GST 311 GENERAL ENTREPRENEURSHIP

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GST 311 GENERAL ENTREPRENEURSHIP

CHAPTER 1: Introduction to Entrepreneurship and Problem Solving Behaviour

The World of the Entrepreneur

- Welcome to the world of the entrepreneur! Across the globe, growing numbers of people are realizing their dreams of owning and operating their own businesses.
  - Interest in entrepreneurship has never been higher than it has been at the beginning of the twenty-first century
  - Capitalist societies depend on entrepreneurs to provide the drive and risk taking necessary for the system to supply people with the goods and services they need.
  - Entrepreneurship plays a significant role in the business world by:

i. Introducing innovative products
ii. Pushing back technological frontiers
iii. Creating new jobs
iv. Opening foreign markets

Who is an Entrepreneur

An entrepreneur is one who
- creates a business in the face of risk and uncertainty
- for the purpose of achieving profit and growth
- by identifying significant opportunities
- and assembling the necessary resources to capitalize on them.

Entrepreneur is a person who either creates new combinations of production factors such as
New methods of production, new products, new market, find new sources of supply and new organizational forms. OR as a person who is willing to take risks OR a person who by exploiting market opportunities, eliminates disequilibrium between aggregate supply and aggregate demand OR as one who owns and operates a business. (Tyso, Petrin, Rogers, 1994, p.2-4).

Characteristics of Entrepreneur (Entrepreneurial profile)

i. Desire for responsibility
ii. Preference for moderate risk (Minimize risk by building a solid business plan)
iii. Confidence in their ability to succeed
iv. Desire for immediate feedback
v. High level of energy
vi. Future orientation (A focus on future opportunities, rather than focus on past events)
vii. Skill at organizing
viii. Value of achievement over money
ix. High degree of commitment
x. Tolerance for ambiguity (willingness to take risks)
xi. Flexibility (adapt their businesses to meet changing tastes and trends)
xii. Tenacity (Try, try and try again)

The Benefits of Entrepreneurship

i. Opportunity to create your own destiny
ii. Opportunity to make a difference (combining concern for social issues and a desire to earn a good living).
iii. Opportunity to reach your full potential
iv. Opportunity to reap impressive profits
v. Opportunity to contribute to society and be recognized for your efforts
vi. Opportunity to do what you enjoy and have fun at it

The Potential Drawbacks of entrepreneurship

i) Uncertainty of income
ii) Risk of losing your entire investment
iii) Long hours and hard work
iv) Lower quality of life until the business gets established
v) Complete responsibility (have to make all decisions)
vi) Discouragement (Face many obstacles along the way).

The Cultural Diversity of Entrepreneurship

- Anyone has the potential to become an entrepreneur.
- Indeed, diversity is a hallmark of entrepreneurship, and the following represent the diverse mix of people who make up the rich fabric of entrepreneurship:

a) Young Entrepreneurs
b) Women Entrepreneurs
c) Minority Enterprises
d) Immigrant Entrepreneurs
e) Part-Time Entrepreneurs
f) Home-Based Business
g) Family-owned business
h) Copreneurs (entrepreneurial couples who work together as co-owners of their business)
i) Corporate Castoffs (People who lose their company jobs and start their own businesses)
j) Corporate dropouts

The Power of "Small" Business

- A small business is one that employs fewer than 100 people.
- "Gazelles" refer to very successful small businesses that are growing at 20% or more per year with at least $100,000 in annual sales; they create 70% of net new jobs in the economy.
- The small business sector's contributions are many:

a. They make up 99% of all businesses
b. They employ 51% of the private sector workforce
c. They create two-thirds to three-fourths of the net new jobs in the economy
d. They produce 51% of the country's private gross domestic product (GDP)
e. They account for 47% of all business sales.

The 10 Deadly Mistakes of Entrepreneurship

1. Management Mistakes (primary cause of business failure)

2. Lack of Experience
3. Poor Financial Control
4. Weak Marketing Efforts
5. Failure to Develop a Strategic Plan (Failure to plan is planning to fail)
6. Uncontrolled Growth (As the business increases in size and complexity, problems increase in magnitude, and the entrepreneur must learn to deal with them)
7. Poor Location
8. Improper Inventory Control
9. Incorrect Pricing (Small businesses usually underprice their products and services. The first step in establishing accurate prices is too know what a product or service costs to make or provide)
10. Inability to Make the "Entrepreneurial Transition" (Once a business is started and starts to grow, it usually requires a radically different style of management, one that entrepreneurs are not necessary good at)

Putting Failure into Perspective

- Because they are building businesses in an environment filled with uncertainty and shaped by rapid change, entrepreneurs recognize that failure is likely to be part of their lives, but they are not paralyzed by that fear.
  - Failure is a natural part of the creative process. The only people who never fail are those who never do anything or never attempt anything new.
  - One hallmark of successful entrepreneurs is the ability to fail intelligently, learning why they failed so that they can avoid making the same mistake again.
  - Entrepreneurial success requires both persistence and resilience, the ability to bounce back from failure.

