>
</tr>
</tbody>
</table>
Efficiency Ratios

**Inventory turnover ratio**

How it is calculated: Cost of goods sold / Inventory

What it measures: The number of times a company’s inventory turns or cycles during a period of time, typically one year.

What it tells: How effectively the company is managing inventory. Generally, the higher the turnover, the better. However, high turnover may also indicate that there is not enough merchandise and sales are being lost.

**Days sales outstanding (DSO)**

How it is calculated: Accounts receivable / (Net sales / 365)

What it measures: Average number of days it takes customers to pay their bills.

What it tells: How effectively a company is collecting money, and how much “float” it must finance. DSO also shows how effective its credit policies are. Remember, the tighter the credit policy, the lower the DSO ratio. A tight credit policy, however, may also reduce sales.

**Investment turnover ratio**

How it is calculated: Net sales / Total assets

What it measures: The amount of sales generated by the assets.

What it tells: How efficiently a company uses its assets to generate sales. The measurement shows how quickly and how often an asset (piece of machinery or investment) pays for itself. For example, if an older piece of equipment works more slowly but pays for itself three times in a year while a newer model takes two years to pay for itself, the owner must reflect on whether the payoff is worth the greater investment.
Exercise 14.2.4
Review Financial Ratios

Learning Objective

• Calculate and use financial ratios of a given company to identify its financial status in relation to a previous year and to the industry standards.

Overview

Ratios provide a sound basis to make comparisons about the financial status of a company. They can be used to compare a company’s progress from one year to the next. Ratios can also be used to analyze the differences between company ratios and the standards in the industry. This exercise will help you calculate ratios for a toy manufacturing company. Then you will compare these ratios to last year’s ratios and to the toy manufacturing industry. After practicing this skill, you will be able to apply this knowledge to your own business.

Step 1

Calculate ratios. The financial template provided with this course will automatically calculate financial ratios for your business based on the figures you enter in the worksheets. Still, it is good to understand the basis for the calculations. Doing the calculations will help you build this understanding. The income statement and balance sheet for the current year has been provided.

<table>
<thead>
<tr>
<th>SOUTHVIEW TOY MANUFACTURING</th>
<th>Current Year in '000s</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income Statement</strong></td>
<td></td>
</tr>
<tr>
<td>Net Sales</td>
<td>$694</td>
</tr>
<tr>
<td>– Cost of goods sold</td>
<td>442</td>
</tr>
<tr>
<td>= Gross income</td>
<td>252</td>
</tr>
<tr>
<td>– Operating expenses</td>
<td>223</td>
</tr>
<tr>
<td>= Operating income</td>
<td>29</td>
</tr>
<tr>
<td>– Depreciation</td>
<td>9</td>
</tr>
<tr>
<td>= Net income</td>
<td>$ 20</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SOUTHVIEW TOY MANUFACTURING</th>
<th>Current Year in '000s</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet for Year End</strong></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$ 57</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>60</td>
</tr>
<tr>
<td>Inventory</td>
<td>105</td>
</tr>
<tr>
<td>Other current assets</td>
<td>110</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>332</td>
</tr>
<tr>
<td>Net fixed assets</td>
<td>15</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>$347</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>$231</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>251</td>
</tr>
<tr>
<td>Total equity</td>
<td>96</td>
</tr>
<tr>
<td><strong>Total liabilities &amp; equity</strong></td>
<td>$347</td>
</tr>
</tbody>
</table>
SOUTHVIEW TOY MANUFACTURING

Financial Ratios

<table>
<thead>
<tr>
<th>Profitability Ratios</th>
<th>Last Year</th>
<th>Current Year</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Margin Gross Income</td>
<td>35.04%</td>
<td>40.70%</td>
<td></td>
</tr>
<tr>
<td>Net Sales</td>
<td>35.04%</td>
<td>40.70%</td>
<td></td>
</tr>
<tr>
<td>Operating Margin Operating Income</td>
<td>3.42%</td>
<td>4.60%</td>
<td></td>
</tr>
<tr>
<td>Net Sales</td>
<td>3.42%</td>
<td>4.60%</td>
<td></td>
</tr>
<tr>
<td>Net Margin Net Income</td>
<td>1.71%</td>
<td>3.30%</td>
<td></td>
</tr>
<tr>
<td>Net Sales</td>
<td>1.71%</td>
<td>3.30%</td>
<td></td>
</tr>
<tr>
<td>Return on Assets (ROA) Net Income</td>
<td>4.44%</td>
<td>3.30%</td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>4.44%</td>
<td>3.30%</td>
<td></td>
</tr>
<tr>
<td>Return on Equity (ROE) Net Income</td>
<td>18.87%</td>
<td>7.66%</td>
<td></td>
</tr>
<tr>
<td>Total Equity</td>
<td>18.87%</td>
<td>7.66%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liquidity Ratios</th>
<th>Last Year</th>
<th>Current Year</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio Total Current Assets</td>
<td>1.02</td>
<td>1.70</td>
<td></td>
</tr>
<tr>
<td>Total Current Liabilities</td>
<td>1.02</td>
<td>1.70</td>
<td></td>
</tr>
<tr>
<td>Quick Ratio Current Assets - Inventory</td>
<td>0.48</td>
<td>0.60</td>
<td></td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>0.48</td>
<td>0.60</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Risk Ratios</th>
<th>Last Year</th>
<th>Current Year</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt Ratio Total Liabilities</td>
<td>0.76</td>
<td>0.57</td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>0.76</td>
<td>0.57</td>
<td></td>
</tr>
<tr>
<td>Debt to Equity Total Liabilities</td>
<td>3.25</td>
<td>1.32</td>
<td></td>
</tr>
<tr>
<td>Total Equity</td>
<td>3.25</td>
<td>1.32</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Efficiency Ratios</th>
<th>Last Year</th>
<th>Current Year</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory Turnover Cost of Goods Sold</td>
<td>4.09</td>
<td>1.10</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>4.09</td>
<td>1.10</td>
<td></td>
</tr>
<tr>
<td>Days Sales Outstanding Accounts Receivable</td>
<td>29.32</td>
<td>84.32</td>
<td></td>
</tr>
<tr>
<td>Net Sales/365</td>
<td>29.32</td>
<td>84.32</td>
<td></td>
</tr>
<tr>
<td>Investment Turnover Net Sales</td>
<td>2.60</td>
<td>1.00</td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>2.60</td>
<td>1.00</td>
<td></td>
</tr>
</tbody>
</table>
Step 2

Analyze ratios. Compare the current year’s ratios to last year’s ratios. Write down three ratios that have changed the most. Did the ratio increase or decrease? What is the implication of this increase or decrease—is it a success or a problem? What might be the reason for the change? What could have happened that resulted in this change?

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Increase/Decrease</th>
<th>Implication</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Step 3

Analyze industry standards. Now take a look at the two years of ratios for Southview Toy Manufacturing and how they compare to the industry standard ratios. These ratios are collected from competitors of similar size to Southview Toy Manufacturing and reported through financial statement studies. Identify one ratio that shows Southview Toy Manufacturing performing better than the industry. Also, identify one ratio that reveals an area that Southview Toy Manufacturing needs to improve.
Scenario 14.2.4

Run KC—Using Ratios

Learning Objective
- Understand what three profitability ratios—gross margin, operating margin and net margin—reveal about business operations.

Overview
Financial statements (income, cash flow and balance sheet) are projection and management tools. Figures from financial statements are used to calculate financial ratios. These ratios are then used to analyze a company’s performance in percentages. Measuring performance in percentages rather than raw numbers, allows the owner to evaluate the performance of a company over a period of time, to compare the business to other companies in the same industry and to plan for the future. Dozens of ratios exist and can be categorized as one of four types of ratios: profitability, liquidity, risk and efficiency.

Scenario
Tim is an accountant and has a clear understanding of financial statements. While his wife is planning to keep her full-time job, she wants to help with the business on weekends and, because they are investing their savings, she wants to understand the financial aspects of the company. After working through the income and cash flow statement exercise for the sock business Tim ran during his college years, she has a good understanding of the financial statements themselves. Now, she wants to understand financial ratios and what they reveal about business operations by tackling just a few basic profitability ratios.

Step 1
Calculating Margins. Using figures from the Year End Income Statement provided, calculate gross margin, operating margin and net margin for Run KC.

<table>
<thead>
<tr>
<th>Profitability Ratios</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Margin</td>
<td>Gross Income</td>
<td></td>
<td>Net Sales</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>Operating Income</td>
<td></td>
<td>Net Sales</td>
</tr>
<tr>
<td>Net Margin</td>
<td>Net Income</td>
<td></td>
<td>Net Sales</td>
</tr>
</tbody>
</table>
### Run KC
#### Year-End
#### Income Statement (Projected)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales (Less Returns &amp; Allowances)</td>
<td>387,750</td>
<td>545,400</td>
<td>688,250</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>213,263</td>
<td>299,970</td>
<td>378,538</td>
</tr>
<tr>
<td><strong>Gross Income</strong></td>
<td><strong>$174,488</strong></td>
<td><strong>$245,430</strong></td>
<td><strong>$309,713</strong></td>
</tr>
</tbody>
</table>

**Operating Expenses**

- Advertising: 13,400, 9,000, 9,600
- Bad Debt Expense: –, –, –
- Bank Charges: –, –, –
- Depreciation & Amortization: 5,962, 7,390, 8,819
- Dues & Subscriptions: 500, –, 500
- Insurance: 2,400, 1,600, 1,800
- Licenses & Fees: 300, 250, 250
- Marketing & Promotion: 15,000, 14,750, 14,500
- Meals & Entertainment: –, –, –
- Miscellaneous: 3,000, 3,000, 3,000
- Office Expense: 760, 760, 760
- Office Supplies: 900, 400, 400
- Outside Services: –, 4,800, 5,400

**Payroll Expenses**

- Salaries & Wages: 67,600, 70,800, 114,000
- Payroll Taxes: 8,112, 8,520, 13,800
- Benefits: –, –, –
- Professional Fees: 4,600, 1,975, 2,450
- Property Taxes: –, –, –
- Rent: 60,000, 66,000, 72,000
- Repairs & Maintenance: 800, 800, 800
- Shipping & Delivery: –, –, –
- Telephone: 1,500, 1,500, 1,800
- Training & Development: –, –, –
- Travel: 4,100, 4,875, 5,650
- Utilities: 5,400, 6,000, 6,600
- Vehicle: –, –, –
- Credit Card Fees: 4,655, 6,670, 8,480
- Other: 3,000, –, –

**Total Operating Expenses**

$201,989, $209,090, $270,609

**Operating Income**

$ (27,501), $ 36,340, $ 39,103

**Interest Expense**

10,802, 8,051, 5,072

**Other Income (Interest, Royalties, etc.)**

6,000, 12,000, 20,250

**Income Before Taxes**

$ (32,303), $ 40,289, $ 54,281

**Income Taxes (If C corporation)**

–, –, –

**Net Income**

$ (32,303), $ 40,289, $ 54,281
Analyzing Trends. For each margin, study the changes between years. What do these changes indicate for each?

Gross Margin:

Operating Margin:

Net Margin:

Step 2

Industry Comparison. Compare the industry averages for Specialty Running Shoe Stores provided below with those calculated for Run KC. How does Run KC compare to industry norms? What do they indicate?

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Industry Averages</th>
<th>Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Margin</td>
<td>54.81%</td>
<td></td>
</tr>
<tr>
<td>Operating Margin</td>
<td>7.85%</td>
<td></td>
</tr>
<tr>
<td>Net Margin</td>
<td>6.36%</td>
<td></td>
</tr>
</tbody>
</table>
14.2.5 Ratio Analysis

Ratio analysis can be difficult and confusing when used to evaluate a startup company. Financial ratios for a start-up company differ from those of an existing business. This is not a reason, however, to exclude ratios for your financial forecasting. Using ratios to evaluate your business can be a valuable process. Some of the information, such as the average sales dollars for the type of business and the cost of goods sold percentage, may be helpful to the start-up entrepreneur. Information that gives the entrepreneur an idea of what is typical for a mature business within their industry is a good starting point for projecting a new business’ financial forecast. This information also shows what the business’ financial picture may look like down the road. Ratios can also highlight errors in data entry and logic in preparing financial forecasts.

When using financial ratios to analyze a company, entrepreneurs should answer the following questions:

**How consistent and realistic are the numbers used to calculate the ratios?** If the numbers have been tallied in an inconsistent manner, are not realistic, or are not up-to-date, the ratios will be of no value.

**How closely do the individual ratios compare with company policies?** Company policies should be established to help the business meet financial goals. For example, most entrepreneurs set a standard for the number of days they will allow on credit terms. If they allow customers a Net/30 payment schedule, then their Day Sales Outstanding should be near 30 days. This number would confirm that the company is following the policy to collect on receivables within 30 days.

**How closely do the individual ratios compare with other companies within the industry?** A very valuable use of a company’s ratios is to compare them to other businesses in the same industry. By doing this, much can be learned about ways to improve overall profitability. For example, an entrepreneur may find that his company is in a very small minority of companies with a slow inventory turnover which indicates that he is keeping his inventory longer than most other companies within the industry. Since this practice is a poor use of cash, he needs to evaluate the reasons and make improvements in his inventory policy.

If financial statements and ratios indicate that a business will not be profitable within the first three years of its existence, it is possible that the company is not charging enough for their products or services. How does their pricing compare to that of the competition? The biggest mistake new business owners make is pricing too low. Now that you have a better understanding of the expense structure and potential profitability of your business, you should take this opportunity to go through the pricing process again.

Another way to make improvements to the profitability of the business is to reduce expenses. One way to do so is for the entrepreneur to use non-monetary resources, such as time, knowledge and abilities, to save on costs. Consider creative ways to use all the resources you have available to you before you rely on money. Many times a little ingenuity and creativity can save a lot.

