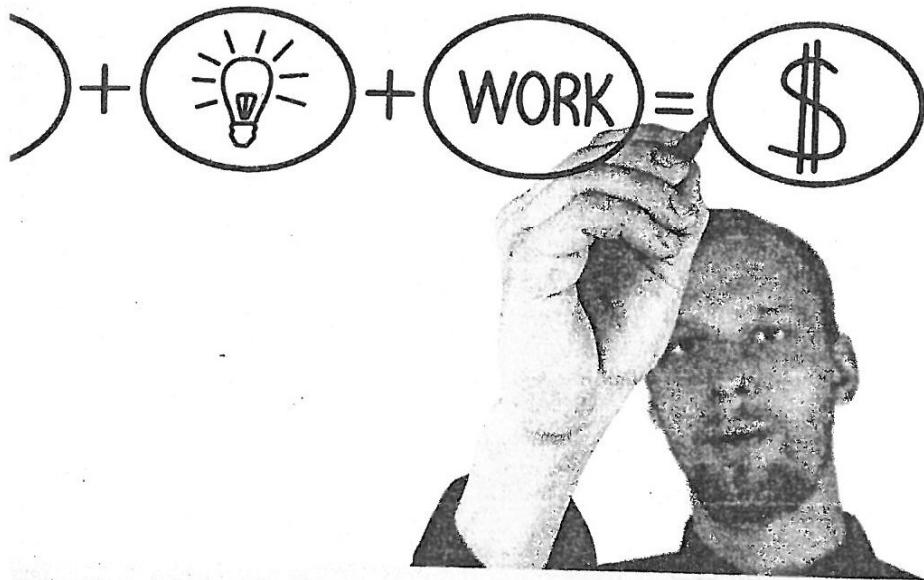


# 4

## SECTION II The Entrepreneurial Journey Begins

### Conducting a Feasibility Analysis and Designing a Business Model

#### BUSINESS PLAN



Thomas Kuijansuu/Getty Images, Inc.

#### Learning Objectives

On completion of this chapter, you will be able to:

1. Describe the process of conducting an idea assessment.
2. Explain the elements of a feasibility analysis.
3. Describe the six forces in the macro environment of an industry.
4. Understand how Porter's Five Forces Model assesses the competitive environment.
5. Describe the various methods of conducting primary and secondary market research.
6. Understand the four major elements of a financial feasibility analysis.
7. Describe the process of assessing entrepreneur feasibility.
8. Describe the nine elements of a business model.



For many entrepreneurs, the easiest part of launching a business is coming up with an idea for a new business concept or approach. Business success, however, requires much more than just a great new idea. In addition to coming up with a business idea and launching a business, five critical steps guide the process of going from idea generation to growing a successful business. Together these steps make up the new business planning process. Following these steps increases the entrepreneur's chances for launching a successful and sustainable business.

### **idea assessment**

the process of examining a need in the market, developing a solution for that need, and determining the entrepreneur's ability to successfully turn the idea into a business.

Once entrepreneurs develop ideas for new businesses, the next step is to assess these ideas. An idea assessment is the process of examining a need in the market, developing a solution for that need, and determining the entrepreneur's ability to successfully turn the idea into a business. The best business ideas start with a group of customers with a common problem or need. Successful entrepreneurs learn to apply the creative processes discussed in Chapter 3 to find solutions for these customers. Entrepreneurs often identify multiple possible business ideas for any given market need. The idea assessment process helps an entrepreneur more efficiently and effectively examine multiple ideas to identify the solution with the most potential. Examining multiple business ideas ensures that the entrepreneur does not lock in on a single idea and overlook others that have an even greater chance for success.

After identifying the most promising idea using the idea assessment process, the entrepreneur subjects it to a feasibility analysis to determine whether they can transform the idea into a viable business. A *feasibility analysis* is the process of determining whether an entrepreneur's idea is a viable foundation for creating a successful business. Its purpose is to determine whether a business idea is worth pursuing. A feasibility study answers the question, "Should we proceed with this business idea?" Its role is to serve as a filter, screening out ideas that lack the potential for building a successful business, before an entrepreneur commits the necessary resources to develop and test a business model or to build a business plan. A feasibility study primarily is an investigative tool. It is designed to give an entrepreneur a picture of the market and the sales and profit potential of a particular business idea. Will a ski resort located here attract enough customers to be successful? Will customers in this community support a sandwich shop with a retro rock-n-roll theme? Can we build the product at a reasonable cost and sell it at a price customers are willing and able to pay? Does this entrepreneurial team have the ability to implement the idea successfully?

If the idea passes the feasibility analysis, the entrepreneur moves on to the next steps of the new business planning process. If the idea fails to pass muster, the entrepreneur drops it and moves on to the next idea. He or she has not wasted valuable time, money, energy, and other resources building a plan for launching a business that is destined to fail because it is based on a flawed concept. Although it is impossible for a feasibility study to guarantee an idea's success, conducting a study reduces the likelihood that entrepreneurs will waste their time pursuing fruitless business ventures.

The business model answers the question, "How would we proceed with this business idea?" Developing a business model, which is the third step in planning a new business, helps the entrepreneur to fully understand all that will be required to launch and build the business. Business modeling is another step that determines the potential for success for the new venture. It is a visual process that examines how all the moving parts of the business must work together to build a successful venture. It is the step in the planning process in which the entrepreneur tests the concept and uses what it learned from real customers to refine the business model before the entrepreneur commits the resources to grow the business to its full potential.

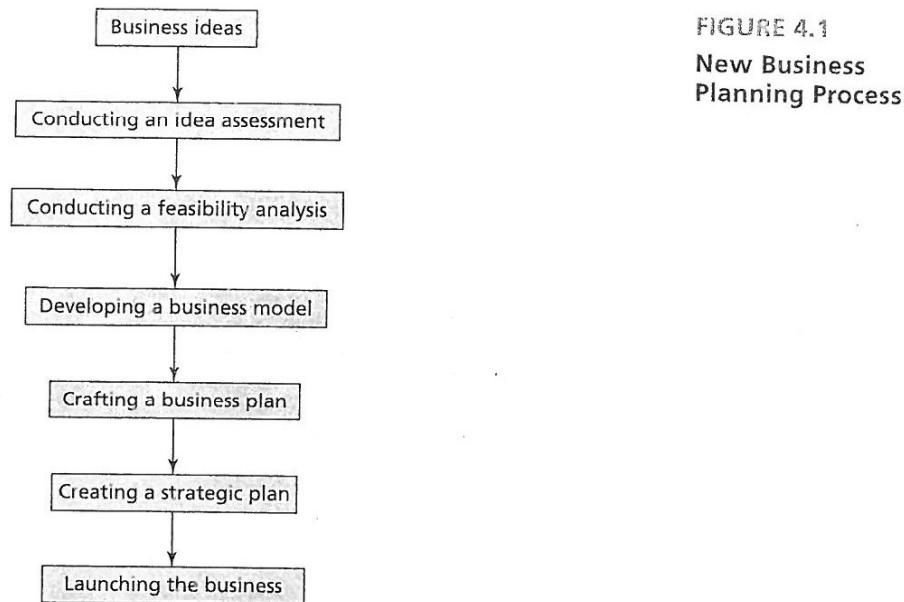
The idea assessment, feasibility study, business model, business plan, and strategic plan all play important but separate roles in the start-up and growth of an entrepreneurial venture (see Figure 4.1). This chapter describes the idea assessment, feasibility study, and business model development. Chapter 5 examines how to craft a business plan to guide the start-up of a new business, as well as the strategic planning process that helps navigate the growth of the business.

### **LO1**

Describe the process of conducting an idea assessment.

## **Idea Assessment**

Successful entrepreneurs understand that the process of going from ideas to the launch of a new business venture is like a funnel. When the entrepreneur observes a need in the market, using the creative process generates many business ideas that might address this need. Each step in the new



**FIGURE 4.1**  
**New Business**  
**Planning Process**

business planning process narrows down the number of ideas until the entrepreneur is ready to launch a business that he or she has carefully researched and tested. An idea assessment helps the entrepreneur efficiently evaluate the numerous ideas that come out of the creative process before committing the time and effort to craft a business plan, design a business model, or even conduct a feasibility analysis. One effective tool used to help assess ideas is the idea sketch pad.<sup>1</sup>

Entrepreneurs too often jump ahead and begin modeling or planning their business ideas. They get excited about the potential they imagine if they launched a business based on the idea. However, most ideas do not become successful businesses. Alex Bruton, developer of the idea sketch pad, says it is human nature to misjudge how unlikely it is for a new business idea to actually become a successful business.<sup>2</sup> Rather than act on a hunch, successful entrepreneurs are disciplined in evaluating each new idea. Because it takes so many ideas to come up with a viable business concept, entrepreneurs must become adept at quickly sorting through all of them.

The idea sketch pad helps an entrepreneur assess ideas in a relatively short period of time. When using the sketch pad, the entrepreneur asks a series of key questions addressing five key parameters (see Figure 4.2).

1. **Customers.** Start with a group of customers who have a clear need that is not being addressed. This may be a need that no business is currently addressing, or it may be a need that no business is fully or adequately meeting for these customers. The entrepreneur assesses the customers by answering basic questions about the potential users of the product or service and the potential buyers if they are different than the users. For instance, for sugary cereals, children are the users and their parents are the buyers. Specifically who would be the users of the offering? How would they use the offering? How many potential customers are there?
2. **Offering.** Describe your idea for a product or service to offer the customers. Are you offering a product, a service, an experience, or a combination of one or more of these? What are its key features? Describe it in detail and sketch out an image of it if you can.
3. **Value proposition.** Explain why your product or service will be important to the customers. Why would your offering be valuable to the user and/or buyer? How does it address the need these customers currently have that is not being met?
4. **Core competencies.** Does your offering include any technologies or unique features that will help differentiate it from competitors? Is it based on intellectual property that you can protect?

### The Really Big Idea Sketch Pad v2.

These are the parameters to change when creating or refining a venture or project idea. Think of it as sketching your idea.

name of this idea: \_\_\_\_\_

Who are the people involved in starting this venture?

What relevant experience do they bring to the table? What specific knowledge do they bring to the table?

#### directions

1. Write the answers to each question on Post-It Notes.
2. Put them on the sketchpad in the marked areas, e.g.
3. If you don't have enough room, then simplify.
4. Assess your idea using the "really big idea critique pad".
5. Repeat and replace Post-Its liberally.

Do you have any core, differentiating competencies, such as a technology or science?

Who is the user or beneficiary?  
How does the user use your offering?

Who is the economic buyer or decision maker?  
How many buyers are there?

Why is the offering important to the user?  
Why is the offering important to the buyer?

What type of offering is envisioned? i.e. commodity, good, service, or experience?  
Name and describe it...  
Sketch it or otherwise help people visualize it ...