How to Avoid the Pitfalls

1. Know Your Business in Depth
2. Develop a Solid Business Plan
3. Manage Financial Resources
4. Understand Financial Statements (To truly understand what is going on in the business, an owner must have at least a basic understanding of accounting and finance)
5. Learn to Manage People Effectively (No matter what kind of business you launch, you must learn to mange people. Every business depends on a foundation of well-trained, motivated employees. No business owner can do everything alone.)
6. Keep in Tune with Yourself (Monitor your health, manage your time, and have passion for what you do).

CHAPTER 2: INSIDE THE ENTREPRENEURIAL MIND: FROM IDEAS TO REALITY

Creativity, Innovation, and Entrepreneurship

- What is the entrepreneurial "secret" for creating value in the marketplace? In reality, the "secret" is no secret at all: It is applying creativity and innovation to solve problems and to exploit opportunities to enhance or to enrich people's lives.
  - Creativity is the ability to develop new ideas and to discover new ways of looking at problems and opportunities.
  - Innovation is the ability to apply creative solutions to problems and opportunities to enhance or to enrich people's lives.

- Successful entrepreneurs come up with ideas and then find ways to make them work to solve a problem or to fill a need.
- Entrepreneurship is thus the result of a disciplined, systematic process of applying creativity and innovation to needs and opportunities in the marketplace.

Creativity A Necessity for Survival

- **I**n this fiercely competitive, fast-faced, global economy, creativity is not only and important source for building a competitive advantage, but it also is a necessity for survival.
- A paradigm is a preconceived idea of what the world is, what it should be like, and how it should operate.
- Entrepreneurs must always be on guard against existing paradigms because they are obstacles to creativity. Successful entrepreneurs often go beyond conventional wisdom as they ask "why not…?"
- Success even survival in this fiercely competitive, global environment requires entrepreneurs to tap their creativity and that of their employees constantly.

Barriers to Creativity

- The number of potential barriers to creativity is limitless, but entrepreneurs commonly face 10 "mental locks" on creativity:

i. Searching for the one "right" answer
- Deeply ingrained in most educational systems is the assumption that there is one "right" answer to a problem.
- In reality, however, depending on the question one asks, there may be (and usually are) several "right" answers.

ii. Focusing on "being logical"
- Focusing too much on being logical discourages the use of one of the mind's most powerful creations: intuition.
- Intuition is a crucial part of the creative process because using it often requires one to think about things in new and different ways.

iii. Blindly following the rules
- Sometimes creativity depends on our ability to break the existing rules so that we can see new ways of doing things.

iv. Constantly being practical
- Suspending practicality for a while frees the mind to consider creative solutions that otherwise might never arise. (Consider the invention of the airplane).

v. Viewing play as frivolous (not important)
- A playful attitude is fundamental to creative thinking
- Children learn when they play, and so can entrepreneurs
- Watch children playing and you will see them invent new games, create new ways of looking at old things, and learn what works and what doesn't in their games.

vi. Becoming overly specialized
- Creative thinkers do not limit their search for ideas in areas in which they have expertise. They search for ideas outside their areas of specialty.

vii. Avoiding ambiguity (uncertainty)
- Avoiding uncertain situations often stifles creativity
- Ambiguity can be a powerful creative stimulus; it encourages us to "think something

different".

viii. Fearing looking foolish

- People tend toward the status quo because they don't want to look foolish.
- Entrepreneurs perform a vital function "creative destruction" in which they look at old ways of doing things and ask, "Is there a better way?" By destroying the old, they create the new.

ix. Fearing mistakes and failure

- Creative people realize that trying something new often leads to failure; however they do not see failure as an end. It represents a learning experience on the way to success.

x. Believing that " I'm not creative"

- Some people limit themselves because they believe creativity belongs only to a select few.
- Everyone has within themselves the potential to be creative.