The financial template automatically calculates financial ratios. Click on the “Financial Analysis-Ratios” tab to view them. When using these financial ratios to analyze your company, ask yourself these questions:

- How consistent and realistic are the numbers used to calculate the ratios?
- How might the ratios be over- or under-stated because this business is a start-up?
- How closely do the individual ratios compare with company policies?
- How closely do the individual ratios compare with other companies within the industry?
Exercise 14.2.5
Financial Analysis

Learning Objective
• Calculate and use financial ratios of a given company to analyze its financial status in relation to a previous year and to the industry standards.

Overview
Financial statements are projection and management reports. Ratios use information from these reports to reveal the financial status of the company to the entrepreneur. Ratios help entrepreneurs see relationships or correlations between financial items on the various financial statements. Ratios allow the entrepreneur to evaluate the performance of the company over a period of time, to compare the business industry standards, and to plan for the future. Calculating financial ratios should become part of the regular financial monitoring and reporting process. This exercise will help you calculate ratios for an existing company. Then you will compare these ratios to last year’s ratios and to the industry. After practicing this skill, you will be able to apply this knowledge to your own business.

Step 1
Review Company Information. Meramac Corporation was organized four years ago to produce and market several new types of avionics’ test systems. The small company is growing and profitable. Meramac is about to install a major computer upgrade and will need to borrow $500,000 to do so. Diane Weber, president of Meramac, decided to conduct her own financial analysis of the company’s financial statements prior to seeking financing for the capital improvement project.

After research, Diane determined that the following ratios are typical of the industry. In preparing to borrow money, she first computed financial ratios for her company and compared them to industry averages.

INDUSTRY AVERAGES (IA)

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Industry Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current ratio</td>
<td>2.4 to 1</td>
</tr>
<tr>
<td>Acid-test (quick) ratio</td>
<td>1.2 to 1</td>
</tr>
<tr>
<td>Inventory turnover</td>
<td>10 times</td>
</tr>
<tr>
<td>Debt ratio</td>
<td>33%</td>
</tr>
<tr>
<td>Debt-to-equity ratio</td>
<td>0.70 to 1</td>
</tr>
<tr>
<td>Return on assets (ROA)</td>
<td>13.5%</td>
</tr>
<tr>
<td>Return on equity (ROE)</td>
<td>28%</td>
</tr>
</tbody>
</table>

Company information is available for 201B and 201A:
MERAMAC CORPORATION

Comparative Income Statements: For the Years Ended December 31, 201B and 201A
(201B is the most recent year)

<table>
<thead>
<tr>
<th></th>
<th>201B</th>
<th>201A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$20,000,000</td>
<td>$15,000,000</td>
</tr>
<tr>
<td>Less: Cost of goods sold</td>
<td>−13,000,000</td>
<td>−9,000,000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$7,000,000</td>
<td>$6,000,000</td>
</tr>
<tr>
<td>Less: Operating expenses</td>
<td>−5,260,000</td>
<td>−4,560,000</td>
</tr>
<tr>
<td>Net operating income</td>
<td>$1,740,000</td>
<td>$1,440,000</td>
</tr>
<tr>
<td>Less: Interest expense</td>
<td>−240,000</td>
<td>−240,000</td>
</tr>
<tr>
<td>Net income before taxes</td>
<td>$1,500,000</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>Less: Income taxes (30%)</td>
<td>−450,000</td>
<td>−360,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$1,050,000</td>
<td>$840,000</td>
</tr>
</tbody>
</table>

Comparative Balance Sheets: December 31, 201B and 201A

ASSETS: 201B 201A

<table>
<thead>
<tr>
<th></th>
<th>201B</th>
<th>201A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>200,000</td>
<td>400,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>1,500,000</td>
<td>800,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>3,000,000</td>
<td>1,200,000</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Total current assets</td>
<td>$4,800,000</td>
<td>$2,500,000</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>$5,170,000</td>
<td>$5,400,000</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$9,970,000</td>
<td>$7,900,000</td>
</tr>
</tbody>
</table>

LIABILITIES AND STOCKHOLDERS’ EQUITY: 201B 201A

<table>
<thead>
<tr>
<th></th>
<th>201B</th>
<th>201A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>$2,500,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Bonds payable, 12%</td>
<td>2,000,000</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>$4,500,000</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>Stockholders’ Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common Stock</td>
<td>$2,500,000</td>
<td>$2,500,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>2,970,000</td>
<td>2,400,000</td>
</tr>
<tr>
<td>Total stockholders’ equity</td>
<td>$5,470,000</td>
<td>$4,900,000</td>
</tr>
<tr>
<td>Total Liabilities and Stockholders’ Equity</td>
<td>$9,970,000</td>
<td>$7,900,000</td>
</tr>
</tbody>
</table>

The following additional information is available on Meramac:

1. The company’s stock is currently selling for $60 per share; during 201A the stock sold for $45 per share.

2. All sales are on account. Diane is aware that the company is taking 5 days longer to collect its receivables than the industry average and this worsened in 201B. Diane is not sure if the cause is poor collection efforts or sales to customers who are poor risks.

As the president of Meramac Corporation, Diane is very concerned. Sales increased by $5 million in 201B, yet the firm’s net income increased by only a small amount. Additionally, the company’s operating expenses went up in 201B even though a major effort was launched to cut costs.
Step 2

**Calculate Ratios.** Use the balance sheets and income statements for Meramac to calculate the following ratios for 201B and 201A. Compare these ratios to Industry Averages.

<table>
<thead>
<tr>
<th></th>
<th>201B</th>
<th>201A</th>
<th>Industry Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. The working capital</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(= CA – CL)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. The current ratio</td>
<td></td>
<td></td>
<td>2.4 to 1</td>
</tr>
<tr>
<td>c. The quick (acid-test) ratio</td>
<td></td>
<td></td>
<td>1.2 to 1</td>
</tr>
<tr>
<td>d. The inventory turnover</td>
<td></td>
<td></td>
<td>10 times</td>
</tr>
<tr>
<td>e. The debt ratio</td>
<td></td>
<td></td>
<td>33%</td>
</tr>
<tr>
<td>f. The debt-to-equity ratio</td>
<td></td>
<td></td>
<td>.70 to 1</td>
</tr>
<tr>
<td>(TL/TE)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g. The return on total assets</td>
<td></td>
<td></td>
<td>13.5%</td>
</tr>
<tr>
<td>(Net income after taxes/TA)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>h. The return on stockholders’ equity (Net income after taxes/Stockholders’ equity (common stock))</td>
<td></td>
<td></td>
<td>28%</td>
</tr>
</tbody>
</table>
### Step 3

**Calculate Ratios.** For 201B and 201A income statements and balance sheets, what percentage is each category (rounded to one decimal place)?

**MERAMAC CORPORATION**

**Comparative Income Statements: For the Years Ended December 31, 201B and 201A**

<table>
<thead>
<tr>
<th></th>
<th>201B</th>
<th></th>
<th>201A</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percent (of Sales)</td>
<td>Amount</td>
<td>Percent (of Sales)</td>
</tr>
<tr>
<td>Sales</td>
<td>$20,000,000</td>
<td>100.0%</td>
<td>$15,000,000</td>
<td>100%</td>
</tr>
<tr>
<td>Less: Cost of goods sold</td>
<td>$13,000,000</td>
<td>____%</td>
<td>$9,000,000</td>
<td>____%</td>
</tr>
<tr>
<td>Gross profit</td>
<td>$7,000,000</td>
<td>____%</td>
<td>$6,000,000</td>
<td>____%</td>
</tr>
<tr>
<td>Less operating expenses</td>
<td>$5,260,000</td>
<td>____%</td>
<td>$4,560,000</td>
<td>____%</td>
</tr>
<tr>
<td>Net operating income</td>
<td>$1,740,000</td>
<td>____%</td>
<td>$1,440,000</td>
<td>____%</td>
</tr>
<tr>
<td>Less: Interest expense</td>
<td>$240,000</td>
<td>____%</td>
<td>$240,000</td>
<td>____%</td>
</tr>
<tr>
<td>Net income before taxes</td>
<td>$1,500,000</td>
<td>____%</td>
<td>$1,200,000</td>
<td>____%</td>
</tr>
<tr>
<td>Less: Income taxes (30%)</td>
<td>$450,000</td>
<td>____%</td>
<td>$360,000</td>
<td>____%</td>
</tr>
<tr>
<td>Net Income</td>
<td>$1,050,000</td>
<td>____%</td>
<td>$840,000</td>
<td>____%</td>
</tr>
</tbody>
</table>

**Comparative Balance Sheets: December 31, 201B and 201A**

<table>
<thead>
<tr>
<th></th>
<th>201B</th>
<th></th>
<th>201A</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percent (of TA)</td>
<td>Amount</td>
<td>Percent (of TA)</td>
</tr>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$200,000</td>
<td>____%</td>
<td>$400,000</td>
<td>____%</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$1,500,000</td>
<td>____%</td>
<td>$800,000</td>
<td>____%</td>
</tr>
<tr>
<td>Inventory</td>
<td>$3,000,000</td>
<td>____%</td>
<td>$1,200,000</td>
<td>____%</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>$100,000</td>
<td>____%</td>
<td>$100,000</td>
<td>____%</td>
</tr>
<tr>
<td>Total current assets</td>
<td>$4,800,000</td>
<td>____%</td>
<td>$2,500,000</td>
<td>____%</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>$5,170,000</td>
<td>____%</td>
<td>$5,400,000</td>
<td>____%</td>
</tr>
<tr>
<td>Total Assets (TA)</td>
<td>$9,970,000</td>
<td>100%</td>
<td>$7,900,000</td>
<td>100%</td>
</tr>
</tbody>
</table>

**LIABILITIES AND STOCKHOLDERS’ EQUITY**

<table>
<thead>
<tr>
<th></th>
<th>201B</th>
<th></th>
<th>201A</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>$2,500,000</td>
<td>____%</td>
<td>$1,000,000</td>
<td>____%</td>
</tr>
<tr>
<td>Bonds payable, 12%</td>
<td>$2,000,000</td>
<td>____%</td>
<td>$2,000,000</td>
<td>____%</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>$4,500,000</td>
<td>____%</td>
<td>$3,000,000</td>
<td>____%</td>
</tr>
<tr>
<td>Stockholders’ Equity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common Stock</td>
<td>$2,500,000</td>
<td>____%</td>
<td>$2,500,000</td>
<td>____%</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>$2,970,000</td>
<td>____%</td>
<td>$2,400,000</td>
<td>____%</td>
</tr>
<tr>
<td>Total Stockholders’ equity</td>
<td>$5,470,000</td>
<td>____%</td>
<td>$4,900,000</td>
<td>____%</td>
</tr>
<tr>
<td>Total Liabilities (TL) and Stockholders’ Equity (SE)</td>
<td>$9,970,000</td>
<td>100%</td>
<td>$7,900,000</td>
<td>100%</td>
</tr>
</tbody>
</table>
Step 4

Analyze ratios.

1. Based on the income statements and balance sheets, what areas appear to have improved? Which areas reflect troublesome changes for the business?

2. Based on this analysis, should the loan be approved? Why or why not?

3. Explain to the stockholders why the increase in profits was so small in 201B. Were there any benefits realized from the company’s cost-cutting efforts?

Assignment 14a: Financial Plan

Congratulations! You have completed the actual financial projection process. Now you will use that information to complete the Financial Plan. First, print the financial statements you need for your business plan. Using the Print Options Worksheet, print the following financial statements:

- Monthly Income Statement
- Break-Even Analysis
- Monthly Cash Flow Statement
- Year-End Income Statement
- Year-End Balance Sheet
- Financial Analysis/Ratios

Second, complete the Financial Plan section in the Business Plan template, which is the narrative portion of the financial plan. In the financial narrative, you will describe your start-up costs, sales and income projections, your break-even analysis, your cash requirements, sources of financing, and exit strategy. This assignment contains specific questions to help you focus on the highlights of your financial plan.

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 to your business. Include these worksheets in the appendix of the business plan.

- Start-up Funding & Expenditures
- Operating Expenses Projections
- Sales Projections
- Inventory Projections
- Capital Budget Projections
- Equity & Debt Worksheet
- Amortization Schedule
14.3 Planning a Financial Future

14.3.1 Growth Plan

Entrepreneurs need a financial plan for each stage of business. The start-up business plan identifies a financial plan for the concept and start-up stages, which may extend through the first and second year in business. The plan also covers the beginning of the operating stage, usually entered by the third year in business. Some businesses continue to grow at a slow, steady rate throughout the operating stage. Most successful businesses, however, plan for a specific amount of growth. The growth stage culminates in an exit strategy, the entrepreneur’s planned harvest of the wealth created in the business.

A business only enters the growth stage if it is successful during the operating stage. Success is established through repeated profitability, market awareness, and savvy management. The growth will likely be funded in part from profits retained through the operating stage. External funding sources will also be necessary when implementing aggressive growth strategies. These sources may include debt, venture capital, angel investments, franchising, private placement, and initial public stock offerings. Some growth strategies will necessitate several rounds of financing to reach the desired goals.

The growth plan is the entrepreneur’s long-term vision of the business at each stage of its existence. Not knowing where the business should be in five, 10, or 20 years after start-up is like driving a car with no destination in mind.

Planning for growth is an important part of planning for the long-term success of the business. The growth plan must answer these questions:

- What new products/services, store locations, distribution centers, and marketplaces will the growth plan include?
- What will be the projected revenues from the growth plan?
- What are the financial requirements for pursuing the growth plan?
- How will the necessary capital for future growth be obtained?
- What additional management personnel and other employees will be needed to support the projected growth?
- Which operating costs will increase as a result of the growth plan?
- How will the growth plan enable the owners or investors to harvest wealth with an exit strategy?