### the innographer

To download and print copies of this sketch pad, visit: [www.theinnographer.com/toolkit/really-big-ideas](http://www.theinnographer.com/toolkit/really-big-ideas)

This work is licensed as part of the DIY Innovation Toolkit™ under creative commons: <http://theinnographer.com/privacy-and-terms-of-use/>

**FIGURE 4.2**

### Idea Sketch Pad

*Source:* Dr. Alex Bruton, The Innographer, Ltd., [theinnographer.com/toolkit/idea-modeling](http://theinnographer.com/toolkit/idea-modeling).

5. **People.** Identify the key people on the team who will launch this business. Who are the founding entrepreneurs of this venture? Do they have the skills and knowledge needed to successfully turn the idea into a start-up venture? Can they attract key team members who will fill in any gaps in knowledge, skills, and experience?

By placing the answers to these questions on the sketch pad, entrepreneurs can clearly visualize gaps or weaknesses in their idea. Rather than use the tool to make minor changes in an idea, they



Joseph Rank, [www.cartoonstock.com](http://www.cartoonstock.com)

can find ways to fundamentally change the idea to improve its chances for success in the market before they move ahead and launch a new business.<sup>3</sup> Successful entrepreneurs do not become emotionally attached to ideas. If the idea shows promise based on the idea sketch pad, they move ahead to the next step of conducting a feasibility analysis. If the gaps or weaknesses cannot be easily addressed, entrepreneurs turn to the next idea and assess it using the sketch pad process.

## Feasibility Analysis

After conducting the idea assessment, an entrepreneur scrutinizes the idea further through a feasibility analysis. A feasibility analysis consists of four interrelated components: an industry and market feasibility analysis, a product or service feasibility analysis, a financial feasibility analysis, and an entrepreneur feasibility analysis (see Figure 4.3). Rhonda Abrams, nationally-syndicated columnist, author, and successful entrepreneur, says that feasibility analysis is an opportunity to take a hard look at your idea to see whether it needs minor or major pivots, or if warranted, to be completely abandoned so you can move on to another idea.<sup>4</sup>

When evaluating the feasibility of a business idea, an analysis of the industry and targeted market segments serves as the starting point for the remaining three components of a feasibility analysis. The focus in this phase is two-fold: (1) To determine how attractive an industry is overall as a “home” for a new business and (2) to evaluate possible niches a small business can occupy profitably. When examining an industry, an entrepreneur should examine both the macro environment that can have an impact across many industries and the specific competitive environment of the industry of interest (see Figure 4.4).

## Industry and Market Feasibility

The first step in assessing industry attractiveness is to paint a picture of the industry in broad strokes, assessing it from a “macro” level. Most opportunities for new businesses within an industry are due to changes taking place in that industry. Foundational macro forces shape industries and the markets they serve. Changes in any of these macro forces can dramatically change the competitive nature of an industry and fundamentally change the needs and wants in its target market. Entrepreneurs must be vigilant when monitoring macro forces. Changes in macro forces may have created the initial opportunity the entrepreneur pursued when launching the business, and change will likely continue. If the entrepreneur does not adapt the business to meet the changes these macro forces create in the industry and market, even the most innovative new business may become outdated and left behind in the competitive landscape.

LO2

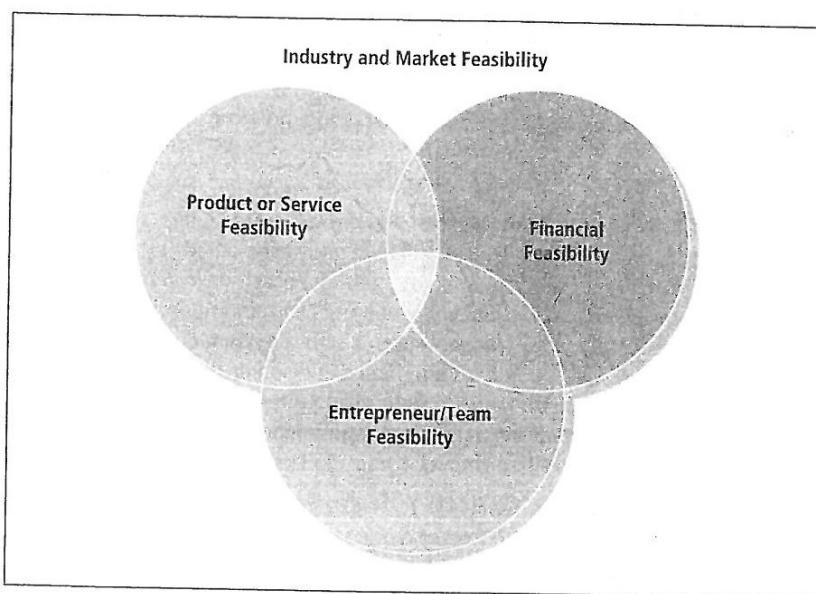
Explain the elements of a feasibility analysis.

**feasibility analysis**

an analysis of the viability of a business idea that includes four interrelated components: an industry and market analysis, the product or service analysis, a financial analysis, and an entrepreneur analysis.

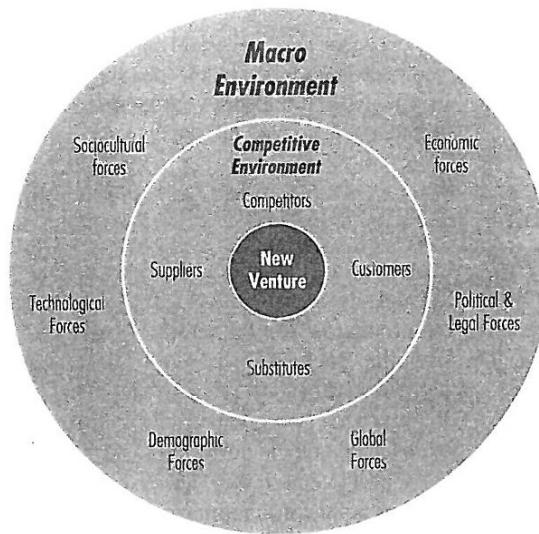
LO3

Describe the six forces in the macro environment of an industry.



**FIGURE 4.3**  
**Elements of a Feasibility Analysis**

**FIGURE 4.4**  
**Environmental Forces and New Ventures**



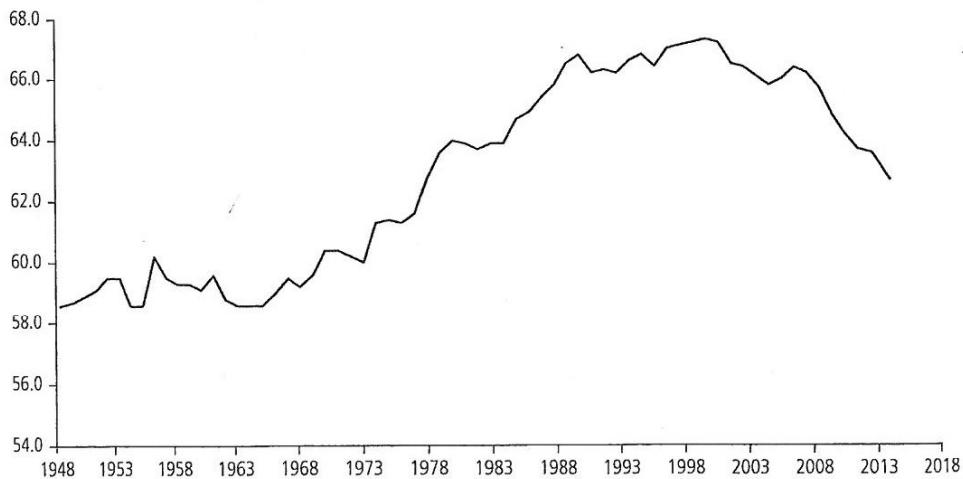
Six foundational macro forces create change in industries and the markets they serve:

1. **Sociocultural.** Social and cultural change can lead to dramatic changes that can create whole new industries and fundamentally transform existing industries. For example, in the 1970s and 1980s women began entering the workforce at much higher rates than had been the case previously. This change was a result of the women's movement of the 1960s. Figure 4.5 displays the dramatic increase in the size of the American workforce that resulted from this cultural change. Not only did more women enter the workforce, but they also had career aspirations to compete for jobs that previously had been dominated by male workers. This cultural change led to the birth of the daycare industry. It also resulted in a new segment within the women's fashion industry for women's business attire. It led to rapid growth in the restaurant industry as families began eating in restaurants much more frequently than previous generations and to a growth period for the auto industry as the percentage of families with two cars doubled from 1960 to 2011.<sup>5</sup>

**Technological.** Technological breakthroughs lead to the development of new products and entirely new industries. For example, the Internet is a technology that has had a profound impact on many industries. Before the Internet age, a few large companies dominated the music industry. The Internet led to the creation of many new businesses within the music industry, including Pandora, Spotify, and Apple's iTunes, which changed

**FIGURE 4.5**  
**American Labor Force Participation Rate**

*Source:* Labor Force Statistics from the Current Population Survey, U.S. Department of Labor, November 14, 2013, <http://data.bls.gov/timeseries/LNS11300000>



how customers buy and listen to music. The Internet also changed how people consume information. As the news became available online, there was a dramatic decrease in the number of people reading print newspapers. As result, advertising revenues have plummeted for print newspapers, while online newspapers have experienced steady growth in advertising.

**ENTREPRENEURIAL PROFILE: Hill Kemp and Suns River**

The world's limited water supply is a growing concern. Hill Kemp, founder and CEO of Suns River, is using solar technology to help turn poor quality water into safe, distilled water. The device is a solar still that purifies even the saltiest water into safe, clean water. Although technology is not new, Kemp's process is much more efficient. Using Suns River technology, a family can convert 80 percent of brackish water into distilled water. What is left is a block of salt. Each Suns River unit can supply a family of four with all the clean water they need. Kemp is targeting his product for coastal desert areas that would benefit from an affordable means to generate clean water. Suns River systems sell for \$3,000 to \$5,000. Kemp plans to expand the Suns River product line to include solar stills that can produce enough water to use for agricultural greenhouses.<sup>6</sup> ■

2. **Demographic.** Changing demographics create opportunities for entrepreneurs. For example, as Generation Y (those born during the 1980s to early 1990s) reaches adulthood, businesses will begin to pay attention to the next generation, Generation Z. Although Generation Y is optimistic and idealistic, those who are part of Generation Z (those born between the mid-1990s to about 2013) are much more realistic. School violence and the Great Recession (which began in 2008) have shaped their lives. Generation Z is more realistic in how they view the world. Because they have watched their parents' generation struggle with prolonged unemployment and economic uncertainty, they intend to be careful with their money. Those in Generation Z will seek products and services that offer value. In a survey of members of Generation Z conducted by the Intelligence Group, 57 percent said they would rather save money than spend it!<sup>7</sup>

**ENTREPRENEURIAL PROFILE: Jason Greenspan**

**and Silver Stars Fitness** Jason Greenspan targets a different market than most fitness clubs. Rather than cater to young working professionals, Greenspan's Silver Stars Fitness located in New York City is specifically designed for the fitness needs of baby boomers. Silver Stars Fitness offers classes such as Mature Boot Camp for basic strength and cardiovascular workouts, Burn Baby Burn that targets fat loss, Balance and Fall Prevention, Zumba Silver, Central Park Walking, Arthritis Soothing, and Osteoporosis Bone Blast. Silver Stars offers smaller classes that are all held during the middle of the day to make them most convenient for retired baby boomers. Greenspan plans to expand to more locations to keep up with the growing population of retired baby boomers.<sup>8</sup> ■

3. **Economic.** Although many companies struggle during economic downturns, some businesses are able to grow. For example, businesses in the e-learning industry thrived during the Great Recession. Web-based learning provides customers with opportunities to improve their education and skills at an affordable price. Given the highly competitive job market during a recession, additional knowledge and skills offer job seekers a competitive advantage when applying for a new position. However, those who were unemployed or afraid of becoming unemployed were unwilling to pay the growing cost of tuition for traditional educational programs. Companies that provide high quality Web-based e-learning at a fraction of the cost of traditional university-based education filled this gap in the market.
4. **Political and legal.** The enactment of new legislation creates opportunities for entrepreneurs. For example, when the Affordable Health Care Act (also known as ObamaCare)



Silver Star Fitness

how customers buy and listen to music. The Internet also changed how people consume information. As the news became available online, there was a dramatic decrease in the number of people reading print newspapers. As a result, advertising revenues have plummeted for print newspapers, while online newspapers have experienced steady growth in advertising.



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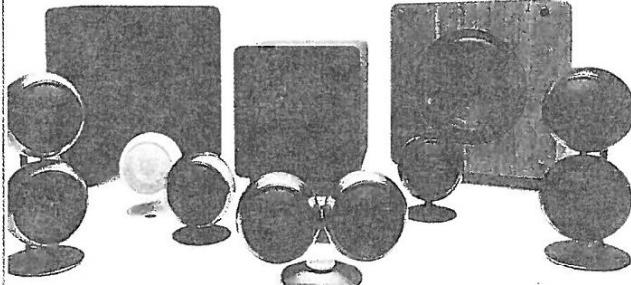


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was passed in 2010, entrepreneurs recognized that the legislation created a complex array of new requirements for healthcare companies. Because of this legislation, payment for healthcare is shifting from fee-for-service (healthcare providers are paid a set amount for each procedure or service they provide) to a system based on pay-for-performance. In a pay-for-performance system, insurance companies reward healthcare providers and hospitals for initiatives that improve the quality, efficiency, and overall value of health care. Because pay-for-performance is new to healthcare, savvy entrepreneurs are creating new companies that help healthcare providers and hospitals to track and report performance-related metrics based on the value of the healthcare they provide, measure and improve quality of healthcare outcomes, and enhance efficiency in their healthcare delivery systems.

5. *Global.* Global trends create opportunities for even the smallest of companies. More open global markets allow businesses to seek customers and suppliers from all corners of the world.



Ethan Siegl, Orb Audio LLC



#### ENTREPRENEURIAL PROFILE: Ethan Siegel and Orb Audio

Orb Audio, headquartered in New York City, manufactures high-end speakers for home theater systems from its factory in Sherman Oaks, California. Rather than sell through traditional retail outlets, Orb Audio sells directly to the customer through its Web site. When the dollar weakened against other currencies in 2008, cofounder Ethan Siegel noticed a sharp increase in orders from international markets. The weak dollar made American-made goods more attractive to international customers whose buying power improved with the declining dollar. Siegel started running Internet advertisements aimed at consumers in the markets where most of the increase in international sales were coming from, including Great Britain, Canada, Finland, and Australia. Global sales for Orb Audio now comprise 35 percent of sales. Finland alone accounts for

10 percent of total sales for Orb Audio. Although domestic sales for Orb Audio have declined since 2008, total revenue continues to grow due to the expansion of international sales for this small manufacturer.<sup>9</sup>

While evaluating the six foundational macro trends, entrepreneurs should answer the following questions to help further evaluate the attractiveness of that industry in light of the impact of the macro forces for change:

- How large is the industry?
- How fast is it growing?
- Is the industry as a whole profitable?
- Is the industry characterized by high profit margins or razor-thin margins?
- How essential are its products or services to customers?
- What trends are shaping the industry's future?
- What threats does the industry face?
- What opportunities does the industry face?
- How crowded is the industry?
- How intense is the level of competition in the industry?
- Is the industry young, mature, or somewhere in between?

Addressing these questions helps entrepreneurs determine whether the potential for sufficient demand for their products and services exist.

#### LO4

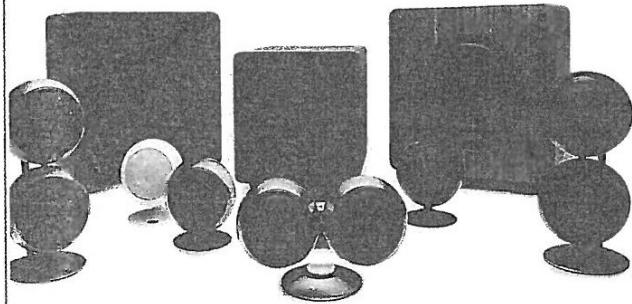
Understand how Porter's Five Forces Model assesses the competitive environment.

### Porter's Five Forces Model

After evaluating the broader macro environment, the entrepreneur changes focus to the more immediate competitive environment. A useful tool for analyzing a specific industry's attractiveness within the competitive environment is the Five Forces Model developed by Michael Porter

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#### **LO4**

Understand how Porter's Five Forces Model assesses the competitive environment.

### **Porter's Five Forces Model**

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## Hands On . . . How To

### Forces Shaping Innovation: The Driverless Car

Driverless cars have been the stuff of science fiction for several decades. As a result of several recent technological breakthroughs, a fully functional driverless car may soon become possible. However, all of the macro forces shaping the automobile industry must come into alignment for the driverless car to become a true market opportunity.

**Sociocultural environment.** For generations, the automobile has been enmeshed within the American culture. While other countries developed advanced mass transit systems, Americans stayed loyal to their cars and the freedom they offered to allow them to drive when, where, and how they wanted to. However, research from KPMG suggests that there may be a change in consumer attitudes. People are growing weary of ever-longer and more congested commutes. The KPMG study finds that Americans would enthusiastically demand driverless cars if they offered the promise of cheaper and quicker commutes *and* if the cars still allowed people to turn off the driverless feature for pleasure driving. A survey conducted by CarInsurance.com found that 20 percent of drivers would "hand over the keys tomorrow" if a safe, driverless car were available for consumers to purchase. Ninety percent of those surveyed would consider a driverless car if it could bring down insurance costs.

**Technological environment.** Due to advances in sensors, microcontrollers, GPS, radar, lasers, and cameras, the technological feasibility for a driverless car has advanced quickly in recent years. Traditional automobile companies, including Nissan, General Motors, and Lexus, all have driverless car technologies under development. Google is a leader in the development of technology to enable driverless cars. Google has logged hundreds of thousands of miles of testing for its driverless technology with no reported safety issues. In addition, upstart electric car company Tesla is developing an auto-pilot system it plans to offer with its cars by 2020.

**Demographic environment.** As baby boomers age, driverless car technologies offer this generation the promise of continued autonomy even after they reach the age that is no longer safe for them to drive.

**Economic environment.** With continuing concerns about the cost and supply of energy, driverless cars may offer significant fuel savings. Computers in the driverless cars will

be able to determine the most direct route with least traffic congestion and will drive at controlled speeds, all of which will improve fuel consumption for every car on the road.

**Political/legal environment.** Although the other macro forces all seem to favor the emergence of a market for driverless cars, the political and legal environment is not all favorable. Toyota has been fighting multiple lawsuits for several years that are tied to allegations that its cars are prone to unintended acceleration. The complaints allege that the cars would unexpectedly begin to accelerate under various conditions, and that these accelerations led to numerous accidents. A main cause of the problems may be in the software in the computers that control all modern automobiles. In a pivotal case in Oklahoma, Toyota has been put in a position where it must prove that its software *does not* have any bugs that may have caused the unexpected acceleration events. If this case goes against Toyota, auto makers can assume that they must be prepared to demonstrate that any critical software system that controls the operation of a car must be free of any bugs under any and all possible circumstances. Some legal experts believe this seemingly impossible standard leaves auto companies no choice but to shelve any products with software that directs the operation of the vehicle.

1. What changes in the macro environmental forces are shaping the feasibility of the driverless car?
2. If you were an executive at an automobile company, would you pursue your own model of a driverless car? Why or why not?
3. What other opportunities for new businesses can you envision that may result from the introduction of the driverless car into the market?

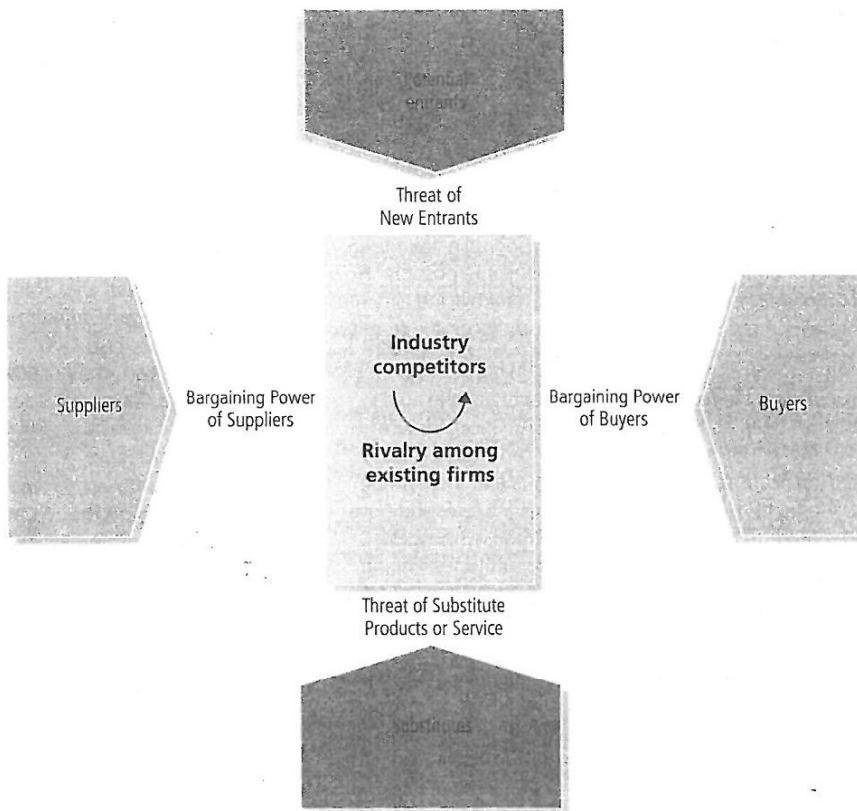
*Based on:* "Self-driving Cars: Are We Ready?" KPMG, 2013, [www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/self-driving-cars-are-we-ready.pdf](http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/self-driving-cars-are-we-ready.pdf); Mark Vallet, "Survey: Drivers ready to trust robot cars?", *CarInsurance.com*, November 1, 2013, [www.carinsurance.com/Articles/autonomous-cars-ready.aspx](http://www.carinsurance.com/Articles/autonomous-cars-ready.aspx); Christina DesMarais, "Driverless cars: Tesla, Google, Nissan and Others Shift Gears," *GreenBiz.com*, November 19, 2013, [www.greenbiz.com/blog/2013/11/19/driverless-cars-tesla-google-nissan-shift-gear?mkt\\_tok=3RkMMJWWF9wsRoluK7NZKXnjHpfX56u4rUa63IMI%2F0ER3fOvrPUfGjI4CTMtqI%2BSLDwEYGJlv6SgFSLHEMa5qw7gMXRQ%63D](http://www.greenbiz.com/blog/2013/11/19/driverless-cars-tesla-google-nissan-shift-gear?mkt_tok=3RkMMJWWF9wsRoluK7NZKXnjHpfX56u4rUa63IMI%2F0ER3fOvrPUfGjI4CTMtqI%2BSLDwEYGJlv6SgFSLHEMa5qw7gMXRQ%63D); Holman W. Jenkins, Jr., "Will Tort Law Kill Driverless Cars?", *Wall Street Journal*, December 17, 2013, <http://online.wsj.com/news/articles/SB10001424052702304403804579264261779925166>.