Accurately projecting the future in a growth plan is difficult. Still, these questions should be answered with considerable thought and analysis. Growth projections should be based on realistic figures that have been uncovered while researching the market and the industry and on the three-year financial projections in the start-up plan.
14.3.2 Exit Strategy

An exit strategy is a specific plan for harvesting the wealth created by a business through the accumulation of assets and the building of future profit potential. An exit strategy should be planned from the start of the business and help drive day-to-day operations. This strategy is often, but not always, coordinated with the entrepreneur’s plans to leave the business.

Successful businesses create wealth for owners by providing profits and payouts, accumulating value in assets, and building future profit potential.

**Tip**

With appropriate long-term planning, service businesses that rely heavily on the entrepreneur’s expertise can build a tangible asset that the entrepreneur may be able harvest as a part of their exit strategy. Adding staff so that the business is not entirely dependent on the entrepreneur’s skills is one way to build a business that can exist after the entrepreneur’s exit. Adding a product component to a service business is another way. For example, a consulting business may develop and sell training materials; a commercial cleaning company may brand and sell their own cleaning products.

Successful exit strategies harvest the physical, intellectual, and potential wealth the entrepreneur has built in the business. Decisions entrepreneurs will need to make ahead of time include how much control they wish to maintain, how quickly they want to transition the business, and how much money they want to receive. Since many exit strategies have legal and tax consequences, none of the options should be pursued without professional advice from an attorney and accountant. An entrepreneur can:

- Sell the business to an individual buyer who will operate the business. This method usually provides a quick transition for both entrepreneurs. A common drawback is that the seller often must finance part of the purchase price.
- Sell the business to one or more employees. Banks may be more comfortable loaning money to employees since they have first-hand knowledge of the business. Employees, however, often want to pay less than fair market value because of their past involvement.
- Sell the business to all employees through an employee stock ownership plan (ESOP). Because of the formal process around ESOPs, the business is more likely to be sold at fair market value. Tax benefits may also motivate the seller.

**Reality**

Of the millions of businesses placed on the market each year, only about 15 percent are sold. These businesses often had a clear exit strategy planned from the beginning.
• Sell the business to another business or competitor that may maintain or merge operations. This option usually provides a more attractive price for the seller. The transition may take longer, however, as the seller may be needed in a key position for several years after the sale.

• Take the business public. A premium price is often earned through this type of exit strategy, which helps to compensate the entrepreneur and management team for going through the Securities Exchange Commission’s (SEC) approval process, developing operating standards, and using considerable financial resources to boot.

• Leave the business to a family member. This exit strategy may be one of the easiest. A carefully documented operating and control system should be developed to ensure continued business success.

from real entrepreneurs

After the successful sale of his business for several million dollars, David commented that the investment group that purchased it had done so partially because his “was the most well-documented business they had ever seen.” As an engineer by training, the same analytical skills that David used to develop and successful launch new products also served him well in planning and documenting the operations of his business so others could run it.

The following exit strategies will not reap the same benefits as the ones described earlier. Still, without a detailed exit strategy, entrepreneurs can:

• Liquidate the assets and close the doors. This option may provide the entrepreneur with a little money, but does not provide any reward for the years of business ownership.

• Retain ownership and hire a manager. The hired management can either make this option a dream or a nightmare and leaves an ultimate exit strategy yet to be accomplished.

More Info

Exit Strategies, Kauffman Foundation. Why exit strategies are an important part of the planning process. entrepreneurship.org/en/resource-center/exit-strategies.aspx
Exercise 14.3.2
Exit Strategy

Learning Objective
- Develop an exit strategy based on your growth plan and other considerations relevant to you and your business.

Overview
Smart entrepreneurs plan their exit from the business in the beginning planning stages because it forces them to analyze what they really want from the business. The successful business builds wealth for its owners by accumulating assets and building future profit potential. Savvy entrepreneurs should always plan a gainful way to harvest this value at a time of their choosing.

Step 1
Identify your preferred exit strategy. Selecting an exit strategy is not always easy. Many factors go into developing a successful exit strategy. First, consider the typical exit strategies in your industry. Are most businesses sold? Do they go public? Or, do they just cease to exist? Also answer these questions:
- How much control do you wish to maintain during the stages leading up to implementing your exit strategy?
- How much control, if any, do you wish to maintain after executing the exit strategy?
- How quickly do you want to transition the business?
- How much money do you want to receive?

Based on this information, prioritize the following list of exit strategies. Rate the following strategies, from 1 to 6, to indicate your preference. A “1” indicates this strategy is your first choice and “6” means last choice.

I plan to exit my business in the following way:

___ Sell the business
___ Merge the business with another
___ Go public
___ Sell to employees
___ Pass to my family
___ Cease doing business
___ Other (describe)

Step 2
Identify when your strategy will be implemented. Not only do you need to plan a specific exit strategy, you need to identify when the strategy will happen. Rate the following time frames, from 1 to 4, to indicate your preference. A “1” indicates your first choice and “4” means last choice.

I plan to exit my business in:

___ Less than two years
___ Three to five years
___ Six to ten years
___ More than ten years
Step 3

Identify the growth plan necessary to achieve the exit strategy. As you review your first choices in Step 1 and Step 2, identify the growth plan necessary for you to achieve your exit strategy in the chosen time frame. Consider new product/service offerings, personnel, and money that will be needed.

### NEW OFFERINGS TO MARKET

<table>
<thead>
<tr>
<th>New products/services</th>
<th>New store locations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>New markets</th>
<th>New distribution channels</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<tr>
<td></td>
<td></td>
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</tbody>
</table>

### PERSONNEL REQUIREMENTS

<table>
<thead>
<tr>
<th>Management personnel</th>
<th>Other employees</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### FINANCIAL REQUIREMENTS

<table>
<thead>
<tr>
<th>Money needed</th>
<th>Potential sources</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
14.3.3 Monitoring the Budget

One major responsibility of the entrepreneur is to monitor budgets. Once the annual budget is set, it should be monitored every business day. Doing so and charting financial performance against financial goals is part of entrepreneurship.

In some businesses, budgets are prepared annually and not reviewed until the next budget is prepared. This annual look at the budget is ineffective in helping entrepreneurs reach financial goals. It is like planning a garden, planting the seeds, and then coming back at the end of the season to harvest the produce. Just like a garden, a budget must be watched daily to keep the business on track. Having an annual budget and reviewing it on a regular basis can help in these functions and more:

- Provide a basis to financially manage the business.
- Control costs.
- Reduce spending.
- Predict sales.
- Adjust inventory levels.
- Improve cash flow.

Utilizing different types of budgets can make it easier to monitor the budgeting process. Entrepreneurs should develop their own system to effectively monitor their financial situation. No two budget systems need be alike.

**Operational Budget**—Projects the revenue and expense (and resulting profits) for the company for a one-year period. This budget is probably the most commonly used. It is a good indicator of overall financial performance since it concentrates on net profits.

**Cash Flow Budget**—Details the cash collected and needed, usually monthly. Sometimes overlooked, this budget can mean the difference between success and failure. The cash flow budget details the cash sources and uses to ensure the business’s ability to pay out cash when necessary and to build cash reserves for future growth.

**Capital Budget**—Assesses the equipment needed to reach the projected level of sales. This budget may be included in the cash flow budget. The importance of the capital budget is to project the overall cost of equipment and to evaluate potential sources of the funds needed.

Budgeting plays a major role in business planning. By adopting various budgetary procedures, management guides the business through the concept, start-up, operating, and growth stages to a predetermined exit strategy.

**from real entrepreneurs**

One menswear merchant developed three budgets: sales, capital and expenses. The sales budget was developed in great detail by product lines and months. It was used not only for developing the cash flow statements and financial budgets but also as the basis for buying. The capital budget was less detailed and reviewed every quarter. The expenses budget listed overhead expenses in detail as well as expenses that pertained to each department.
Assignment 14a: Financial Plan

<table>
<thead>
<tr>
<th>Business Plan Questions</th>
<th>Section Content Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Start-Up Costs</td>
<td>11.2</td>
</tr>
<tr>
<td>What are your estimated costs to start this business? Are these one-time costs or on-going costs? Indicate any major categories of expenses such as inventory or equipment.</td>
<td></td>
</tr>
<tr>
<td>Sales Projections</td>
<td>12.2</td>
</tr>
<tr>
<td>What are your sales projections for the next three years? How did you determine sales? Are the projections reasonable? Note: Use the Year End Income Statement for these figures.</td>
<td></td>
</tr>
<tr>
<td>Income Projections</td>
<td>11.1 and 14.1.5</td>
</tr>
<tr>
<td>What are your net income projections for the next three years? When will your company be profitable? Note: Use the Year End Income Statement for these figures.</td>
<td></td>
</tr>
<tr>
<td>Break Even Analysis</td>
<td>12.4.1</td>
</tr>
<tr>
<td>What is the break-even point for your product/service? After projecting fixed costs and sales figures, use this formula for the break-even point: Break-even point = Fixed costs / (Sales price per unit – Variable costs).</td>
<td></td>
</tr>
<tr>
<td>Cash Requirements</td>
<td>13.2 and Assignment 13b</td>
</tr>
<tr>
<td>How much cash will be required to cover start-up costs, operations, and/or growth? What is the low point in your cash flow? When does this occur?</td>
<td></td>
</tr>
<tr>
<td>Sources of Financing</td>
<td>13.3</td>
</tr>
<tr>
<td>Based on cash requirements to start, maintain operations, and grow, will you seek debt or equity financing? What is the cost of obtaining these funds?</td>
<td></td>
</tr>
<tr>
<td>Exit Strategy</td>
<td>14.3.2</td>
</tr>
<tr>
<td>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?</td>
<td></td>
</tr>
</tbody>
</table>

Assignment 14b: Financial Plan Feasibility Checklist

Using the assignments in Chapters 11 through 14, you created the Financial Plan. Now check your plan against the financial criteria for the model business. If you rate below a three for any criterion, consider whether this aspect is fundamental to the success of your business.

Don’t be surprised if some of your answers have changed from when you used this tool in Assignment 4. Also at this point, you should be able to answer all questions, including those that you weren’t able to answer in Assignment 4.

While no business rates high on all criteria, you can use your answers on this checklist to help decide whether to pursue this business. You can also use this checklist to set targets for your business and refer to these benchmarks periodically to assess your progress.
Assignment 14b: Model Business Feasibility Checklist—Financial Plan

Learning Objective

• Identify strengths and weaknesses in your financial plan as compared to the Model Business.

Overview

The Model Business Feasibility Checklist identifies the major criteria that can make or break the success of a business. This checklist has already been used to evaluate the overall feasibility of the business concept. Now, you will use the financial criteria to reevaluate the feasibility of your financial plan. By doing this, you can develop benchmarks for improvement.

Tools

Model Business Feasibility Checklist—Financial Plan

Step 1

Review the financial criteria. The model, or perfect, business has all these things. If you need help understanding a criterion, refer to the criteria explanation page.

Step 2

Rate your financial plan. Using a scale from 1 to 5 (1 meaning that your concept absolutely does not meet these criteria and 5 meaning that your concept entirely meets these criteria), rate your business concept against the model business criteria by typing the number in the box that corresponds to the number you choose. By now you should be able to rate your business on all the criteria included. If you do not know some of the answers, review the related sections in Chapters 11-14 to help determine your answers.

Step 3

Evaluate your financial plan. Generally, for a financial plan to be feasible it must achieve at least one-half of the possible points overall and at least one-half of the possible points in any of the three sections. A score less than 3 for any individual criterion indicates a weakness in the financial plan, which requires further consideration.

Step 4

Identify one or two criteria that you rated low. Consider ways you can improve these scores. Do you need more information, a unique marketing strategy, or creative solutions? Most scores can be improved over time. List several options that could raise the scores of the low criteria you identified.
## Business Feasibility Checklist

<table>
<thead>
<tr>
<th>FINANCIAL FEASIBILITY</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding is easily obtained.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue stream is continuous.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money is collected prior to sales.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hiring and retaining employees is easy.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory/Service providers are dependable.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross margin is 100 percent.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal problems do not exist.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wealth is generated through an exit strategy.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total: 40
# Model Business Feasibility Checklist—Criteria Explanations

If you need help rating your business using the Model Business Feasibility Checklist, check out the following guidelines. Look closely at the options for each model business factor. Then, choose the one that most closely represents your situation. Be honest!  
1 = Low  5 = High