of the Harvard Business School (see Figure 4.6). Five forces interact with one another to determine the setting in which companies compete and hence the attractiveness of the industry: (1) the rivalry among competing firms, (2) the bargaining power of suppliers, (3) the bargaining power of buyers, (4) the threat of new entrants, and (5) the threat of substitute products or services.

**Rivalry among companies competing in the industry.** The strongest of the five forces in most industries is the rivalry that exists among the businesses competing in a particular

**FIGURE 4.6**  
**Five Forces Model  
of Competition**

*Source:* Adapted from Michael E. Porter, "How Competitive Forces Shape Strategy," *Harvard Business Review* 57, no. 2 (March-April 1979): 137–145.



market. Much like the horses running in the Kentucky Derby, businesses in a market are jockeying for position in an attempt to gain a competitive advantage. When a company creates an innovation or develops a unique strategy that transforms the market, competing companies must adapt or run the risk of being forced out of business. This force makes markets a dynamic and highly competitive place. Generally, an industry is more attractive when:

- The number of competitors is large or, at the other extreme, quite small (fewer than five).
- Competitors are not similar in size or capability.
- The industry is growing at a fast pace.
- The opportunity to sell a differentiated product or service is present.

**Bargaining power of suppliers to the industry.** The greater the leverage suppliers of key raw materials or components have, the less attractive is the industry. For instance, Under Armour, which is in the athletic footwear and apparel industry, has agreements with 27 manufacturers in 14 countries. Its top 10 suppliers manufacture less than half of its products. Because of its diversity in suppliers, Under Armour has a favorable bargaining position with them. It is not dependent on any one or even a small group of its suppliers.<sup>10</sup> Generally, an industry is more attractive when:

- Many suppliers sell a commodity product to the companies in it.
- Substitute products are available for the items suppliers provide.
- Companies in the industry find it easy to switch from one supplier to another or to substitute products (i.e., "switching costs" are low).
- The items suppliers provide the industry account for a relatively small portion of the cost of the industry's finished products.

**Bargaining power of buyers.** Just as suppliers to an industry can be a source of pressure, buyers also have the potential to exert significant power over businesses, making it less attractive. When the number of customers is small and the cost of switching to competitors'

products is low, buyers' influence on companies is high. Famous for offering its customers low prices, Wal-Mart, the largest retailer in the world, is also well known for applying relentless pressure to its 21,000 suppliers for price concessions, which it almost always manages to get.<sup>11</sup> Generally, an industry is more attractive when:

- Industry customers' "switching costs" to competitors' products or to substitutes are relatively high.
- The number of buyers in the industry is large.
- Customers demand products that are differentiated rather than purchase commodity products they can obtain from any supplier (and subsequently can pit one company against another to drive down price).
- Customers find it difficult to gather information on suppliers' costs, prices, and product features—something that is becoming much easier for customers in many industries to do by using the Internet.
- The items companies sell to the industry account for a relatively small portion of the cost of their customers' finished products.

*Threat of new entrants to the industry.* The larger the pool of potential new entrants to an industry, the greater is the threat to existing companies in it. This is particularly true in industries where the barriers to entry, such as capital requirements, specialized knowledge, access to distribution channels, and others are low. Generally, an industry is more attractive to new entrants when:

- The advantages of economies of scale are absent. Economies of scale exist when companies in an industry achieve low average costs by producing huge volumes of items (e.g., computer chips).
- Capital requirements to enter the industry are low.
- Cost advantages are not related to company size.
- Buyers are not extremely brand-loyal, making it easier for new entrants to the industry to draw customers away from existing businesses.
- Governments, through their regulatory and international trade policies, do not restrict new companies from entering the industry.



#### ENTREPRENEURIAL PROFILE: Jesse Parker and John Montague and Aspire

**Beverages** The market for sports drinks has been dominated by two major brands, Gatorade and PowerAde. However, new competitors are entering the market due to growing concern that the major brands contain high-fructose corn syrup, artificial coloring, and other unhealthy ingredients. Jesse Parker and John Montague, two self-described hockey dads, launched Aspire Beverages to compete in this well-established market with a healthier alternative. As parents, they were concerned about the unhealthy ingredients their children were consuming with the sports drinks they drank. The Minneapolis-based company promotes its drinks as having no artificial sugars, artificial colors, or artificial flavors. Distribution of Aspire is through traditional retail outlets such as grocery stores, so it is competing for shelf space with the major national brands.<sup>12</sup> ■

*Threat of substitute products or services.* Substitute products or services can turn an entire industry on its head. For instance, many makers of glass bottles have closed their doors in recent years as their customers—from soft drink bottlers to ketchup makers—have switched to plastic containers, which are lighter, less expensive to ship, and less subject to breakage. Printed newspapers have seen their readership rates decline as new generations of potential readers turn to their iPads and smart phones for sources of news that are constantly updated. Generally, an industry is more attractive when:

- Quality substitute products are not readily available.
- The prices of substitute products are not significantly lower than those of the industry's products.
- Buyers' cost of switching to substitute products is high.

After surveying the power these five forces exert on an industry, entrepreneurs can evaluate the potential for their companies to generate reasonable sales and profits in a

**TABLE 4.1 Five Forces Matrix**

Assign a value to rate the importance of each of the five forces to the industry on a 1 (not important) to 5 (very important) scale. Then assign a value to reflect the threat that each force poses to the industry.

Multiply the importance rating in column 2 by the threat rating in column 3 to produce a weighted score.

Add the weighted scores in column 3 to get a total weighted score. This score measures the industry's attractiveness. The matrix is a useful tool for comparing the attractiveness of different industries.

Minimum Score = 5 (Very attractive)

Maximum Score = 125 (Very unattractive)

Force	Importance (1 to 5) (1 = Not Important, 5 = Very Important)	Threat to Industry (1 to 5) (1 = Low 3 = Medium 5 = High)	Weighted Score Col 2 × Col 3
Rivalry among companies competing in the industry	5	2	10
Bargaining power of suppliers in the industry	2	2	4
Bargaining power of buyers	2	4	8
Threat of new entrants to the industry	3	4	12
Threat of substitute products or services	4	1	4
		<b>Total</b>	<b>38</b>

particular industry. In other words, they can answer the question, "Is this industry a good home for my business?" Table 4.1 provides a matrix that allows entrepreneurs to assign quantitative scores to the five forces influencing industry attractiveness. Note that the lower the score for an industry, the more attractive it is.

**Market niches.** The next step in assessing an industry is to identify potentially attractive niches that exist in the industry. Many small businesses prosper by sticking to niches in markets that are too small to attract the attention of large competitors; occupying an industry niche enables these businesses to shield themselves to some extent from the power of the five forces. The key question entrepreneurs address about a possible niche market is "Can we identify a niche that is large enough to produce a profit, or can we position our company uniquely in the market to differentiate it from the competition in a meaningful way?" Entrepreneurs who have designed successful focus or differentiation strategies for their companies can exploit these niches to their advantage. Questions entrepreneurs should address in this portion of the feasibility analysis include:

- Which niche in the market will we occupy?
- How large is this market segment, and how fast is it growing?
- What is the basis for differentiating our product or service from competitors?
- Do we have a superior business model that will be difficult for competitors to reproduce?

Companies can shield themselves from some of the negative impact of these five forces by finding a niche and occupying it. For example, Taylor Morrison found a niche market in residential real estate that addresses the needs of immigrant families seeking housing: Allow multiple generations of the same family to live together. He is building townhouses in Arizona that allow children, parents, and grandparents to live together comfortably in a single townhouse unit. Each townhouse has a bedroom and a bathroom on the ground floor for the grandparents. The second level has the kitchen, living room, and dining room. The third floor has three bedrooms and two bathrooms for the parents and their children.<sup>13</sup>

Generally, a niche strategy is a good way for a new business to enter the market. It usually takes fewer resources for the start-up due to lower marketing costs and the ability to start on a smaller scale. Success rates tend to be higher for niche businesses because they have less direct competition. Without much competition, niche businesses can charge higher prices, which allows for quicker positive cash flow during start-up and better margins once profitable.

However, entrepreneurs should be aware of some cautions with a niche strategy:

- **Entering a niche requires adaptability in your initial plan.** While developing their business models, entrepreneurs can misjudge what customers actually need within a niche market. Unless they are willing and able to adjust their business models to react to the realities of the market niche, the business will fail if it does not offer the customers what they really want.
- **Niches change.** Even if an entrepreneur evaluates the market correctly in the beginning, niche markets (like any market) change over time. Success in a niche requires that entrepreneurs adapt as the market changes. Too many entrepreneurs get stuck doing the same thing or offering the same product while their customers' needs and wants evolve. Even though it is a niche, the market is not isolated and is subject to the same forces and trends that can impact any market.
- **Niches can go away.** Although many niches can last for years, no market is forever. Niches can dry up—sometimes quite suddenly. Again, adaptation can offer some hope, but if the decline is too rapid, niche businesses can fail.
- **Niches can grow.** Although significant growth in a market may not sound bad, it can attract more competitors. If a niche market grows large enough, it can attract some very large competitors. At some point the entrepreneur's cozy market niche can become quite crowded. Eventually, it may no longer be a true market niche, which requires that the entrepreneur adapt his or her business strategies to meet this more competitive market. Prices will be forced downward, while at the same time the costs of business may go up due to increased marketing costs, greater expectations from customers, and higher labor costs due to more competition for qualified employees.

Although finding a market niche is the most common and a relatively safe entry strategy for new entrepreneurial businesses, it still requires continued attention to competitive forces in the market.