<table>
<thead>
<tr>
<th>Model Business Factor</th>
<th>Options</th>
</tr>
</thead>
</table>
| **Funding is easily obtained.**              | 1. I’m going to have to invest a huge amount, maybe more than I am willing to risk.  
                                           | 2. I’m not really sure how much funding my business will require.  
                                           | 3. I need to invest quite a bit of money, but I can afford to risk it.  
                                           | 4. I need to invest a moderate amount of money; I can afford to risk it.  
                                           | 5. No sweat! I don’t have to invest much money at all; I can comfortably risk it. |
| **Revenue stream is continuous.**           | 1. I never know what’s going to come in because of seasonality, large contracts, etc.  
                                           | 2. Monthly sales will fluctuate significantly but are somewhat predictable.  
                                           | 3. Our sales vary somewhat from month to month due to sales cycles and products offered.  
                                           | 4. Most of the time, sales will be steady from month to month.  
                                           | 5. We can always count on steady sales from month to month. |
| **Money is collected prior to sales.**       | 1. We send out a bill for products/services and wait over 30 days for customers to pay.  
                                           | 2. We send out a bill for products/services and the typical customer pays within 30 days.  
                                           | 3. Customers pay at the time of service or when they receive the product.  
                                           | 4. Our customers make an upfront deposit that covers the direct costs of the product/service.  
                                           | 5. Cash is King! The entire price of the product/service is paid prior to delivery. |
| **Hiring and retaining employees is easy.**  | 1. Turnover will be high. The cycle of hiring and training will be continuous.  
                                           | 2. I will spend lots of time and money hiring and training employees.  
                                           | 3. For now, I can control labor costs by using sub-contractors as the company grows.  
                                           | 4. I have well-qualified employees and expect a low turnover rate.  
                                           | 5. This is great! I have top employees and a zero turnover rate! |
| **Inventory/Service providers are dependable.** | 1. I do not have a clue where to get most of the inventory/supplies I need.  
                                           | 2. I’m not completely sure about where I’m going to get the inventory/supplies I need.  
                                           | 3. I’ve found them, but only a few companies can give me what I need.  
                                           | 4. Many companies can supply what I need.  
                                           | 5. No problem! Numerous companies with good reputations can supply what I need. |
| **Gross margin is 100 percent.**             | 1. My gross margin is low since our costs of direct materials and labor are high.  
                                           | 2. My gross margin is fairly low since our costs of direct materials and labor are relatively high.  
                                           | 3. My gross margin is average with average costs of direct materials and labor.  
                                           | 4. We have some costs of direct materials and labor, but they are lower than average.  
                                           | 5. Nearly 100 percent! No significant direct costs of materials or labor exist. |
| **Legal problems do not exist.**             | 1. I’ve got problems. I am already facing legal action. For example, violation of a non-compete from a former employer.  
                                           | 2. I will have problems. I have multiple business owners, high liability products, leasing issues or products that must be legally protected.  
                                           | 3. I am concerned about protecting my personal assets from legal liability.  
                                           | 4. Legal problems do occur in this industry, but most can be anticipated and managed with proper planning.  
                                           | 5. Few lawsuits or legal harassments occur in this entire industry. |
| **Wealth is generated through exit strategy.** | 1. I will not be able to sell my business when I am ready to exit.  
                                           | 2. I don’t know if I can sell my business without me as the owner.  
                                           | 3. I will be able to sell some of the proprietary assets of the business.  
                                           | 4. I will be able to get a reasonable amount of money since I plan to build proprietary assets.  
                                           | 5. My exit strategy will allow for a profitable way out of the business. |

* The gross margin is the amount left over after the business pays direct materials and labor costs of the product/service.
Summary

This chapter continued to focus on financial planning by reinforcing an understanding of financial statements and developing an understanding of financial ratios.

- Financial statements are essential tools for entrepreneurs.
- To be able to read financial statements effectively, entrepreneurs must understand basic financial and accounting concepts.
- The income statement is a valuable tool to determine the profitability of a business.
- The balance sheet reflects the solvency of the business.
- The cash flow statement indicates if there is enough cash on hand to pay the expenses.
- Financial ratios are a useful way of analyzing a company’s financial performance against the industry or previous years’ performance.
- Planning a financial future includes a growth plan, an exit strategy, and budgeting processes.
Finalizing the Business Plan

Overview
Throughout the course, you have researched, analyzed, tested, modified, and rewritten sections of your business plan. At this point, the main sections should be complete. In this chapter, you will learn what is necessary to finalize your business plan.

The chapter will also provide tips and guidelines for assembling the business plan after the final sections have been added. After the plan is put together, you will evaluate it for completeness and accuracy. A checklist is provided for easy reference. The plan should also be critiqued by a trusted mentor and a spelling and grammar expert.

You should also compare your business plan to your original personal vision and the model business. Then, you will determine the next steps to turn your dream of starting a business into a reality.

Objectives
In this chapter, you will learn to:
• Add the final elements and assemble the business plan.
• Evaluate the plan for completeness, clarity, and conciseness.
• Compare the business plan to your personal vision and the model business.
• Assess and plan the next steps to follow after you have completed the business plan.
15.1 Completing the Business Plan

15.1.1 Introduction

After the research is complete and the main content is written, the final components of the business plan can be completed and the plan assembled. The finished plan is a reflection of the entrepreneur's professionalism. In addition to evaluating the business concept, readers will also be evaluating the entrepreneur based on how well the plan was prepared. They will assess the business plan on how easy it is to:

- Read
- Find information quickly
- Determine the strengths of the business concept
- Understand the overall goals and objectives of the entrepreneur

To make the business plan easier to use, entrepreneurs should add the following items, which are discussed in detail in this chapter.

- Cover page
- Table of contents
- Executive summary
- Appendix

15.1.2 Cover Page

The cover page of the business plan is the first thing the reader will see. An effective cover page will do two things: create a positive first impression and communicate key information. The cover page can be creative, but should be simple, useful, and easy to read. Make it easy for lenders and investors to contact you by including phone numbers and e-mail addresses, double-checked for accuracy. Others may choose to ignore the business plan if they cannot easily find contact information.

On the cover page, include the following information:

- Business name
- Motto or tag line that describes your business
- Logo
- Date the plan was prepared
- Entrepreneur’s name
- Business or home address
- Entrepreneur’s phone numbers and other contact information
- E-mail address and website

The company logo should be displayed on the cover page. A picture or sketch of the product/service can also be very valuable. Artwork is effective when it is relevant to the business concept and professional in appearance.

Tip

Make it as easy as possible for lenders and investors to contact you. Include phone numbers and e-mail addresses and double-check their accuracy.
from real entrepreneurs

Alvin, who wrote a business plan for a dinner theater, used clip art pictures of Las Vegas showgirls on the cover page and each section’s first page. He was seeking bank financing for tenant improvements, equipment, and supplies. The showgirls’ revealing costumes did not accurately illustrate either his business or his projected use of new funds. Only when Alvin removed those pictures, could he find a loan officer who would even suggest he fill out a loan application form.

If the business plan is going to be distributed to several different investors or lenders, each plan should be numbered separately on the cover page. This system will allow tracking of 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 confidentiality statement, such as, “The contents of this plan are proprietary and confidential. It is not to be duplicated in any way.”

Tip

If your company name does not describe your business, consider adding a descriptive tag line below the company name.

Reality

Consider having the recipient sign a nondisclosure agreement in which the reader agrees to refrain from revealing the contents or ideas of the plan to anyone else. By disclosing information without a signed nondisclosure agreement, you may lose your ability to protect the information through trade secrets, patents, or other types of protection.

More Info

What Goes into a Nonconfidential Overview of My Business? What to share about your business in a situation where the information does not have confidentiality protection. entrepreneur.com/ask/answer23446.html

Confidentiality Statement Checklist. Identifies what to include. sunrisepage.com/plan/confiden.html
Assignment 15a: Cover Page

You can create a professional looking cover page with the template for assignment 15a: Cover Page. Include the name of the company, your name, and your title. Many entrepreneurs use “President” as their title. Also include the company’s contact information. If the actual address of the business is undecided, use your home address. Providing this key information makes it easy for investors and other readers to contact you. The company logo should be displayed on the cover page along with the company name and tag line, if you have one. Add the date the plan was prepared. In addition to letting readers know when the plan was written, it will help you keep track of the most recent version.

### Example

**Your Business Name**
  
  **Tag Line or Motto**
  
  **Your Logo**
  
**BUSINESS PLAN**

Business Plan Prepared By
  
  **Your Name**
  
  **Your Title**
  
  **Your Company Name**
  
  **Your Company Address**
  
  **City, State, and Zip Code**
  
  **Your Phone/Fax Number(s)**
  
  **Your E-mail and Web Addresses**

**Date Prepared**
  
  **Month, Year**

The contents of this plan are proprietary and confidential.
It is not to be duplicated in any way.

### 15.1.3 Table of Contents

An organized and accurate table of contents will help you and the readers of your plan find information quickly. The table of contents includes a list of subject headings and subheadings with accompanying page numbers. Tabs can be added to the final business plan for easy referral to the different sections.

The following is an example of how the management and organization section should appear in the table of contents.
In the business plan template, the table of contents has been created for you. However, be sure to check your page numbers to be sure they are accurate. You will need to insert subheadings under the appendix section based on the information you place in that section.

Following is an example of the Table of Contents included in the Business Plan Template.

**Tip**
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.

### Example TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXECUTIVE SUMMARY</td>
<td>#</td>
</tr>
<tr>
<td>PRODUCT/SERVICE</td>
<td>#</td>
</tr>
<tr>
<td>DESCRIPTION OF PRODUCT/SERVICE</td>
<td></td>
</tr>
<tr>
<td>FEATURES AND BENEFITS</td>
<td></td>
</tr>
<tr>
<td>STAGE OF DEVELOPMENT</td>
<td></td>
</tr>
<tr>
<td>PRODUCT/SERVICE LIMITATIONS</td>
<td></td>
</tr>
<tr>
<td>PRODUCT/SERVICE LIABILITY</td>
<td></td>
</tr>
<tr>
<td>PRODUCTION</td>
<td></td>
</tr>
<tr>
<td>FACILITIES</td>
<td></td>
</tr>
<tr>
<td>SUPPLIERS</td>
<td></td>
</tr>
<tr>
<td>RELATED PRODUCT/SERVICES AND SPIN-OFFS</td>
<td></td>
</tr>
<tr>
<td>TRADEMARKS, PATENTS, COPYRIGHTS, LICENSES, ROYALTIES</td>
<td></td>
</tr>
<tr>
<td>GOVERNMENT APPROVALS</td>
<td></td>
</tr>
<tr>
<td>MANAGEMENT AND ORGANIZATION</td>
<td>#</td>
</tr>
<tr>
<td>LEGAL FORM OF BUSINESS</td>
<td></td>
</tr>
<tr>
<td>MANAGEMENT TEAM</td>
<td></td>
</tr>
<tr>
<td>BOARD OF DIRECTORS/ADVISORY BOARD</td>
<td></td>
</tr>
<tr>
<td>RECRUITMENT AND SELECTION OF EMPLOYEANS</td>
<td></td>
</tr>
<tr>
<td>COMPETITIVE ADVANTAGE</td>
<td></td>
</tr>
<tr>
<td>EMPLOYEE REWARD AND INCENTIVE PLAN</td>
<td></td>
</tr>
<tr>
<td>COMMUNICATION</td>
<td></td>
</tr>
<tr>
<td>INFRASTRUCTURE</td>
<td></td>
</tr>
<tr>
<td>MARKETING PLAN</td>
<td>#</td>
</tr>
<tr>
<td>INDUSTRY PROFILE</td>
<td></td>
</tr>
<tr>
<td>CURRENT SIZE</td>
<td></td>
</tr>
<tr>
<td>GROWTH POTENTIAL</td>
<td></td>
</tr>
<tr>
<td>INDUSTRY TRENDS</td>
<td></td>
</tr>
<tr>
<td>OTHER CHARACTERISTICS</td>
<td></td>
</tr>
<tr>
<td>DISTRIBUTION CHANNELS</td>
<td></td>
</tr>
<tr>
<td>COMPETITIVE ANALYSIS</td>
<td></td>
</tr>
<tr>
<td>DIRECT COMPETITION</td>
<td></td>
</tr>
<tr>
<td>INDIRECT COMPETITION</td>
<td></td>
</tr>
<tr>
<td>FUTURE COMPETITION</td>
<td></td>
</tr>
<tr>
<td>COMPETITIVE ADVANTAGE</td>
<td></td>
</tr>
<tr>
<td>MARKET ANALYSIS</td>
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</tr>
<tr>
<td>TARGET MARKET PROFILE</td>
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</tr>
<tr>
<td>CUSTOMER PROFILE</td>
<td></td>
</tr>
<tr>
<td>MARKET ANALYSIS</td>
<td></td>
</tr>
<tr>
<td>FUTURE MARKETS</td>
<td></td>
</tr>
<tr>
<td>MARKET PENETRATION</td>
<td></td>
</tr>
<tr>
<td>COMPANY IMAGE</td>
<td></td>
</tr>
<tr>
<td>LOCATION</td>
<td></td>
</tr>
<tr>
<td>CUSTOMER SERVICE</td>
<td></td>
</tr>
<tr>
<td>ADVERTISING AND PROMOTION</td>
<td></td>
</tr>
<tr>
<td>PUBLICITY</td>
<td></td>
</tr>
<tr>
<td>TELEMARKETING/DIRECT MAIL</td>
<td></td>
</tr>
<tr>
<td>INTERNET</td>
<td></td>
</tr>
<tr>
<td>TRADE SHOWS</td>
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<td>INTERNAL SALES FORCE</td>
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</tr>
<tr>
<td>EXTERNAL SALES FORCE</td>
<td></td>
</tr>
<tr>
<td>MARKET PENETRATION EFFECTIVENESS</td>
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</tr>
<tr>
<td>PRICING</td>
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<td>PRICING STRATEGY</td>
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<td>PRICE LIST</td>
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</tr>
<tr>
<td>PRICING POLICIES</td>
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</tr>
<tr>
<td>FINANCIAL PLAN</td>
<td>#</td>
</tr>
<tr>
<td>START-UP COSTS</td>
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</tr>
<tr>
<td>SALES PROJECTIONS</td>
<td></td>
</tr>
<tr>
<td>INCOME PROJECTIONS</td>
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</tr>
<tr>
<td>BREAK-EVEN ANALYSIS</td>
<td></td>
</tr>
<tr>
<td>CASH REQUIREMENTS</td>
<td></td>
</tr>
<tr>
<td>SOURCES OF FINANCING</td>
<td></td>
</tr>
<tr>
<td>EXIT STRATEGY</td>
<td></td>
</tr>
<tr>
<td>PROJECTED FINANCIAL STATEMENTS</td>
<td></td>
</tr>
<tr>
<td>MONTHLY CASH FLOW STATEMENT</td>
<td></td>
</tr>
<tr>
<td>YEAR-END INCOME STATEMENT</td>
<td></td>
</tr>
<tr>
<td>YEAR-END BALANCE SHEET</td>
<td></td>
</tr>
<tr>
<td>FINANCIAL RATIOS</td>
<td></td>
</tr>
</tbody>
</table>
Assignment 15b: Table of Contents

For this assignment, you will create a table of contents for your business plan. Start with the template, which lists all of the major sections—headings and subheadings. Your professor will provide instructions to you as to whether you should leave all headings/sections in the business plan or omit those sections/headings that do not apply to your business. Depending on the instructions you receive, make sure the Table of Contents correspond to the format of your business plan. Use this list to go through your plan and add the appropriate page numbers.

Tip

It works best to create the table of contents after the rest of the plan is complete. At this point, the heading and subheading titles are finalized and the page numbers should go unchanged.

15.1.4 Executive Summary

The executive summary is a brief overview of the entire business plan. It will be the first text section in the completed plan. Readers should find the answers to most of their questions in this summary. Since the executive summary is intended to highlight key information from the entire business plan, it is written last. It should not exceed two to three pages in length.

Before beginning to write the executive summary, the entrepreneur will need to identify the audience or readers of the plan as the executive summary will be slightly different depending upon who will be reading it. For example, a lender would not receive the same executive summary as a mentor. If you have an existing business, also include the following information:

- When and why the company was formed
- The marketing history of the product/service
- The company’s annual sales, profits, and overall performance to date

Reality

In many cases, the executive summary is the only section of the plan that an evaluator will read. If the executive summary does not clearly and concisely convey the business concept and its uniqueness, most lenders or investors will read no further.
The executive summary should contain critical information from these sections of the business plan:

- Venture Description
- Management and Organization Plan
- Marketing Plan
- Financial Plan

Common mistakes when writing the executive summary include:

- 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
- Long sentences and phrases
- Too long
- Failure to establish management team capabilities and specify what the management team hopes to accomplish with the business
- Failure to identify how much money the company needs, how the funds will be obtained and used, and when investors will be repaid

**Assignment 15c: Executive Summary**

The executive summary tells your reader what you propose to do, how you intend to do it, who will be involved, what it will cost, and the potential rewards. By answering the four sets of questions included in this assignment you will create an executive summary. This brief overview of the business includes highlights of the current stage of development of the venture, the management team, the market and customers, the marketing plan, and the financing required.

Write the executive summary in narrative form using impersonal language. Use your name when referring to yourself in the business plan. For example, write, “Janelle Jones has experience in…..” instead of “I have experience in…..”

The executive summary should be no more than two or three pages, but it should contain enough detail to adequately describe the business. In many cases, this is the only section of the plan that some evaluators will read. It should tell the reader what you want from them. For example, if you are seeking a loan, it should state how much money is needed, how the money will be used, the financing terms desired, and most importantly to the lender, how and when the money will be repaid.

**Tip**

Most entrepreneurs write a draft executive summary when initially developing their business plans. After finalizing the business plans, they usually rewrite the executive summary to reflect changes that have been made.

**from real entrepreneurs**

Juan uses his executive summary to introduce his new business to suppliers, vendors, potential employees, and potential customers. “Our vision of operations is clearly defined in our executive summary. People get a real sense of what we are about just by reading it,” Juan recalls.
Scenario 15.1.4

Run KC—Executive Summary

Learning Objective

• Identify information which should be included in an Executive Summary.

Overview

The Executive Summary is a brief overview of the business plan. It should highlight the venture itself, the management team, the industry and market, and the financing required. The Executive Summary should clearly and concisely convey the business concept and uniqueness. If it does not, most lenders or investors will read no further.

Before writing the Executive Summary, the entrepreneur should identify the audience or readers. To whom will the business plan be presented and for what purpose? There may be more than one audience for the plan. If this is the case, the entrepreneur should write a different executive summary to highlight specific areas of interest for each reader.

Scenario

Tim has completed the business plan for Run KC and is ready to present it to potential funders. He needs to write an Executive Summary that will intrigue the audience so they will be interested enough to read the entire plan.

Step 1

Identify the audience. In Chapter 12, you discussed start-up funding options for Run KC. Based on the recommendations made at that time, identify who the Executive Summary should be written for and for what purpose.

Step 2

Engage the audience. For each category below, use what you have read about Run KC throughout the course to identify two details about the business venture that might be of particular interest to the audience identified in Step 1. Remember, the Executive Summary should make the audience interested enough to read the entire plan.

Venture Description
Assignment 15c: EXECUTIVE SUMMARY

**Business Plan Questions**

**Venture Description**
Clearly describe the venture. What is the current stage of development? Current stage of development may be start-up, initial operations, expansion, rapid growth, or stable operations. What is unique about the product/service, and what proprietary rights does the business have?

**Management and Organization Plan**
What form of organization does the business operate under and why? Who are the key management team members, what roles will they fulfill, and what skills do they have to help the business? Who are the key support groups for your management team, including accountants, attorneys, consultants, board of directors, and advisory board members?

**Marketing Plan**
What is the market like in terms of the industry, the customer, customer needs, product benefits, and target markets? Who are the major competitors, and what are their strengths and weaknesses? What are your market penetration plans? Include specific facts and figures from your market research.

**Financial Plan**
What will it cost to start this business? What are the projections for sales and net profit? What is the break-even point? How much cash will be needed to start and operate this business? What sources of financing have been, and will be, sought? How much money has been contributed by the entrepreneur? What is your exit strategy?
15.1.5 Business Plan Appendix

The main sections of the business plan should not include excessive detail or technical specifications. An appendix is the appropriate place to put all supporting information in the business plan. These documents lend credibility to the plan. The entrepreneur should ensure that the documents included in the appendix are easy to find, readable, and understandable.

The appendix should have its own heading within the table of contents to help the reader locate specific documents. The appendix index lists all of the documents included. Any references in the body of the business plan to information located in the appendix should refer to the document title and the appendix page.

The following documents should appear in the appendix rather than in the text of the business plan:

- Worksheets from the financial template including:
  - Start-Up Funding and Expenditures
  - Operating Expenses
  - Sales
  - Inventory
  - Capital Budget
  - Equity & Debt
  - 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 contracts, distributor contracts, nondisclosure agreements, and other legal documents
- Samples of product/service brochures or other advertising
- Copies of any logos that have been developed
- Copies of related market studies or articles from trade journals or other appropriate media, including the source and date
- Related information to support the industry study, such as demographics or magazine articles, including the source and date
- Professional photographs of the product, facilities, or equipment
- Detailed descriptions of products
- Map showing the location of business
- Copy of any credit reports on the business
- Copies of reference letters, recommendations, or endorsements that are less than 12 to 16 months old
- Customer-signed orders or letters of intent

Tip

The entrepreneur’s credibility can be established or lost by the contents of the appendix. If inaccuracies or missing data are discovered, the reader will question the accuracy of everything else written in the plan. Accurate and complete references will likely result in the reader accepting the assertions found in the body of the plan rather than verifying claims themselves.
Assignment 15d: Appendix

The main sections of the business plan should not include excessive detail or technical specifications. An Appendix is the appropriate place to put all supporting information. For this assignment, you will create the appendix for your business plan. Although readers may not look at every page in the appendix, they will recognize that data provided in the plan is documented.

Section 15.1.5 contains a list of items to include in the Appendix. Determine which of these items are relevant to your business plan. The appendix will vary in length according to the amount of detailed information needed to support the claims made in the business plan. If the appendix becomes too large, it can be made into a separate document.

There is no template provided for this assignment. All documents can be included in the appendix just as they are. You should prepare a secondary table of contents at the beginning of the appendix to identify the location and type of documents included.

15.2 Assembling the Business Plan

15.2.1 Organizing the Business Plan

After writing the executive summary and collecting appendix documents, the next step is to assemble the business plan. When reviewing a business plan, lenders and investors learn more than the details about the proposed business venture; they learn about the person or team who prepared the plan. They look for attention to detail, thoroughness, and professionalism in addition to a credible business plan. These indicators help them assess if the person or team who put the plan together has the professionalism to manage the money that they will lend or invest. The business plan is the lender’s first indication of the kind of work the team can do.

Each business plan section should begin on a new page and should appear in the following order:

- Cover Page
- Table of Contents
- Executive Summary
- Product/Service Plan
- Management and Organization Plan
- Marketing Plan
- Financial Plan
- Appendix

More Info

Business Plan Outline—A helpful outline of topics to be included in the business plan. The outline follows this section.
Planning the Entrepreneurial Venture

Business Plan Outline

Executive Summary

• Venture Description
• Management and Organization Plan
• Marketing Plan
• Financial Plan

Product/Service

• Description of Product/Service
• Features and Benefits
• Stage of Development
• Product/Service Limitations
• Product/Service Liability
• Production
• Facilities
• Suppliers
• Related Products/Services and Spin-Offs
• Trademarks, Patents, Copyrights, Licenses, Royalties
• Governmental Approvals

Management and Organization

• Legal Form of Business
• Management Team
• Board of Directors/Advisory Board
• Recruitment and Selection of Employees
• Compensation and Ownership
• Employee Reward and Incentive Plan
• Communication
• Infrastructure

Marketing Plan

• Industry Profile
  • Current Size
  • Growth Potential
  • Industry Trends
  • Conclusions
  • Other Characteristics
  • Distribution Channels

• Competitive Analysis
  • Direct Competition
  • Indirect Competition
  • Future Competition
  • Competitive Analysis

• Market Analysis
  • Target Market Profile
  • Customer Profile
  • Market Analysis
  • Future Markets

• Market Penetration
  • Company Image
  • Location
  • Customer Service
  • Advertising and Promotion
  • Publicity
  • Telemarketing/Direct Mail
  • Internet
  • Trade Shows
  • Internal Sales
  • External Sales
  • Market Penetration Effectiveness

• Pricing
  • Pricing Strategy
  • Price List
  • Pricing Policies

Financial Plan

• Start-up Costs
• Sales Projections
• Income Projections
• Break-even Analysis
• Cash Requirements
• Sources of Financing
• Exit Strategy
• Projected Financial Statements
• Monthly Cash Flow Statement
• Year-End Income Statement
• Year-End Balance Sheet
• Financial Ratios

APPENDIX
15.2.2 Formatting and Designing the Business Plan

An easy-to-read font and a simple design work best for the business plan. A 12-point font in a serif style, such as Times, is the easiest for most people to read. Gimmicks such as all caps and excessive use of bold or underlining are distracting and detract from the importance or significance of the text. If a corporate identity has already been established, the chosen logo, fonts, and color scheme should be used.

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.

Each page should flow smoothly to the next page. If a heading falls at the bottom of a page and the content for that section falls on the next page, move the heading to the next page as well. Finally, each page should be appropriately numbered. The sample business plan provided in this course provides excellent examples of simple formatting and design.

15.2.3 Printing and Binding the Business Plan

The plan should be printed using a high-quality laser or ink-jet printer on white or light colored, standard-sized paper, 8.5 x 11 inches. Color can be used effectively for the headings, subheadings, and graphs. The main text should not be printed in color. Too much color can detract from the content of the business plan.

The best type of binding secures the pages, makes it easy to flip back and forth, and lays flat on a desk. Most office supply stores and copy centers offer affordable, professional binding services. Avoid slick, plastic binders with detachable spines. If the business plan is being used internally, three-ring binders work well. This type of binding will allow for easy removal or replacement of pages as the business plan is updated. The business plan can also be shared electronically by creating a pdf. file or word processing document.

Reality
A simply bound, well-written, grammatically correct, and properly organized plan is far more likely to be well received than a handsomely bound, well-illustrated plan that contains spelling errors, is poorly organized, or includes unsupported assumptions.
15.3 Evaluating the Business Plan

15.3.1 Introduction

Once the business plan is complete, the entrepreneur will want to have the plan reviewed from several different perspectives. First of all, the narrative portion of the business plan should be grammatically correct and free of spelling errors. The formatting should be logical and should make it easy to read. Secondly, the content of the business plan should adequately describe the opportunity and the potential the opportunity presents. Areas where information is insufficient or missing need to be addressed. And, finally, the entrepreneur will want to complete their own evaluation of the business plan to ensure that it appropriately represents them and their business prior to distributing it to others.

15.3.2 Grammar and Proofing Review

Because of the entrepreneur’s familiarity with their business plan’s content, it is difficult for them to proofread their own business plan. A qualified proofreader should provide specific feedback about grammar, spelling, or other errors that might still exist in a completed plan. Ideally, entrepreneurs should work with the proofreader to understand why changes in logic or language are necessary. This exercise will help the entrepreneur when writing future business documents. The plan should be evaluated for the following:

• Grammar, punctuation, and spelling. If errors occur in the plan, readers will have less confidence in the writer as an entrepreneur. This business plan is a reflection of the entrepreneur’s ability to start and operate a business. A lack of attention to details in the writing of the plan may indicate a lack of attention to details in the operations of the business.

• Logical flow of information. Information presented in an illogical order makes the business concept very difficult for readers to understand. The plan writer should keep in mind that readers do not have the deep understanding of the business that the entrepreneur does. Entrepreneurs should explain the business to readers, taking care to cover the topics in a logical sequence and using language that does not require specialized knowledge specific to the business.

• Use of “I,” “we,” or other personal pronouns. If entrepreneurs talk about “I,” “we,” and “me,” in the plan, the focus is on the entrepreneur and not on the business. Most statements that start with “I” can be rephrased. For example, the statement “I really want to start a business that meets the needs of customers,” can easily be changed to, “This business will respond to the needs of customers.” When referring to self, the entrepreneur should write in third-person, using his or her name, rather than using “I” or “we.”

• Documented facts. Facts should drive decisions in the business planning process. Neglecting to include the sources of facts causes readers to question them.

• Negative words or phrases. The business plan should be a positive plan of action for a business. Whenever possible, the entrepreneur should avoid using negative phrases. Negativity sets the wrong tone for the plan. Consider the following phrases:
  • The service is easily marketed; however, a subcontractor has not yet been found to provide the technical services.
  • The break-even point is 5,000 units, but the company has not been able to produce more than 3,000.
  • Customers demand a combination of products and services the business can’t provide.
The following statements still convey the same message, but in a more positive way:

- Marketing will begin as soon as a contract is signed with a subcontractor who will provide the technical services.
- With current production personnel and facilities, 3,000 units are produced monthly. The break-even point is 5,000 units per month.
- Currently the company is offering a single service. Based on customer demand, opportunities exist to expand this service to include products.