#### ENTREPRENEURIAL PROFILE: Kurt Nelson, Tyler Seymour, and Drew Burchfield and Alooompa

Kurt Nelson, Tyler Seymour, and Drew Burchfield launched their business, Alooompa, to develop a variety of mobile apps for the music industry. During the early stages of the business, they realized that their most promising avenue for scaling their business was to focus on one specific niche within the music industry—live music festivals. Alooompa's mobile app for the Bonnaroo Music Festival, a popular four-day rock music festival in Manchester, Tennessee, attracted the attention of several other music festival organizers. Kurt Nelson, president of Alooompa, says focusing on that single niche allowed the company to develop a core framework that could be adapted to any music festival and to many other similar events. Alooompa has become known as a market leader in music festival apps. Although Alooompa operates in a niche market, it is a large and growing market that has allowed the company to expand to music festivals throughout Europe and in other countries around the world.<sup>14</sup> ■

## Product or Service Feasibility Analysis: Is There a Market?

Once entrepreneurs discover that sufficient market potential for their product or service idea actually exists, they sometimes rush in with their exuberant enthusiasm ready to launch a business without actually considering whether they can actually produce the product or provide the service at a reasonable cost. A product or service feasibility analysis determines the degree to which a product or service idea appeals to potential customers and identifies the resources necessary to

#### LO5

Describe the various methods of conducting primary and secondary market research.

**primary research**

the process of collecting data firsthand and analyzing it.

**secondary research**

the process of gathering data that has already been compiled and is available, often at a reasonable cost or sometimes even free.

produce the product or provide the service. This portion of the feasibility analysis addresses the question, “Are customers willing to purchase our goods and services?” Entrepreneurs need feedback from potential customers to successfully answer this question. Conducting primary research involves collecting data firsthand and analyzing it; secondary research involves gathering data that has already been compiled and is available, often at a reasonable cost or sometimes even free. In both types of research, gathering both quantitative and qualitative information is important to drawing accurate conclusions about a product’s or service’s market potential. Primary research tools include customer surveys, focus groups, construction of prototypes, in-home trials, and “windshield” research (driving around and observing the competition). The goal of primary and secondary research should not only be to find support to validate the business concept. An overly optimistic entrepreneur may overlook important information about the true feasibility of the business if he or she only searches for information that affirms starting the business. It also is important to search for information that does not support the concept. Depending on the nature and severity of any negative evidence, the entrepreneur can either adapt the concept if it is possible to do so or, if necessary, abandon the idea entirely.

**CUSTOMER SURVEYS AND QUESTIONNAIRES** Keep them short. Word your questions carefully so that you do not bias the results, and use a simple ranking system (e.g., a 1-to-5 scale, with 1 representing “definitely would not buy” and 5 representing “definitely would buy”). Test your survey for problems on a small number of people before putting it to use. Web surveys are inexpensive, easy to conduct, and provide feedback fast. Do not only survey people you know or those who are convenient to reach. Survey people who represent the target market of the business.

**FOCUS GROUPS** A focus group involves enlisting a small number of potential customers (usually 8 to 12) to give you feedback on specific issues about your product or service (or the business idea itself). Listen carefully for what focus group members like and don’t like about your product or service as they tell you what is on their minds. The founders of one small snack food company that produced apple chips conducted several focus groups to gauge customers’ acceptance of the product and to guide many key business decisions, ranging from the product’s name to its packaging. Once again, consider creating virtual focus groups on the Web. One small bicycle retailer conducts 10 online focus groups each year at virtually no cost and gains valuable marketing information from them. Feedback from online customers is fast, convenient, and real-time.

**PROTOTYPES** An effective way to gauge the viability of a product is to build a prototype of it. A prototype is an original, functional model of a new product that entrepreneurs can put into the hands of potential customers so that they can see it, test it, and use it. Prototypes usually point out potential problems in a product’s design, giving inventors the opportunity to fix them even before they put the prototype into customers’ hands. The feedback customers give entrepreneurs based on prototypes often leads to design improvements and new features, some of which the entrepreneurs might never have discovered on their own. Makers of computer software frequently put prototypes of new products into customers’ hands as they develop new products or improve existing ones. Known as beta tests, these trials result in an iterative design process in which software designers collect feedback from users and then incorporate their ideas into the product for the next round of tests. Three-dimensional printing creates a less expensive way for entrepreneurs to develop a basic prototype of a product based on drawings. Although the output of a three-dimensional printer is not a fully functional product, it does provide a method of creating a model to test and to use to source manufacturing of component parts.

**in-home trial**

a market research technique that involves sending researchers into customers’ homes to observe them as they use a company’s product or service.

**IN-HOME TRIALS** One technique that reveals some of the most insightful information into how customers actually use a product or service is also the most challenging to coordinate: in-home trials. An in-home trial involves sending researchers into customers’ homes to observe them as they use the company’s product or service. However, in-home trials can be expensive to conduct and therefore may not be affordable for the budgets of most entrepreneurs.

**“WINDSHIELD” RESEARCH** A good source of information is to observe customers interacting with existing businesses within an industry. Windshield research involves driving around and

observing customers interacting with similar kinds of businesses and learning what customers like and don't like about those businesses. For example, before one potential investor was willing to commit funding for a new coffee shop, he required that the entrepreneur get traffic counts at local competitors' outlets. He observed heavy demand and often long lines, which helped provide support for the need for a new coffee shop.

Secondary research should be used to support, not replace, primary research. Secondary research, which is usually less expensive to collect than primary data, includes the following sources:

**TRADE ASSOCIATIONS AND BUSINESS DIRECTORIES** To locate a trade association, use *Business Information Sources* (University of California Press) or the *Encyclopedia of Associations* (Gale Research). To find suppliers, use *The Thomas Register of American Manufacturers* (Thomas Publishing Company) or *Standard and Poor's Register of Corporations, Executives, and Industries* (Standard and Poor Corporation). *The American Wholesalers and Distributors Directory* includes details on more than 18,000 wholesalers and distributors.

**INDUSTRY DATABASES** Several online business databases are available through university libraries, such as BizMiner, *Encyclopedia of American Industries*, *Encyclopedia of Emerging Industries*, *Encyclopedia of Global Industries*, *Encyclopedia of Products & Industries—Manufacturing*, *IBISWorld*, *Manufacturing & Distribution USA: Industry Analyses, Statistics and Leading Companies*, and *Market Share Reporter*. These databases offer a rich variety of information on specific industries, including statistical analyses, geographic reports, trend analyses, and profiles.

**DEMOGRAPHIC DATA** To learn more about the demographic characteristics of customers in general, use *The State and Metropolitan Data Book* (Government Printing Office) and *The Sourcebook of Zip Code Demographics* (CACI, Inc.), which provides detailed breakdowns of the population in every zip code in the country. *Sales and Marketing Management's Survey of Buying Power* (Bill Communications) has statistics on consumer, retail, and industrial buying.

**CENSUS DATA** The Bureau of the Census publishes a wide variety of reports that summarize the wealth of data found in its census database, which is available at most libraries and at the Census Bureau's Web site at [www.census.gov](http://www.census.gov).

**FORECASTS** *The U.S. Industry & Trade Outlook* published by the Department of Commerce, International Trade Administration traces the growth of 200 industries and gives a five-year forecast for each one. Many government agencies, including the U.S. Department of Commerce ([www.commerce.gov](http://www.commerce.gov)), offer forecasts on everything from interest rates to the number of housing starts. Again, a government research librarian can help you find what you need.

**MARKET RESEARCH** Someone may already have compiled the market research you need. The *FINIndex Worldwide Directory of Market Research Reports, Studies, and Surveys* (Cambridge Information Group) lists more than 10,600 studies available for purchase. Other directories of business research include *Simmons Study of Media and Markets* (Simmons Market Research Bureau Inc.) and the *A.C. Nielsen Retail Index* (A.C. Nielsen Company).

**ARTICLES** Magazine and journal articles pertinent to your business are a great source of information. Use the *Reader's Guide to Periodical Literature*, the *Business Periodicals Index* (similar to the Reader's Guide but focusing on business periodicals), and *Ulrich's Guide to International Periodicals* to locate the ones you need.

**LOCAL DATA** Your state Department of Commerce and your local Chamber of Commerce will very likely have useful data on the local market of interest to you. Call to find out what is available.

**THE INTERNET** Entrepreneurs can benefit from the vast amount of market research information available on the Internet. This is an efficient resource with up-to-date information, and much of it is free. Entrepreneurs must use caution, however, to ensure the credibility of online sources.



## Do You Want Fries with Those Crickets?

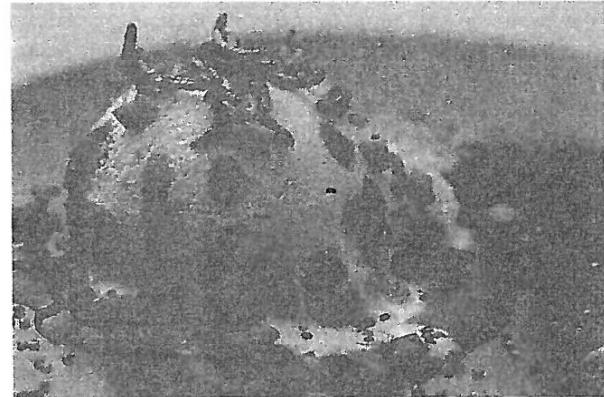
Insects are a common source of food protein for people in many parts of the world. One study suggests that 80 percent of the world population regularly includes insects in their diets. However, in much of the Western world the thought of eating bugs is considered less than appetizing! This soon may be changing. With continued global population growth, concerns about the sustainability of Western agricultural practices, and rising meat and grain prices, Western cultures are beginning to entertain the notion of edible insects as a good source of protein. Entrepreneurs have taken note of these changes in attitudes and are beginning to develop business models that will benefit from the growing acceptance of worms, crickets, and other bugs as a food source.

### Insects in Energy Bars

Patrick Crowley introduced his energy bars, called Chapul, as a means to offer an environmentally friendly source of protein to customers. Through his research, Crowley discovered that crickets are 10 times more efficient than cows or pigs at turning vegetable matter into protein. Crowley partnered with a friend who is a chef to develop a recipe for energy bars using cricket flour and had the bars approved by the Food and Drug Administration. Crowley ran a Kickstarter campaign that raised enough money to make 2,000 bars, which sold quickly through online and retail sales. Based on his early success, Crowley contracted with a company to make larger batches of the bars. Chapul cricket bars are sold in 75 stores, and Crowley is negotiating with larger national chains including Whole Foods. Chapul is trending to reach \$1 million in annual revenues within its first two years of operations.

### Insect Farming Supply

One of the advantages of cultivating insects as a source of protein is that it does not take much space to run an insect farm. In fact, a California company called Tiny Farms sells kits that allow anyone to farm edible insects in their homes or businesses. Andrew Brentano, cofounder of Tiny Farms, notes that there is a shortage of food-grade insects available in the United States due to the increasing acceptance and demand for edible insects. Each



Don Bugito

kit includes a starter package of bugs (locusts, grasshoppers, and worms), insect farming tools and equipment, bug food, and an instruction manual for growing insects for food. Tiny Farms also provides online support, forums, and consulting for aspiring insect farmers. In addition to serving those raising bugs for personal consumption, Tiny Farms intends to become a major supplier for the growing number of commercial bug farmers.

### Insect Food Cart

Monica Martinez loved snacking on bugs when she was a young child growing up in Mexico. She decided to find a way to share her taste for insects with residents of her new home, San Francisco, California. Martinez's food cart, Don Bugito, offers menu items such as wax moth larvae tacos, chocolate covered salted crickets, and toffee mealworms over vanilla ice cream. Martinez also offers in-home catering services, featuring a full five-course meal of edible insects, and has begun to sell prepackaged versions of some of her creations.

1. What are the macro trends that support businesses selling edible insects to American consumers?
2. What are the risks that come with being an early entrant into the edible insect market?
3. Do you believe an edible insect business would be successful where you live? Why or why not?



Daniel Imrie-Situnayake, Tiny Farms

*Based on:* Parija Kavilanz, "This Energy Bar Gets its Kick From . . . Crickets," *CNNMoney*, July 23, 2013, <http://money.cnn.com/2013/07/23/smallbusiness/cricket-bar/index.html>; Victoria Woollaston, "Forget the Vegetable Patch! This Kit Lets You Grow Your Own Edible INSECTS," *Daily Mail*, November 29, 2013, [www.dailymail.co.uk/sciencetech/article-2515043/Forget-vegetable-patch-This-kit-lets-grow-edible-INSECTS-help-cut-meat-eating.html](http://www.dailymail.co.uk/sciencetech/article-2515043/Forget-vegetable-patch-This-kit-lets-grow-edible-INSECTS-help-cut-meat-eating.html); Kristine A. Wong, "Does Fake Meat Have Legs? The Business Case for Alt-proteins," *Green Biz*, November 27, 2013, [www.greenbiz.com/blog/2013/11/27/fake-meat-have-legs-proteins-meatless?mkt\\_tok=3RkMMJWWF9wsRoluKXKZKXonjHpsX56u4rUa63IMI%2FOER3fOvrPufGj14CtCtRq1%2BSLDwEYGJlv65gFSLHEMa5qw7GMXRQ%3D](http://www.greenbiz.com/blog/2013/11/27/fake-meat-have-legs-proteins-meatless?mkt_tok=3RkMMJWWF9wsRoluKXKZKXonjHpsX56u4rUa63IMI%2FOER3fOvrPufGj14CtCtRq1%2BSLDwEYGJlv65gFSLHEMa5qw7GMXRQ%3D); Katharine Schwab, "Don Bugito Introducing Insects to American Diet," *SF Gate*, September 3, 2013, [www.sfgate.com/food/article/Don-Bugito-introducing-insects-to-American-diet-4784046.php](http://www.sfgate.com/food/article/Don-Bugito-introducing-insects-to-American-diet-4784046.php); Spencer Michels, "Bugs for Dinner?" *PBS NewsHour*, May 7, 2012, [www.pbs.org/newshour/rundown/2012/05/bugs-for-dinner.html](http://www.pbs.org/newshour/rundown/2012/05/bugs-for-dinner.html).

## Financial Feasibility Analysis: Is There Enough Margin?

The third component of a feasibility analysis involves assessing the financial feasibility of a proposed business venture. At this stage of the process, a broad financial analysis that examines the basic economic feasibility is sufficient. This component of the feasibility analysis answers the question, "Can this business generate adequate profits?" If the business concept passes the overall feasibility analysis, an entrepreneur should conduct a more thorough financial analysis when developing the business model and creating a full-blown business plan. The four major elements to be included in a financial feasibility analysis include the initial capital requirement, estimated earnings, time out of cash, and resulting return on investment.

**CAPITAL REQUIREMENTS** Just as a boy scout needs fuel to start a fire, an entrepreneur needs capital to start a business. Some businesses require large amounts of capital, but others do not. Typically, service businesses require less capital to launch than do manufacturing or retail businesses. Start-up companies often need capital to purchase equipment, buildings, technology, and other tangible assets as well as to hire and train employees, promote their products and services, and establish a presence in the market. A good feasibility analysis provides an estimate of the amount of start-up capital an entrepreneur will need to get the business up and running.

When preparing to launch his microbrewery, Cigar City Brewing, Joey Redner needed \$585,000 to purchase the brewing system, other equipment, and inventory and to cover initial operating expenses. Redner was able to secure a bank loan after his father agreed to pledge business property as collateral. To help bootstrap his operations, Redner was able to get a large contingent of volunteers to help staff the business, who all agreed to work for free beer. He also set up distribution agreements with two beer distributors before he began brewing his craft beers.<sup>15</sup>

It is important to keep in mind that the typical start-up in the United States can successfully launch with an average of only \$10,000,<sup>16</sup> and one in five start-ups get launched with no funding at all.<sup>17</sup> How do entrepreneurs get started with so little funding? Most entrepreneurs employ a variety of techniques called *bootstrapping*. Bootstrapping is the process of finding creative ways to exploit opportunities to launch and grow businesses with the limited resources available for most start-up ventures. It includes a variety of strategies and techniques that cover all of the functions of running a business: marketing, staffing, inventory and production management, cash flow management, and administrative processes needed to keep a business operating.<sup>18</sup>

You will learn more about bootstrapping in Chapter 8 and more about finding sources of business funding, both debt and equity, in Chapter 14.

**ESTIMATED EARNINGS** In addition to producing an estimate of the start-up company's capital requirements, an entrepreneur also should forecast the earning potential of the proposed business. Industry trade associations and publications such as the *RMA Annual Statement Studies* offer guidelines on preparing sales and earnings estimates for specific types of businesses. From these, entrepreneurs can estimate the financial results they and their investors can expect to see from the business venture if the start-up is executed according to plan.

**TIME OUT OF CASH** A common cause of business failure is running out of cash before the business breaks even and can support itself through the cash flow from operations. According to a study by U.S. Bank, four out of five small business failures can be attributed to "starting out with too little money."<sup>19</sup> During the planning stage, the entrepreneur should estimate the total cash it will take to sustain the business until the business achieves break-even cash flow. This estimate should be based on a less-than-optimistic scenario because there are almost always unexpected costs and delays in the start-up and growth of a new business. For an operating business, to calculate the number of months until the business runs out of cash, simply divide the amount of available cash remaining in the business by the negative cash flowing from the business each month. The result is the number of months the business can survive at its current rate of negative cash flow. Ideally, the business will be able to grow quickly enough to avoid reaching the point of no more cash.

**RETURN ON INVESTMENT** The final aspect of the financial feasibility analysis combines the estimated earnings and the capital requirements to determine the rate of return the venture is

### LO3

Understand the four major elements of a financial feasibility analysis.

expected to produce. One simple measure is the rate of return on the capital invested, which is calculated by dividing the estimated earnings the business yields by the amount of capital invested in the business. This aspect of financial feasibility is generally of most concern to investors. Although financial estimates at the feasibility analysis stage typically are rough, they are an important part of the entrepreneur's ultimate "go" or "no go" decision about the business ventures. A venture must produce an attractive rate of return relative to the level of risk it requires. This risk-return trade-off means that the higher the level of risk a prospective business involves, the higher the rate of return it must provide to the entrepreneur and investors. Why should an entrepreneur take on all of the risks of starting and running a business that produces a mere 3 or 4 percent rate of return when he or she could earn that much in a risk-free investment at a bank or other financial institution? Although entrepreneurs should pay more attention to this calculation, many do not because they tend to get wrapped up in the emotion and excitement of their business ideas. You will learn more about developing detailed financial forecasts for a business start-up in Chapter 11.

Wise entrepreneurs take the time to subject their ideas to a feasibility analysis like the one described here, whatever outcome it produces. If the analysis suggests that transforming the idea into a viable business is not feasible, the entrepreneur can move on to the next idea, confident that he or she has not wasted valuable resources launching a business destined to fail.

If the analysis so far finds that there is a market for the idea and that it has real potential as a profitable business, the entrepreneur can move to the final component of the feasibility analysis.

#### LO7

Describe the process of assessing entrepreneur feasibility.

## Entrepreneur Feasibility: Is This Idea Right for Me?

Suppose that the feasibility analysis thus far has established that the industry and market are favorable, there is strong evidence of demand for the product or service in the market, and the concept appears financially feasible. There is one last component of feasibility to examine—the readiness of the entrepreneur (and, if applicable, the entrepreneur's team) to launch the venture successfully. Many new businesses require that an entrepreneur have a certain set of knowledge, experiences, and skills to have any chance of being successful. This is called *entrepreneurial readiness*. Some of these can be simple skills. For example, starting a landscaping business requires knowing how to operate a lawnmower and other equipment. Being successful in a landscaping business also depends on some level of knowledge about plants and grasses. Other new businesses may require a higher level of knowledge and skills. For example, starting an accounting firm requires a high level of knowledge and experience in the laws and practice of accounting. Entrepreneurs can gain the knowledge and skills they need from previous jobs, from their formal education, or from their interests or hobbies. They can also acquire knowledge as part of what they work on during the planning process. Entrepreneurial readiness also involves issues such as temperament, work ethic, and so forth. Performing an entrepreneurial self-assessment can help evaluate entrepreneurial readiness (see Figure 4.7).

Another way to ensure the necessary knowledge and skills are in place is through building a team. For example, an aspiring entrepreneur may have an idea for a new app for smart phones but may not have any programming or design skills. He or she would be best served by exploring the possibility of adding people to the team with that skill set. If there is more than one entrepreneur starting the business, all of them should complete an assessment and use this as a launching point to examine their collective entrepreneurial feasibility.

Beyond the entrepreneur's readiness to start a business, the second aspect of entrepreneur feasibility is to assess whether the business can meet the financial and nonfinancial needs of the entrepreneur and the team. Will the business be able to generate enough profit to support everyone's income needs? If it is successful, will it also meet the wealth goals of the founding team? Just because a business is profitable does not mean that it is profitable enough to support the entrepreneur and his or her team. This can vary from entrepreneur to entrepreneur. A 22-year-old single entrepreneur fresh out of college has very different financial needs than a 42-year-old married entrepreneur who has a mortgage, car payments, and tuition for private schools for his or her children! But making money is not the only thing that matters for most people. Does business fit with goals and aspirations the entrepreneur has outside of work? A business that demands

**Personal Aspirations and Priorities**

- What gets you excited, gives you energy, and motivates you to excel?
- What do you like to do with your time?
- What drains energy from you?
  - In the work you do:
  - In personal relationships:
- How do you measure success in your personal life?
  - Family:
  - Friends and relationships:
  - Personal interests and hobbies:
  - Contributions to community and society:
- What do you consider success in your business and career?
  - Short-term:
  - Long-term:
- What are your specific goals for your personal life?
  - Family:
  - Friends and relationships:
  - Personal interests and hobbies:
  - Contributions to community and society:
- What are your goals for your business and career?
  - Income and lifestyle:
  - Wealth:
  - Free time:
  - Recognition and fame:
  - Impact on community:
  - Other:
- What do you want to be doing?
  - In one year:
  - In five years:
  - In ten years:
  - At retirement:

**Core Values**

- List the core personal values that you intend to bring to your business (e.g., treating people fairly, giving something back to the community).
- Where does each of these core values come from (religious faith, family, etc.)?
- Why is each of them important to you?