The tone of your business plan should be positive. Notice how the town changes in the following sentences:

Customers demand a combination of products and services the business can’t provide.

or

Currently the company is offering a single service. Based on customer demand, opportunities exist to expand this service to include products.

15.3.3 Mentor Review

Trusted advisors, preferably those who are familiar with the industry, should review the completed business plan. Their feedback can be immensely valuable in determining the strengths and weaknesses of the plan. The reviewer should check for:

Product/service feasibility. Are there any risks associated with providing this product/service? Is there any untapped expansion potential? Are there governmental regulations not discussed in the plan?

Market feasibility. Does the marketing plan accurately describe the potential of the market? Is the market penetration plan reasonable and affordable?

Financial feasibility. Are the revenues and expenses accurately portrayed? Can the necessary start-up funds be obtained? Is an exit strategy identified?

15.3.4 Business Plan Checklist

After the business plan is has been reviewed by a proof reader or mentor and edits/revisions have been made, the entrepreneur will want to evaluate their own business plan for completeness and accuracy. The checklist in the exercise which follows provides criteria on which to evaluate each section of the business plan. The criteria identify specific information that should be included in the plan as well as tips on how the information should appear.

By evaluating the plan against this checklist, entrepreneurs will find changes that need to be made. These changes will make the plan more readable, concise, complete, fact-based, and error free.

More Info

Business Plan Checklist—A helpful checklist to review the completeness of your business plan. The checklist follows this section.
Exercise 15.3.4
Critique Your Business Plan

Learning Objective

• Use a business plan checklist to evaluate your plan’s strengths and weaknesses with regard to style, format, and content requirements.

Overview

For this exercise, you will evaluate your business plan using the same checklist that your instructor will use to critique your business plan.

Step 1

Read your business plan.

Step 2

Use the checklist which follows to critique your business plan. Place an “X” in the Yes or No box to evaluate each section of the business plan.

Step 3

For each item marked “No,” go back to your business plan and make the necessary changes and/or improve that section of the plan.

Planning the Entrepreneurial Venture: Business Plan Checklist

<table>
<thead>
<tr>
<th>OVERALL READABILITY</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Language is concise (does not read like a novel or term paper).</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Each section stands on its own and clearly defines and satisfies its objective.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Facts are supported with sufficient documentation.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Conclusions drawn from facts are reasonable.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Contents are supported with sufficient charts and graphs.</td>
<td>❑</td>
<td>❑</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>OVERALL SPELLING/GRAMMAR</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spelling is correct.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Grammar is clean.</td>
<td>❑</td>
<td>❑</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>OVERALL FORMATTING</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Font choice is readable.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Spacing between lines is sufficient.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Plan contains headings and subheadings.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Formatting on headings and subheadings is consistent.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Plan includes page numbers.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Formatting on page numbers is consistent.</td>
<td>❑</td>
<td>❑</td>
</tr>
<tr>
<td>Plain contains enough white space for readability.</td>
<td>❑</td>
<td>❑</td>
</tr>
</tbody>
</table>
### Planning the Entrepreneurial Venture: Business Plan Checklist (continued)

<table>
<thead>
<tr>
<th>COVER PAGE/TABLE OF CONTENTS</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cover page contains name of business.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cover page contains chief executive's name.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cover page contains address, telephone and fax numbers, email and web address.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cover page contains company logo.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Page numbers in table of contents correspond correctly.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appendix includes a table of contents.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EXECUTIVE SUMMARY</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does not exceed three pages and wholly describes the new venture.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Describes the unique features and benefits of the product/service.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifies and describes the management team and supporting infrastructure.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Explains the opportunities found within the industry.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contains plans for targeting a market segment and penetrating it.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Specifies how much money the company needs and how funds will be obtained.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>PRODUCTS/SERVICES</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Describes product/service in plain English (not too technical).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Describes product/service in specific terms (not too broad).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provides evidence that the product/service is technologically feasible.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifies unique features.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifies special benefits.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholly explains product/service limitations and potential solutions.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholly explains product/service liabilities and potential solutions.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>If applicable, identifies production process and facility plans.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifies key suppliers, backup suppliers, and subcontractors.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Anticipates future related products/services and spin-offs.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Describes the ways intellectual property will be created and protected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lists requirements from regulatory agencies.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MANAGEMENT AND ORGANIZATION</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explains the legal form of business.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lists key management positions, including primary job responsibilities.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifies key management team members, their qualifications and responsibilities.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifies the board of directors/advvisory council members, including primary contributions expected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Documents the process of recruiting and selecting employees.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clarifies the compensation and employee reward systems.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifies infrastructure needed to support business.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MARKETING PLAN–INDUSTRY PROFILE</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Includes current size and growth potential of the industry.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discusses industry trends and opportunities associated with each.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Addresses geographic locations, seasonality, and industry profit characteristics.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifies existing distribution networks.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MARKETING PLAN–COMPETITIVE ANALYSIS</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifies direct, indirect and future competition.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contains competitive matrix to illustrate position in the marketplace.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Describes competitive advantage.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### MARKETING PLAN—MARKETING ANALYSIS AND PENETRATION

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contains target markets and size of each.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Provides customer profile.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Fully illustrates the image of the company.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Describes plans to reach the market, including customer service, location, sales force, licensing and distributing.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Addresses plans for advertising and promotion.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Includes plans for marketing through technology, including the internet.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Discusses other penetration strategies, including publicity, telemarketing/direct mail, trade shows and social media.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Describes plans for evaluating market penetration effectiveness.</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

### MARKETING PLAN—PRICING

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Addresses pricing strategy.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains price sheet if applicable.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Includes volume and special pricing information.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains the company’s pricing policies.</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

### FINANCIAL PLAN

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales and profit projections appear to be reasonable.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Assumptions and projections are wholly supported.</td>
<td>[ ]</td>
</tr>
<tr>
<td>All production and operating expenses have been included.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Hidden costs have been identified.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Salaries and other benefits are in line with industry standards or entrepreneur’s goals.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contingency plan seems reasonable if sales forecasts go unmet.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Includes Break-even Analysis.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Figures on various documents are consistent.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Sources of debt or equity financing are appropriately identified.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Exit strategy is clearly defined.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains projected financial statements.</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

### APPENDIX—CONTAINS THOSE ITEMS BELOW THAT ARE APPROPRIATE

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contains financial worksheets.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains resumes of the management team and key personnel.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains all employee contracts, stock option plans, retirement plans.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains personal financial statements for each of the principals.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains patent and copyright approvals.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains such agreements as partnerships, sales, distributor contracts, noncompete/nondisclosure, corporate bylaws, and other legal documents.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains copies of product and service brochures or other advertising samples.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains copies of all logos that have been developed.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains copies of recent reference letters, recommendations, and endorsements.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains copies of market studies or articles from trade journals or other media.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains professional photographs of the product.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains detailed outlines of the operating and control systems.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains customer-signed orders or letters of intent.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains documents that support the industry study.</td>
<td>[ ]</td>
</tr>
<tr>
<td>Contains detailed description of high-tech products.</td>
<td>[ ]</td>
</tr>
</tbody>
</table>
15.4 Reviewing the Business Plan
15.4.1 Reviewing the Plan against a Personal Vision

Many people start businesses without analyzing how well the business will meet their own personal goals. As a result, business owners may find themselves unhappy, unfulfilled, and wanting out of their business.

One way to avoid this situation is to compare the business plan to the personal vision you developed in Chapter 1. This comparison provides the opportunity to make sure the business fits your aspirations. After reviewing the business plan and your personal vision, you may decide to make changes to one or the other. If they are not compatible, the entrepreneur would be wise to pursue something else. Matching a business to the personal vision is essential for long-term satisfaction.

from real entrepreneurs

An aspiring entrepreneur dreamed of opening a barbecue restaurant in which she and family members, pulling together and sharing the same vision, would work. Her business plan proved her concept was sound, the market was there, the funds were available, and the profitability likely. As she planned the hours of operation and the different roles each family member would fill, she realized that, at least initially, they would all need to be at the restaurant most of their waking hours. While this was her vision, it was not her family’s. They had other interests beyond working at a restaurant. She abandoned the barbecue restaurant and continued to search for a venture consistent with her personal vision and her family’s happiness.
Exercise 15.4.1
Compare Business Plan to a Personal Vision

Learning Objective

- Evaluate the completed business plan against a personal vision.

Overview

In Exercise 2.3.3 you compared a business opportunity to your personal vision. Now, you will use that same process to compare the completed business plan against your personal vision. As you know, there is no guaranteed, statistically accurate way to calculate the probability of a business matching your personal vision. Much of this evaluation must be done subjectively. Still, it is helpful to have a tool to guide you through the process. This tool will help you review the personal vision criteria most important to you. It also gives you a mechanism to judge how well a planned business meets your personal vision.

Tools

Internet access

Step 1

Review your personal vision from Assignment 1. Take a minute to review the personal vision you created in Assignment 1. Make any changes you feel are necessary to adequately define what success means to you.

Step 2

Enter an “*” in the Priority column on the Personal Vision Evaluation Grid to identify essential criteria. This applies a higher importance to the criteria that are essential to your personal success and satisfaction. For example, maybe the number of hours you are willing to work per week is a critical number. A “**” indicates this criterion cannot be compromised.

Step 3

Rate how well the business plan meets your personal vision. Using a scale of 1 to 10 (with 1 meaning that the planned business does not at all meet your personal vision and 10 meaning that the business perfectly meets your personal vision), identify the level that each of your personal vision criterion is met by the planned business. Replace the number you select with the letter “X”.
Exercise 15.4.1
Personal Vision Evaluation Grid

<table>
<thead>
<tr>
<th>Step 1 and Step 2</th>
<th>Step 3</th>
<th>Rating — Step 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Review Assignment 1 and summarize your answer for each criterion in Column 1 below.</td>
<td>Priority*</td>
<td>How well does the business concept meet your personal vision?</td>
</tr>
<tr>
<td>Lifestyle Criteria</td>
<td></td>
<td>Not at all</td>
</tr>
<tr>
<td>Hours of work per week</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Flexible work hours</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Desired business location</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Business travel</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Morals, beliefs, or standards</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Physical requirements</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Family support</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Professional Criteria</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level of power or status</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Involvement in daily operations</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Match with skills and abilities</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Job security</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Match with vision for future</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Lifestyle or growth business</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Financial Criteria</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal financial obligations</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Future income level</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Business profits</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Personal investment</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
<tr>
<td>Money from outside sources</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td></td>
</tr>
</tbody>
</table>

* Add asterisk (*) for essential Total Score _________________

Step 5

Reflect. Now that you have completed your business plan and compared it to your personal vision, identify the areas that match—the areas of the planned business that will meet your personal vision the best.

Identify the areas that still do not match—the areas of the planned business that will not meet your personal vision.
15.4.2 Reviewing the Plan against a Model Business

If the planned business matches the entrepreneur’s personal vision, the next step is to test it against the model business again. The knowledge and information acquired through the preparation of the business plan enables the entrepreneur to effectively assess their concept against the model business at this time. The model business is used as an acid test to evaluate the feasibility of the venture. In addition, the model business can be used to set benchmarks for the future growth of the company.

Comparing a plan to the model business may reveal additional strengths and weaknesses to consider. Before starting any business, entrepreneurs should think about the strength of the product/service, the market, and the profitability of the venture. Some weaknesses may be more easily overcome than others. If you cannot improve your score on a low-rated criterion on the feasibility checklist, verify whether this low-scoring criterion will keep you from succeeding in the business. You will need to take note of this later when you are deciding whether to pursue your business concept.

from real entrepreneurs

After writing their business plan, one partnership decided to abandon their business concept of starting a party planning and catering business because of the high cost of liability insurance. In some cases, one factor may be significant enough that it alone may be the deal breaker.

The feasibility checklist in assignment 15e provides important information to consider when deciding whether to start your business, modify it, or abandon the concept.

Assignment 15e: Model Business Feasibility Checklist

In this assignment, you will use the Model Business Feasibility Checklist to compare your entire business plan with the model business. Earlier in the course, you used this checklist to evaluate your business concept and the different sections of the business plan. With the results of each evaluation, you may have modified or fine-tuned your plan. Now that you are more knowledgeable about entrepreneurship, don’t be surprised if some of your answers have changed.

This comparison can help you assess the risks of starting the business and determine if this is the direction you want to pursue. If you cannot improve your score on a low-rated criterion, decide if it is fundamental to the success of the business.

Tip

After you complete this assignment, you may want to go back and compare your evaluation with your responses in earlier assignments.
If you decide to start a business, you can use this checklist to set targets for your business and refer to these benchmarks periodically to assess your progress. This checklist can be used throughout the life of a business.

**More Info**
Feasibility Calculator, Assessing a business idea, a venture capitalist’s perspective. entrepreneur.com/calculators/feasibility/index.html

**Assignment 15e: Model Business Feasibility Checklist**

**Learning Objective**
- Compare a planned business to the model business to identify areas that still require improvement to ensure feasibility.

**Overview**
The Model Business Feasibility Checklist identifies the major criteria that can make or break the success of a business. By evaluating a planned business against these criteria, an aspiring entrepreneur can ensure that the written plan will create the best chances for venture success. The criteria can also be used to develop benchmarks for continued growth in the product/service, market, and financial areas.

**Tools**
Model Business Feasibility Checklist

**Step 1**
Review the Model Business Feasibility Checklist. Review the criteria found on the checklist. The model, or perfect, business has all these things. If you need help understanding one of the criteria, refer to the criteria explanations.

**Step 2**
Rate your business. Using a scale from 1 to 5 (1 meaning that your concept absolutely does not meet these criteria and 5 meaning that your concept entirely meets these criteria), rate your business concept against the model business criteria.