**Personal Entrepreneurial Readiness**

- What are the major reasons you want to start a business?
- How many hours are you willing and able to put into your new venture?
- How would you describe your tolerance for uncertainty and risk?
- Do you easily trust other people working with you on a common activity? Why or why not?
- How much financial risk are you willing to take with your new venture (personal assets, personal debt, etc.)?
- Assume you decide not to start your business. A short time later, you see that someone has started the same business and is doing well. How would you feel? Why?
- What are the nonfinancial risks for you in starting a new business?
- How do you react to failure? Give examples.
- How do you react in times of personal stress? How do you deal with stress in your life?
- How much income do you need to support your current lifestyle?
- How long could you survive without a paycheck?
- How much money do you have available to start your business?
- Which of your personal assets would you be willing to borrow against, or sell, to start your business?
- Whose support (nonfinancial) is important for you to have before starting your business (family, spouse, etc.)?

**FIGURE 4.7**  
**Entrepreneurial**  
**Self-Assessment**

*Source:* This self-assessment is adapted from J. Cornwall, and N. Carter, *University of St. Thomas Entrepreneurial Self-Assessment: Start-Up*, monograph published by the John M. Morrison Center for Entrepreneurship, University of St. Thomas, St. Paul, Minnesota, 1999. Used with permission.

extensive travel may not fit with an entrepreneur who has a goal of being highly involved with his or her family. A restaurant, which often demands that the entrepreneur be involved 6 or 7 days a week, 52 weeks a year, may not be a good business model for an entrepreneur who wants to travel and take extended vacations.

Once an entrepreneur tests his or her business idea using the four components of a feasibility assessment, the next stage of the new business planning process is to develop a business model.

#### LO8

Describe the nine elements of a business model.

## Developing and Testing a Business Model

In their groundbreaking study of how successful entrepreneurs develop business models, Osterwalder and Pigneur identified the common elements that successful entrepreneurs and investors use when developing and evaluating a business model. They found that most entrepreneurs use a visual process, such as diagramming their business on a whiteboard, when developing their business ideas.<sup>20</sup> They don't just start writing the text of a business plan. Rather, they map out the key components required to make their businesses successful. A business model adds more detail to the evaluation of a new business begun during the feasibility analysis by graphically depicting the "moving parts" of the business and ensuring that they are all working together.

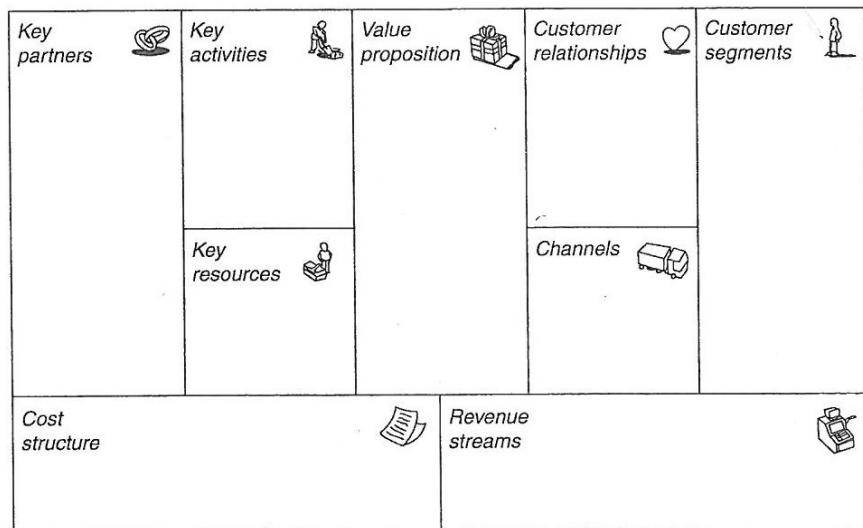
When building a business model, the entrepreneur addresses a series of key questions that will explain how a business will become successful. What value does the business offer customers? Who is my target market? What do they expect of me as my customers? How do I get information to them, and how do they want to get the product? What are the key activities to make this all come together, and what will they cost? What resources do I need to make this happen, including money? Who are key partners I will need to attract to be successful?

In their study, Osterwalder and Pigneur found a pattern of how entrepreneurs use a visual representation of their business model to answer these questions. They used these findings to develop a Business Model Canvas that provides entrepreneurs with a dynamic framework to guide them through the process of developing, testing, and refining their business models (see Figure 4.8). The canvas is comprised of nine elements:

1. *Customer segments*. A good business model always starts with the customer. The entrepreneur's first step is to identify a segment of customers who have a clearly defined need. In the previous steps outlined in this chapter, the entrepreneur begins to define the market for the new business. For most entrepreneurs, the initial market is defined much too broadly. The entrepreneur uses demographic, geographic, socioeconomic, and other characteristics that add specificity to defining the target market. Narrowing the target market enables a small company to focus its limited resources on serving the needs of a specific

**FIGURE 4.8**  
**The Business Model Canvas**

Source: Osterwalder, Alexander and Pigneur, Yves, "Business Model Generation" © Alexander Osterwalder and Yves Pigneur 2010 (Hoboken: John Wiley and Sons Publisher).





## You Be the Consultant

### RendezWoof: Creating a Minimal Viable Product for a Mobile App

Entrepreneurs create minimal viable products to allow them to test their product with real customers as quickly as possible. Testing the product this way helps to determine whether consumers really want the product, provides feedback from these customers to help improve the product, and gathers hard data that demonstrates the proof of concept many investors want before they fund an emerging business.

Judson Aikens wanted to start a business but had a good paying job and was concerned about taking on too much risk. While brainstorming about possible businesses he could launch, Aikens came up for an idea for a new dating app. He had observed that it is easy to meet new people at places like dog parks.

Aikens's idea was to develop an app called RendezWoof that created a virtual dog park. "The app would not only connect dog owners with each other, it would connect them with dog-friendly resources around them," says Aikens. "Using GPS, the app's map would populate restaurants with patios and parks convenient to users interested in meeting up to grab a beer or throw a Frisbee."

Aikens reached out to an entrepreneur, Ben Dolgoff, who had spoken to one of the entrepreneurship classes he had taken in graduate school. Ben was an experienced app developer who had developed and launched several successful apps. After asking Ben to sign a nondisclosure agreement, Aikens shared his idea. Ben said he thought the app had promise as a commercially viable product. He suggested that Aikens develop some designs for his idea and then get back with him. If the idea had promise, Ben said he might be willing to develop the app in exchange for some equity in the new business.

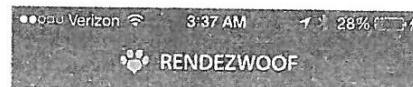
Aikens shared his app idea with a friend who was a graphic designer. She was eager to help him with the designs and was willing to provide ongoing graphic design services in exchange for equity.

The next step was for Aikens to work with the graphic designer to develop a wireframe of the app. A wireframe is a drawing of the various screens that make up an app; it includes the kinds of information displayed, the functions of the app, and the basic flow from screen to screen.

Aikens took the wireframe designs to Ben, who was eager to move forward. Ben's company would develop the app in exchange for equity.

"This arrangement was very acceptable to me," says Aikens. "It simultaneously removed the financial burden of development and provided an experienced go-to consultant I could work with through the life of the app."

Aikens formed an LLC and secured the RendezWoof name on all social platforms and for the Web domain. He opened an Apple developer account and applied for copyrights and trademarks.



We'll never post anything to facebook



Judson Aikens, RendezWoof, LLC

Because he is still working his day job, Aikens spends many late nights working with the developers to improve the app's user interface and user experience.

Because the goal of the initial version of the app is to gain users and prove the concept, RendezWoof initially offered the app for free through the Apple Store. Future versions of the app will have more features, which will allow the company to charge a small fee for the app.

1. Why would you recommend that an entrepreneur develop a minimal viable product or a prototype?
2. Can you think of additional market research that Aikens could have done before developing his product?
3. What are the advantages and disadvantages of offering equity in exchange for work done on a new product?

*Source: Judson Aikens, personal communication, December 17, 2013.*

supplies, but they were constantly using the copy machine. He narrowed his offering to become primarily a copy shop and grew the business to a multinational company with more than 1,200 locations. On the other hand, sometimes the entrepreneur does not offer enough features to fully address the customers' problem. In this situation, the entrepreneur must add the additional features the customer expects.

- *Customer pivot.* Although a product might solve a real market problem or need, sometimes the initial business model targets the wrong customer segment or even the wrong market. For example, PayPal targeted the handheld device market that included the Palm Pilot for its electronic payment system. However, the founders of PayPal soon realized by listening to customer feedback that there was a much larger market for its product. Businesses were beginning to engage in commerce on their Web sites. PayPal pivoted its business model and as a result rapidly grew to become a \$1.6 billion company facilitating Internet commerce.
- *Revenue model pivot.* There are many ways in which the revenue model may pivot. One of the most basic revenue decisions is whether to use a high margin/low volume model or low margin/high volume model. For example, Best Buy began as a single location stereo equipment store called the Sound of Music back in the 1960s. Like all of its competitors, the revenue model was high margin/low volume. The owners would mark up inventory two to three times what the product cost them to purchase. As a result, the store would turn its inventory over about once a year. After a tornado destroyed the building but left the inventory undamaged, the Sound of Music owners rented a large tent and ran a drastic sale. The demand was so overwhelming that when they reopened, they changed their revenue model to low margin/high volume and within a short time renamed the business Best Buy. The low prices created so much demand that the stores would sell their entire inventory about once a month, rather than once a year. Other revenue model pivots change the type of payment received. The model may change from a single payment to recurring revenue, or it may shift from hourly billing to charging a fixed price per service. Social entrepreneurs can pivot from a revenue model based on a nonprofit that raises money through grants and donations to a social enterprise that generates revenues from a product or service.

Several minor pivots may also be necessary for a business model around operational aspects of the business, including promotion, distribution, staffing, or outsourcing.

If pivots to the existing business model are not enough, occasionally a company may completely change its business model. For example, when IBM was facing possible failure in the 1990s, the company drastically shifted its business model from a company that manufactured and sold computer and other office hardware to focus primarily on software and information technology consulting. It is now one of the largest and most profitable information technology companies in the world.

## Conclusion

Entrepreneurs can follow five steps to guide the process of turning a great new idea into a successful business. This chapter examines the first three steps in this process.