**Step 3**
Evaluate your business. Generally, for a business plan to be feasible it must achieve at least one-half of the possible points overall and at least one-half of the possible points in any of the three sections. A score less than 3 for any individual criterion indicates a weakness in the business plan, which requires further consideration.

**Step 4**
Identify one or two criteria that you rated low. Identify one or two criteria on which you rated low. Do you need more information, a unique marketing strategy, or creative solutions? Most scores can be improved over time. List several options that could raise the scores of the low criteria you identified.

**Reality**
Remember, the model business is considered a perfect business, one that does not exist in real life. No one expects your business to receive perfect scores in all areas; however, be realistic in terms of the potential for your business.
Assignment 15e: Model Business Feasibility Checklist

For help with rating see the criteria explanations. 1=Low 5=High

<table>
<thead>
<tr>
<th>PRODUCT OR SERVICE FEASIBILITY</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers perceive a need for product/service.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product/Service is ready to sell.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product/Service has unlimited life.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product/Service is unique and protectable.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product/Service is not regulated by the government.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product/Service line has expansion potential.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product/Service has no liability risk.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td>/35</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MARKET FEASIBILITY</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>NOTES</th>
</tr>
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<tbody>
<tr>
<td>Market can be recognized and measured.</td>
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<tr>
<td>Existing competition has identifiable weaknesses.</td>
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<tr>
<td>Distribution system is established and receptive.</td>
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<tr>
<td>Customers purchase frequently.</td>
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<tr>
<td>Business has great news value.</td>
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<tr>
<td><strong>Total:</strong></td>
<td>/25</td>
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<table>
<thead>
<tr>
<th>FINANCIAL FEASIBILITY</th>
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<th>3</th>
<th>4</th>
<th>5</th>
<th>NOTES</th>
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<tbody>
<tr>
<td>Funding is easily obtained.</td>
<td></td>
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<tr>
<td>Revenue stream is continuous.</td>
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<td>Money is collected prior to sales.</td>
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<td>Hiring and retaining employees is easy.</td>
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<td>Inventory/Service providers are dependable.</td>
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<tr>
<td>Gross margin is 100 percent.</td>
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<tr>
<td>Legal problems do not exist.</td>
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<tr>
<td>Wealth is generated through exit strategy.</td>
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<tr>
<td><strong>Total:</strong></td>
<td>/40</td>
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<tr>
<td><strong>Overall Total:</strong></td>
<td>/100</td>
<td></td>
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</tr>
</tbody>
</table>
**Assignment 15e: Model Business Feasibility Checklist**

If you need help rating your business using the Model Business Feasibility Checklist, check out the following guidelines. Look closely at the options for each model business factor. Then, choose the one that most closely represents your situation.

Be honest!  
1=Low  5=High

### PRODUCT OR SERVICE FEASIBILITY

<table>
<thead>
<tr>
<th>Customer perceives a need for product/service.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Customers are totally clueless about my products/services.</td>
</tr>
<tr>
<td>2. Customers must be educated about my products/services before they see a need for it.</td>
</tr>
<tr>
<td>3. Customers must be convinced to buy from me instead of my competitors.</td>
</tr>
<tr>
<td>4. Customers need my products/services and will often select them over competitors’.</td>
</tr>
<tr>
<td>5. Slam dunk! My customers need my products/services and want to buy from me.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Product/Service is ready to sell.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. I have not started developing my product/service.</td>
</tr>
<tr>
<td>2. I could have problems; I’m still developing my products/services.</td>
</tr>
<tr>
<td>3. I have sold some products/services, but they are not completely tested or trouble free.</td>
</tr>
<tr>
<td>4. I have thoroughly tested my products/services and am fixing the problems.</td>
</tr>
<tr>
<td>5. It’s all figured out! My products/services work well with minimal problems.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Product/Service has unlimited life.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. My products/services must be sold quickly so they don’t perish or become obsolete.</td>
</tr>
<tr>
<td>2. My products/services have a relatively short life cycle which makes profits minimal.</td>
</tr>
<tr>
<td>3. No sweat, I can make a profit before the life cycle ends for my products/services.</td>
</tr>
<tr>
<td>4. My products/services have a fairly long life cycle which will allow for ample profits.</td>
</tr>
<tr>
<td>5. My products/services can be sold forever! The life cycle is unlimited.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Product/Service is unique and protectable.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. I just don’t have anything proprietary; all I offer is similar to the competition.</td>
</tr>
<tr>
<td>2. My product/service is not proprietary, but it stands out from the competition.</td>
</tr>
<tr>
<td>3. I’m going to do my best to create proprietary rights for my products/services.</td>
</tr>
<tr>
<td>4. My product is somewhat unique in function or style and can be legally protected.</td>
</tr>
<tr>
<td>5. Got it covered! My products are unique in function and style and can be legally protected.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Product/Service is not regulated by the government.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Yikes! Complying with regulations is going to require lots of time and money.</td>
</tr>
<tr>
<td>2. The regulations are undergoing change, possibly requiring more time and expense.</td>
</tr>
<tr>
<td>3. It’s okay. The regulations are reasonable, but I’ll have to watch them closely.</td>
</tr>
<tr>
<td>4. It’s easy to comply with regulations for my specific products/services.</td>
</tr>
<tr>
<td>5. I’m free! Regulations are limited to those imposed on all businesses.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Product/Service line has expansion potential.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. My product/service has no expansion potential.</td>
</tr>
<tr>
<td>2. Right now, I only have one product/service to sell.</td>
</tr>
<tr>
<td>3. Definite expansion potential. Will require hard work to make it happen.</td>
</tr>
<tr>
<td>4. I have the beginnings of a product/service line with several things to sell.</td>
</tr>
<tr>
<td>5. My products/services complement each other, and I can easily add more to sell.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Product/Service has no liability risk.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. I’m worried; I may encounter a large legal risk selling my products/services.</td>
</tr>
<tr>
<td>2. I’m not sure what the risks are in selling my products/services.</td>
</tr>
<tr>
<td>3. I can afford to protect myself for the risk involved in selling my products/services.</td>
</tr>
<tr>
<td>4. I will have minimal risk selling my products/services; I can afford to protect myself.</td>
</tr>
<tr>
<td>5. No problem! I’ll have no liability risk selling my products/services.</td>
</tr>
</tbody>
</table>
### MARKET FEASIBILITY

| Market can be recognized and measured. | 1. My customers could be just about anyone, so targeting a certain group may not be easy.  
2. I have many potential customers, so I need to do more research to find my target market.  
3. I have identified my potential customers, but they will be somewhat difficult to reach because of their demographics/buying patterns.  
4. With some effort, I can use my customers’ demographics/buying patterns to find them.  
5. My potential customers are easy to find because of their demographics/buying patterns. |
| Existing competition has identifiable weaknesses. | 1. I have lots of competition who have been in this business longer than I.  
2. I have no competition! Hmm, I wonder why?  
3. I have identified my competition, but I do not know their weaknesses.  
4. I know my competition and their weaknesses, but I need more research.  
5. I have limited competition, and I know their weaknesses. |
| Distribution system is established and receptive. | 1. I must develop a brand new distribution system.  
2. My current distribution system offers only limited options.  
3. I’ve found a distribution system already established with several options.  
4. Several distributors seem receptive to carrying my products/services.  
5. Unbelievable! Distributors are calling me wanting to carry my products/services. |
| Customers purchase frequently. | 1. Customers will only buy once from me, so I must find new customers all the time.  
2. Most customers will only buy once from me.  
3. Customers will buy more than once, but not frequently.  
4. Some customers will purchase products/services frequently.  
5. Wow! My existing customers purchase products/services very frequently. |
| Business has great news value. | 1. My business has zero news value.  
2. My business just doesn’t seem to have great news value.  
3. I think I can come up with an angle to get some publicity.  
4. I know my business has news value, and I can get some good media coverage if I work at it.  
5. My business is so new and interesting that getting in the news is super easy! |
## Assignment 15e: Model Business Feasibility Checklist

### FINANCIAL FEASIBILITY

<table>
<thead>
<tr>
<th>Topic</th>
<th>1. I’m going to have to invest a huge amount, maybe more than I am willing to risk.</th>
<th>2. I’m not really sure how much funding my business will require.</th>
<th>3. I need to invest quite a bit of money, but I can afford to risk it.</th>
<th>4. I need to invest a moderate amount of money; I can afford to risk it.</th>
<th>5. No sweat! I don’t have to invest much money at all; I can comfortably risk it.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding is easily obtained.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue stream is continuous.</td>
<td>1. I never know what’s going to come in because of seasonality, large contracts, etc.</td>
<td>2. Monthly sales will fluctuate significantly but are somewhat predictable.</td>
<td>3. Our sales vary somewhat from month to month due to sales cycles and products offered.</td>
<td>4. Most of the time, sales will be steady from month to month.</td>
<td>5. We can always count on steady sales from month to month.</td>
</tr>
<tr>
<td>Money is collected prior to sales.</td>
<td>1. We send out a bill for products/services and wait over 30 days for customers to pay.</td>
<td>2. We send out a bill for products/services and the typical customer pays within 30 days.</td>
<td>3. Customers pay at the time of service or when they receive the product.</td>
<td>4. Our customers make an upfront deposit that covers the direct costs of the product/service.</td>
<td>5. Cash is King! The entire price of the product/service is paid prior to delivery.</td>
</tr>
<tr>
<td>Hiring and retaining employees is easy.</td>
<td>1. Turnover will be high. The cycle of hiring and training will be continuous.</td>
<td>2. I will spend lots of time and money hiring and training employees.</td>
<td>3. For now, I can control labor costs by using sub-contractors as the company grows.</td>
<td>4. I have well-qualified employees and expect a low turnover rate.</td>
<td>5. This is great! I have top employees and a zero turnover rate!</td>
</tr>
<tr>
<td>Inventory/Service providers are dependable.</td>
<td>1. I do not have a clue where to get most of the inventory/supplies I need.</td>
<td>2. I’m not completely sure about where I’m going to get the inventory/supplies I need.</td>
<td>3. I’ve found them, but only a few companies can give me what I need.</td>
<td>4. Many companies can supply what I need.</td>
<td>5. No problem! Numerous companies with good reputations can supply what I need.</td>
</tr>
<tr>
<td>Gross margin is 100 percent.</td>
<td>1. My gross margin is low since our costs of direct materials and labor are high.</td>
<td>2. My gross margin is fairly low since our costs of direct materials and labor are relatively high.</td>
<td>3. My gross margin is average with average costs of direct materials and labor.</td>
<td>4. We have some costs of direct materials and labor, but they are lower than average.</td>
<td>5. Nearly 100 percent! No significant direct costs of materials or labor exist.</td>
</tr>
<tr>
<td>Legal problems do not exist.</td>
<td>1. I’ve got problems. I am already facing legal action. For example, violation of a non-compete from a former employer.</td>
<td>2. I will have problems. I have multiple business owners, high liability products, leasing issues or products that must be legally protected.</td>
<td>3. I am concerned about protecting my personal assets from legal liability.</td>
<td>4. Legal problems do occur in this industry, but most can be anticipated and managed with proper planning.</td>
<td>5. Few lawsuits or legal harassments occur in this entire industry.</td>
</tr>
<tr>
<td>Wealth is generated through exit strategy.</td>
<td>1. I will not be able to sell my business when I am ready to exit.</td>
<td>2. I don’t know if I can sell my business without me as the owner.</td>
<td>3. I will be able to sell some of the proprietary assets of the business.</td>
<td>4. I will be able to get a reasonable amount of money since I plan to build proprietary assets.</td>
<td>5. My exit strategy will allow for a profitable way out of the business.</td>
</tr>
</tbody>
</table>

*The gross margin is the amount left over after the business pays direct materials and labor costs of the product/service.*
Step 4: Identify low rated criteria and consider ways to improve score.

Identify one or two criteria that you rated low.

Consider ways that these scores could be improved. Is more information needed? Is there a unique marketing strategy that would help? Or is there another creative solution?

Most scores can be improved over time. List several options that could raise the scores of the low criteria you identified.

15.5 Presenting the Business Plan
15.5.1 Selecting an Audience for the Presentation

Either during startup phase of a business or over the course of its life, the entrepreneur may need to present an oral version of the business plan to various audiences. It’s important that the entrepreneur has the ability to do so effectively.

Tip

Great care must be used in striking the first deal with an angel because it sets the pattern for subsequent investments. Later changes are nearly impossible.

Entrepreneurs who are passionate about their businesses may wish to present their plan to a chamber of commerce or entrepreneurs’ club. The plan could also be presented to the advisory council to solicit feedback or to family and friends to gain their support. A business plan presentation might be used to recruit the management team, to help orient new employees, or as a part of the strategic planning process.

Funding is another common reason for giving a business plan presentation. The plan might be presented to family members or friends as potential investors or lenders. It could be given to potential angel investor, or a venture capitalist, down the road. It may be fairly easy to gain an audience for a presentation with family and friends. It can be more difficult to do so with angel investors and venture capitalists. Most angel investors are best reached by networking and referrals from the entrepreneur’s
professional advisors, board members, lawyers, and accountants. If one is lucky enough to be referred to an angel investor, the presentation may be one-on-one or to a group.

Venture capitalists may maintain a public presence, but without a referral from a source they trust, it will be difficult to gain an audience with them.

**from real entrepreneurs**

A principal in a venture capital firm, which initially turned down Scott Cook, the founder of Intuit, said venture capitalists make investments when their fear is overcome by greed. Only after Scott obtained a flood of orders were the venture capitalists interested.

### 15.5.2 Developing a Venture Presentation

Putting together a winning presentation is an art. It takes preparation and lots of practice. Most entrepreneurs can present themselves in a professional and convincing manner if they invest the time and effort required.