The best business ideas start with a group of customers with a common problem or need. Once entrepreneurs develop ideas for new businesses, the first step is to assess these ideas by examining a need in the market, developing a solution for that need, and determining the entrepreneur's ability to successfully turn the idea into a business. The idea assessment process helps an entrepreneur more efficiently and effectively examine multiple ideas to identify the solution with the most potential.

The second step is to conduct a feasibility analysis to determine whether the entrepreneur can transform the idea into a viable business. The role of a feasibility analysis is to serve as a filter, screening out ideas that lack the potential for building a successful business, before an entrepreneur commits the necessary resources to develop and test a business model or to build a business plan.



## You Be the Consultant

### When to Call It Quits on a New Business

Jake Jorgovan had become a successful entrepreneur while he was in college. Jorgovan and a classmate started a video production company. They began by making videos of senior recitals for music students at their school. By the time they had graduated, their company had hired several employees and was booked up with a combination of music industry work and shoots for corporate clients needing videos. Jorgovan won several local and national business plan competitions based on the plans he developed for the company. Shortly after graduation, Jorgovan was recognized as the Youth Entrepreneur of the Year in Nashville, Tennessee, where the business was headquartered.

Not long after that, Jorgovan made the decision to move away from the video industry and start a new business. After extensive research, Jorgovan identified an opportunity within the healthcare industry. Telemedicine was a growth sector within the industry. Jorgovan started his new company, Telehealth PT, to develop a telemedicine application for physical therapists. Telehealth's business model was to provide a framework that would allow physical therapists to provide care through live video conferencing sessions on patients' mobile devices or computers.

Jorgovan began developing the basic technology he could use to demonstrate that his concept could work. His goal was to offer a simple version of the product and test it with a few physical therapy clinics. However, not long after beginning work on the basic product, Jorgovan began to have doubts about his ability to get the business launched. He persevered, trying to overcome the many technical hurdles and personal challenges the new business kept throwing in front of his path.

Even though it soon became clear that his new business was not going to work, Jorgovan had a hard time accepting this failure, mainly because he had known so much success with his previous business. He continued to try to uncover ways to salvage the venture, but eventually he had to admit he had failed.

One of the possible outcomes of conducting feasibility analyses and developing business models is that, like Jake Jorgovan, the entrepreneur discovers the business just won't work. Entrepreneurs should consider this a positive outcome because they are able to discover fatal flaws in a business concept early, saving time and money. The reality is that it can be hard for entrepreneurs to

admit failure and walk away from an idea even when it becomes clear it is doomed to fail. Why? What clouds their judgment?

- **Pride and ego.** It is easy for entrepreneurs to let their egos get too wrapped up in their businesses, even very early in the life of their new ventures. They receive affirmation and encouragement from family and friends for taking the risk to start a business. Soon, their pride in being an entrepreneur can get in the way of making a sound business decision and closing a failing venture.
- **Their "baby."** Many long and lonely hours go into getting a business started. Entrepreneurs can quickly become emotionally attached to the new venture. They can reach a point where they could not even imagine thinking about giving up on it.
- **Getting stuck on sunk costs.** It can be difficult for entrepreneurs to look at the time, money, and reputation they have put into a failing concept as a *sunk cost*. That is, entrepreneurs can never recover the resources they have already committed to a venture.

The purpose of feasibility analysis is to ask the question: Can this business work? Sometimes the answer will be "no." The entrepreneur must be ready to accept this answer and move on to the next opportunity.

1. Why was it hard for Jake to admit his newest venture was not going to work?
2. What would you recommend that entrepreneurs do to ensure they don't hang on too long to a failed business concept?
3. A failed business concept does not mean the entrepreneur has failed. How would you explain this to an entrepreneur facing a failed business concept?

*Based on:* Jeff Cornwall, "Why Entrepreneurs Never Say Die, But Maybe Should," Inc., December 18, 2013, [www.inc.com/jeff-cornwall/why-entrepreneurs-never-say-die-but-maybe-should.html](http://www.inc.com/jeff-cornwall/why-entrepreneurs-never-say-die-but-maybe-should.html); Jake Jorgovan, personal communication, December 6, 2013; Jake Jorgovan, "Accepting Failure," [jake-jorgovan.com](http://jake-jorgovan.com), December 2, 2013, <http://jake-jorgovan.com/blog/2013/12/1/accepting-failure>.

The third step in the process of evaluating ideas is to develop and test the business model. Developing a business model helps the entrepreneur better understand all that will be required to launch and build the business. In this step in the planning process, the entrepreneur tests the concept and uses what he or she learned from real customers to refine the business model before committing the resources to grow the business to its full potential.

Once the entrepreneur completes the idea assessment, feasibility study, and business model steps, he or she is ready to develop a business plan. As the business becomes more successful, the strategic plan becomes an essential management tool. The business plan and strategic plan are covered in Chapter 5.

## Chapter Summary by Learning Objective

### 1. Describe the process of conducting an idea assessment.

- An idea sketch pad is a tool that helps entrepreneurs assess ideas. The idea sketch pad has five parameters:
  - Customers.** Start with a group of customers who have a clear need that is not being addressed.
  - Offering.** Describe your idea for a product or service to offer the customers.
  - Value proposition.** Explain why your product or service will be important to customers.
  - Core competencies.** Determine if your offering has any technologies or unique features that will help differentiate it from competitors?
  - People.** Identify the key people on the team who will launch this business.

### 2. Explain the elements of a feasibility analysis.

- Determine how attractive an industry is overall as a “home” for a new business.
- Evaluate possible niches a small business can occupy profitably.

### 3. Describe the six forces in the macro environment of an industry.

- Sociocultural trends can lead to dramatic changes, creating whole new industries and fundamentally transforming existing industries.
- Technological breakthroughs lead to the development of new products and entirely new industries.
- Changing demographics create opportunities for entrepreneurs.
- Economic trends, both positive and negative, create opportunities.
- Political and legal change, such as new laws and regulations, create opportunities for entrepreneurs.
- Global trends that open global markets allow businesses to seek customers and suppliers from all corners of the world and can help in even the smallest business.

### 4. Understand how Porter's Five Forces Model assesses the competitive environment.

- Entrepreneurs should assess five forces that shape the competitive environment for every business:
  - The rivalry among competing firms
  - The bargaining power of suppliers
  - The bargaining power of buyers
  - The threat of new entrants
  - The threat of substitute products or services

### 5. Describe the various methods of conducting primary and secondary market research.

- Primary research tools include customer surveys, focus groups, building prototypes, conducting in-home trials, and “windshield” research (driving around and observing the competition).
- Secondary research gathers existing data from trade associations and business directories, industry databases, demographic data, census data, forecasts compiled by government agencies, market research reports, articles in magazines and journals, local data, and the Internet.

### 6. Understand the four major elements of a financial feasibility analysis.

- Capital requirements.** Start-up companies often need capital to purchase equipment, buildings, technology, and other tangible assets and to hire and train employees, promote their products and services, and establish a presence in the market.
- Estimated earnings.** In addition to producing an estimate of the start-up company’s capital requirements, an entrepreneur should forecast the earning potential of the proposed business.
- Time out of cash.** To estimate time out of cash, take the negative cash flow from the business each month and divide by how much available cash is left in the business. This gives the number of months the business can survive at its current rate of negative cash flow.
- Return on investment.** A venture must produce an attractive rate of return relative to the level of risk it requires. This risk–return tradeoff means that the higher the level of risk a prospective business involves, the higher the rate of return it must provide to the entrepreneur and investors.

### 7. Describe the process of assessing entrepreneur feasibility.

- Many new businesses require that an entrepreneur possess a certain set of knowledge, experiences, and skills to have a chance of being successful.
- Entrepreneurial readiness also involves issues such as temperament and work ethic.

### 8. Describe the nine elements of a business model.

- Customer segments.** A good business model always starts with the customer. The entrepreneur’s first step is to identify a segment of customers who have a clearly defined need.

- ***Value proposition.*** The value proposition is the collection of products and/or services the business will offer to meet customers' needs.
- ***Customer relationships.*** Not every business provides the same type and same level of customer service.
- ***Channels.*** Channels refer to both communication channels (promotion) and distribution channels (product placement). Communication channels define how the customers seek out information about this type of product. The distribution channel defines the most effective way to get products to the customers for this type of business.
- ***Key activities.*** The goal is to build a basic checklist of what needs to be done to open the business and what activities are necessary to ensure its long-term success.
- ***Key resources.*** This will serve as an initial checklist to ensure that all key resources have been identified that will support a successful launch and sustain the business as it grows.
- ***Key partners.*** This segment of the business model includes important suppliers, outsourcing partners, investors, industry partners, advisers, and all other external businesses or entities that are critical to make the business model work.
- ***Revenue streams.*** How will the value proposition generate revenue?
- ***Cost structure.*** The key activities, key resources, and key partners components of the plan help identify the basic types of costs and give some estimate of their scope.

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## Discussion Questions

- 4-1. What is an idea assessment?
- 4-2. Explain the process of conducting an idea assessment.
- 4-3. Explain why it is necessary to conduct a feasibility analysis.
- 4-4. Describe the four components of a feasibility analysis.
- 4-5. What factor led to the birth of the day-care industry and rapid growth in the restaurant industry?
- 4-6. List and describe the six foundational forces that shape the macro environment of a business venture.
- 4-7. Describe in detail Porter's Five Forces Model.
- 4-8. Discuss whether it is advisable for an entrepreneur to build a prototype of his or her new product.
- 4-9. When it comes for new businesses to enter the market, discuss why entrepreneurs need to be aware of a niche strategy.
- 4-10. List and describe the various tools for conducting primary market research.
- 4-11. What are the four elements of a financial feasibility analysis?
- 4-12. Explain the difference between primary and secondary research.
- 4-13. What are the key questions an entrepreneur must ask while preparing a business model?
- 4-14. List and describe the nine elements of the business model canvas.
- 4-15. Describe the four phases that go into developing a business model.
- 4-16. A sound business model should always begin with a market need. Explain this statement.
- 4-17. What is a pivot in a business model?
- 4-18. Entrepreneurs may use a minimal viable product for a lean start-up process. Define this process.

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## Beyond the Classroom . . .

- 4-19. Identify an idea for a new business for an industry you would like to work within.
- 4-20. Evaluate the idea using the idea sketch pad.
- 4-21. Assess how the six macro forces are creating change within this industry.
- 4-22. Examine the idea using Porter's Five Forces Model.
- 4-23. Develop a plan to conduct market research on your idea using both primary and secondary methods of research.
- 4-24. Complete an entrepreneurial self-assessment.
- 4-25. What do you take away from this self-assessment about your entrepreneurial readiness?
- 4-26. Discuss your findings with someone who knows you well.
- 4-27. Did they offer any insights about your entrepreneurial readiness that you may have overlooked?

## Endnotes

Scan for Endnotes or go to [www.pearsonglobaleditions.com/Scarborough](http://www.pearsonglobaleditions.com/Scarborough)