Addressing an audience of potential investors is very different from selling a product/service to customers. Product/service features and benefits pitched to customers do not necessarily excite investors, who are more interested in money.

Investors are interested in seeing the big picture at the beginning of the venture presentation. They want an engaging story about the venture's profitability, profit margins, management team, product development, size of market, competitive climate, and market niches.

An oral presentation should cover 10 basic areas:

- Company history and background
- Concise product/service description
- Proprietary rights
- Unique features
- Management team
- Market analysis
- Financial picture, cash needs, and how the money will be spent
- Growth and spin-off opportunities
- Potential risks
- Exit strategy for investors to capitalize on their investment

The financial projections should be error free and have well-founded assumptions that explain the projections. Typically, entrepreneurs spend too much time on the technical aspects of the product/service and fail to address how the investor's money will be used and repaid.

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. No matter which method is used, the presenter must be convincing and display leadership ability and passion. These characteristics are crucial to success in raising investor money. Remember, investors bet on the person; the product/service is secondary.

**Tip**

If you have 20 minutes for the presentation, leave 10 minutes for questions and answers, the most important part of the presentation. This time allows presenters the opportunity to build rapport with potential investors and establish the credibility of the management team. Anticipate questions and prepare responses.
More Info
Better Beginnings—Getting ready to do your first presentation? A good beginning leads to a happy ending. An experienced speaker and writer provides entertaining and useful advice on why your business presentations should open with a spark instead of a spreadsheet.

headrush.typepad.com/creating_passionate_users/2006/10/better_beginnin.html

from real entrepreneurs

One entrepreneur who was extremely successful in raising money in the early stages of his business start-up, always took his business plan presentation “off Broadway” before meeting with the big money sources. He first gave his presentation to smaller investors in outlying areas as a way to hone his presentation skills and anticipate the questions investors would ask. He was then well prepared to give his presentation to investors he had identified as potential key players.

15.5.3 Using Visual Aids

Entrepreneurs should include visual aids in their presentations. The visuals should stimulate interest and accentuate key points.

When presenting with audio visuals, entrepreneurs should guard against talking to the screen, computer, or overhead projector. The audience should receive consistent attention. A good presenter makes each listener feel involved. Eye contact with each person for a couple of seconds increases each listener’s sense of importance.

Visual information should not be repeated word-for-word in the presentation. The audience is already reading this information and may be insulted by having it read to them. The information displayed should be used to highlight key points concerning the business plan.

The following audio visual tips will make your presentation more effective:

- Make sure visuals can be seen from the back of the room.
- Do not put too much information on visual aids.
- Present only one key idea per visual.
- Add color carefully with no more than three or four colors per visual.
- Use no more than two different typefaces and a 30-point or larger font size.

More Info
Presentation Tips—Includes many helpful tips on creating a clear, persuasive business plan presentation. The tips follow this section.

Rule of Thumb, Make sure your message is loud and clear by following the 10/20/30 rule of PowerPoint. Guy Kawasaki entrepreneur.com/magazine/entrepreneur/2008/may/192718.html

Presentation Secrets of Steve Jobs, Carmine Gallo (Book)
Presenting to Win: The Art of Telling Your Story, Jerry Weissman.
Planning the Entrepreneurial Venture
Presentation Tips

VENTURE PRESENTATION CHECKLIST

1. Introduction
   - Introduce the venture team.
   - Briefly highlight the team expertise.
   - Start by explaining what problem the venture is solving.
   - Identify potential risks.

Tips
   - Exhibit smooth transitions between each team member’s presentation.
   - Display the venture team’s leadership skills.

2. Audio/visual
   - Use PowerPoint® (or similar software).
   - Incorporate video and sound if possible.
   - Use taped testimonials and sound bites.
   - Use music with the transitions.
   - Include any photos of the company, product, and so on. Have sample brochures and business cards.

Tips
   - If using overheads, do not “talk” to the screen.
   - Have backup overheads/video (in case of equipment failure).
   - Expand on key points; do not repeat what is written on the visuals.

3. Presentation
   - Demonstrate the team’s understanding of launching this venture.
   - Use stories when talking about the venture.
   - Address how long it will take before the venture becomes profitable.
   - Cover investor payback issues.
   - Explain when the venture will break even.
   - Explain what the investors’ money will be used for.
   - Focus on the competitive advantage of the venture.
   - Prove that the venture has a competitive advantage.
   - Use potential customer testimonials and letters of intent.

Tips
   - Exhibit interaction among team members.
   - Display lots of enthusiasm.
   - Focus your eyes on the audience.

4. Summary
   - Be direct when answering questions.
   - Identify a “leader” to field questions or redirect.
   - Show how the management team works together.
   - Close with a sizzle (not a fizzle).
   - Thank the audience for the opportunity to present the venture.

5. Key success factors
   - Explain why the venture will succeed.
   - Highlight the tested product.
   - Show success of the prototype.
   - Demonstrate the competitive advantage of the product.
   - Prove the venture has customers.
   - Explain target market.
   - Identify competitors.
   - Explain pricing.
   - Outline legal structure.
   - Mention operational controls in place.
   - Forecast growth strategies.

Key points
   - Do not use notes if you are comfortable without them.
   - Stay on time.
15.6 Determining Next Steps
15.6.1 Identifying Next Steps to Take

At this point in the process entrepreneurs must decide whether to start their planned business or pursue something else. Entrepreneurs must ask themselves the following questions:

- Did I prove a market will buy my product/service?
- Did I establish a reasonable expectation that the business will be profitable?
- Did I find solutions to reduce or eliminate the problems identified?
- Will this business get me where I want to go?
- Am I ready to commit to further planning and hard work?

**Reality**

Most statistics show that 40 percent of new business start-ups fail within the first year. Most of these businesses should never have been started in the first place. Smart entrepreneurs walk away from business concepts that are not feasible.

**from real entrepreneurs**

One young man planned to start a music store that not only sold music but also rented music CD’s to customers as well. He felt that offering CD rentals would be his competitive advantage in the marketplace. While writing his business plan, research revealed legal issues associated with renting CD’s. He chose not to rethink his entire concept and opened the music story anyway; however, he dropped the idea of CD rentals. Without a unique product/service, the competition was too stiff and the store failed within two years.

15.6.2 Starting the Business

No one but the entrepreneur can answer these questions.

Starting a business will take you on an incredible journey. The business plan serves as the road map. At times, entrepreneurs will be able to follow the business plan exactly. Other times, they will need to adjust the plan to fit the current or anticipated future environment. Throughout this journey, entrepreneurs should celebrate their successes and learn from their mistakes.

As you may have guessed by now, business planning is never fully completed. Every aspect of your business requires monitoring, adjusting, and revisiting through its life. But for now, you are ready to celebrate the accomplishments of this first round of the business planning process.

Once in business, periodically check your progress against your business plan. Dedicating time to planning lets entrepreneurs work ON their business, not just IN it.

Before starting the business, you will need to revisit some of the critical steps outlined in your plan. For example, you will need to know the exact amount of money needed and the most likely source. You will need to uncover answers to legal issues, such as structuring the business, proprietary rights, and contracts. You will also need to build the infrastructure of people that will help make your business successful. These people may include attorneys, accountants, consultants, and bankers.

Starting a business takes commitment; however, the benefits are limitless.
More Info
Starting a business
sba.gov/category/navigation-structure/starting-managing-business/starting-business

Avoiding Pitfalls
When starting a business, realize that others have been on the same path before you and their experiences can help you as you make decisions each day. Also remember the top reasons business fail, identified in section 14.1.1. Go back and review these reasons, and then consider these additional risk factors to help you avoid pitfalls as you proceed with your business start-up:

Business Plan. One of the biggest pitfalls is running the business without a plan. Without one, the business is run by default—whatever happens each day becomes the plan.

Sharing the Plan. Another pitfall is that entrepreneurs may never implement their plans. Whether the plan is on paper or in their heads, sharing it with others in the business is essential.

Process Standardization. Many small businesses do not develop processes to standardize systems, quality, costs, and customer service. When entrepreneurs take the time to develop and communicate the way processes should be done, the results will likely be profits, customer satisfaction, and high employee morale.

Documentation. A business can be the most substantial investment an entrepreneur has. But if the entrepreneur never documents its functions, processes, and operational procedures, it will be difficult to harvest the value of their investment.

Revenue versus investment. The entrepreneurs’ mindset and view of the business can make a big impact on how they build and run their business. If they view it as a revenue stream, they may be driven by immediate cash and the next sale.

Key Measurements. Not monitoring key success measurements makes it difficult to determine how a business is doing annually or even monthly. Key measurements can quickly reveal the financial condition of the business.

Duties. As a business grows, it requires additional staff. Every day businesses add staff without written job descriptions or performance standards. Business would operate much more smoothly if employees clearly understood what was expected of them.

Team. A management team works best when it is made up of people with complementary styles and skills. The entrepreneur needs to take the time to understand what each team member has to offer and encourage communication and teamwork.

More Info
The 6 Biggest Mistakes in Raising Startup Capital, Avoid these traps to increase your chances of securing funding and keeping investors happy.
entrepreneur.com/startingabusiness/startupbasics/startupbasicscolumnistbradsugars/article184350.html

Next Steps—Includes a comprehensive list of steps entrepreneurs should take to get their business started. The steps follow this section.
Exercise 15.6.2: Identifying Next Steps

Learning Objective

• Identify the steps necessary to start your business after writing the plan.

Overview

Your business plan is complete. What’s next? This exercise will provide a checklist you can use to determine the next steps to turn your dream of starting a business into a reality.

Instructions

Review the checklist provided. Identify the items that need to be done with an “X” next to the item. It may help to place the items on a time line so that the tasks that may take longer get started first.
Exercise 15.6.2: Identifying Next Steps

<table>
<thead>
<tr>
<th>NEXT STEPS CHECKLIST</th>
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<tbody>
<tr>
<td>Select a location — Evaluate costs, lease terms, location's ability to attract target market, etc., with outside advisors.</td>
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<tr>
<td>Leasehold Improvements — Arrange for improvements to be made to the business location.</td>
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<tr>
<td>Prepare the location — Determine the furniture and fixtures necessary to establish the physical location.</td>
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<tr>
<td>Establish the office — Determine your needs for administration and set up your office.</td>
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<tr>
<td>Business name — Have the business name(s) evaluated by outside advisors for proprietary protection.</td>
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<tr>
<td>Register the business — Comply with the regulations within the city, county, state, and federal government to register your type of business.</td>
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<tr>
<td>Begin networking — Join local clubs and organizations that will help you market and operate your business.</td>
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<tr>
<td>Establish advisory group — Contact professional advisors to give you entrepreneurial advice.</td>
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<tr>
<td>Select professional consultants — Interview and select outside consultants to provide professional services.</td>
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<tr>
<td>Meet with insurance agents — Based on advice from legal counsel and insurance agents, secure adequate insurance to protect you and your business.</td>
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<tr>
<td>Talk with bankers — Whether you need financing right now or not, begin talking with bankers about your business plans.</td>
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<tr>
<td>Establish accounts at banks — Set up your business checking account, merchant’s account and other accounts as needed.</td>
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<tr>
<td>Learn more about business — Take classes and seminars to improve your entrepreneurial and management skills.</td>
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<tr>
<td>Set up a record-keeping system — Have accountant advise you on a bookkeeping system.</td>
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<tr>
<td>Design materials — Talk with promotional designers to establish printed materials for the market penetration plan.</td>
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<tr>
<td>Job descriptions — Write job descriptions for all positions in the company.</td>
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<tr>
<td>Recruit/hire employees — Using the job descriptions, recruit and hire the right people to fill the positions in the company.</td>
</tr>
<tr>
<td>Develop training — Establish a training program for all new employees to communicate the vision of the company, provide excellent customer service, and perform the specific tasks necessary.</td>
</tr>
<tr>
<td>Website — Determine if you need a Web site, and if so, your goals for the Website, who will develop it, your domain name and registration, and your web hosting company.</td>
</tr>
<tr>
<td>Inventory — Prepare for opening day by purchasing inventory.</td>
</tr>
<tr>
<td>Do it! — Implement your plan. It’s time to begin the entrepreneurial journey!</td>
</tr>
</tbody>
</table>
15.6.3 Pursuing Something Else

Studying a business concept that, upon closer examination, proves not to be a good risk makes the entrepreneur no less successful. If that is the case, you may choose to consider several options including:

- Identifying and researching a new business idea
- Obtaining more education
- Improving one’s own personal financial situation
- Getting a job in the industry to learn more about it before starting a business

If the business planning process helps you determine that your business idea is not a good one in advance of starting the business, you are fortunate. You have saved valuable resources—the time and money that would otherwise have been invested in the business. Now, you can apply the planning process to another business idea.

If you decide business ownership is not for you, your newly developed planning skills can make you a more attractive employee in the workplace. Most organizations need people with entrepreneurial skills who can analyze and evaluate business opportunities.

The planning process learned throughout this course is a valuable skill that you will use time and time again.

Summary

In this chapter, you learned how to complete the various elements of your business plan Moving toward completion included the following key points:

- The cover page provides the first impression the reader has of the entrepreneur as well as basic contact information.
- The table of contents helps readers locate key sections easily.
- The executive summary provides a brief overview of the business.
- The appendix includes the supporting documents for much of the research and many of the forecasts made in the business plan.
- The audience should be identified prior to preparing the written or oral plan’s presentation.
- A checklist can be used to evaluate the plan for completeness and accuracy.
- Having the plan critiqued by a trusted mentor and a spelling and grammar expert is essential.
- Comparing the completed plan with your own personal vision and with a model business can help you decide which steps to take next.
- If you decide not to start the business, you have saved the time and money that would have been invested in this business. You can apply your new planning process skills in your role as an employee or to another business idea.
- If you decide to start your business, you can periodically check your progress against your plan and adjust your plan and business accordingly. Your planning skills are just as important in running your business as they are in getting it started.