How to enhance creativity

- **En**trepreneurs can stimulate creativity in their companies by:

i. Embracing diversity (Hire a diverse workforce)
ii. Expecting creativity
iii. Expecting and tolerating failure
iv. Encouraging creativity
v. Viewing problems as challenges
vi. Providing creativity training
vii. Providing support (Employees should be given the tools and the resources they need to be creative).
viii. Rewarding creativity
ix. Modeling creativity (Entrepreneurs must set an example to employees by being creative themselves).

- Entrepreneurs can enhance their own creativity by:

i. Allowing themselves to be creative
ii. Giving their minds fresh input everyday
iii. Keeping a journal handy to record their thoughts and ideas
iv. Reading books on stimulating creativity
v. Taking some time off to relax

The Creative Process

- Although creative ideas may appear to strike as suddenly as a bolt of lightning, they are actually the result of the creative process, which involves seven steps

i. Preparation:

- involves getting the mind ready for creative thinking
- Preparation might include a formal education, on-the-job training, work experience, and taking advantage of other learning opportunities

ii. Investigation:

- Requires the individual to develop a solid understanding of the problem or decision

iii. Transformation:

- Involves viewing the similarities (convergent thinking) and the differences in the information collected

iv. Incubation:
- Allows the subconscious to reflect on the information collected

v. Illumination:
- Occurs at some point during the incubation period when a spontaneous breakthrough causes "the light bulb to go on"

vi. Verification:
- Involves validating the idea as accurate and useful
- For entrepreneurs, this may include conducting experiments, running simulations, test marketing a product or service, etc, to verify that the new idea will work and is practical to implement.

vii. Implementation:
- Involves transforming the idea into a business reality

Techniques for Improving the Creative Process

- Three techniques are especially useful for improving the creative process:

i. Brainstorming
- A process in which a small group of people interact with very little structure with the goal of producing a large quantity of novel and imaginative ideas
- As group members interact, each idea sparks the thinking of others, and the spawning of ideas becomes contagious.

ii. Mind-mapping
- A graphical technique that encourages thinking on both sides of the brain, visually displays the various relationships among ideas, and improves the ability to view a problem from many sides

iii. Rapid Prototyping
- Based on the premise that transforming an idea into an actual model will point out flaws in the original idea and will lead to improvements in its designs
- Developing a model of an idea enables the entrepreneur to determine what works and what does not.

Protecting Your Ideas

- Once entrepreneurs come up with an innovative idea for a product or service that has market potential, their immediate concern should be to protect it from unauthorized use.
  - This is where patents, trademarks and copyrights become very useful.
  - Patents: A patent is a grant from the federal government that gives an inventor exclusive rights to an invention for 20 years.
  - Trademark: A trademark is any distinctive word, symbol, or trade dress that a company uses to identify its product and to distinguish it from other goods. It serves as the company's "signature" in the market place.
  - Copyright: A copyright protects original works of authorship. It covers only the form in which an idea is expressed, not the idea itself, and lasts for 70 years beyond the creator's death.

CHAPTER 3: FORMS OF BUSINESS OWNERSHIP AND FRANCHISING

a) Three major forms of business ownership (advantages and disadvantages)

I) **The Sole Proprietorship**

- a business owned and managed by one individual

Advantages of a proprietorship

i. Simple to create
ii. Least costly form of ownership to begin
iii. Profit incentive (owner keeps all profits)
iv. Total decision-making authority
v. No special legal restriction (has very few rules for establishing and running, unlike corporation)
vi. Easy to discontinue.

Disadvantages of a proprietorship

i. Unlimited personal liability (owner responsible for all debts of the business)
ii. Limited skills and capabilities (owner may not possess all the skills necessary for successfully running the business).
iii. Feelings of isolation (no one to turn for help in solving problems or getting feedback on a new idea).
iv. Limited access to capital (difficulty in raising additional money to grow and expand business).
v. Lack of continuity for the business (if the proprietor dies, retires or becomes incapacitated, the business usually automatically terminates).

II) The Partnership

- An association of two or more people who co-own a business for the purpose of making a profit.
- A good partnership requires a partnership agreement, which is a document that states in writing all of the terms of operating the partnership and protects the interest of each partner

Advantages of the Partnership

i. Easy to establish
ii. Complementary skills (In successful partnerships, the parties' skills and abilities usually complement one another, strengthening the company's managerial foundations).
iii. Division of profits (no restrictions on how profits should be shared as long as all partners agree).
iv. Larger pool of capital
v. Ability to attract limited partners

- General partners: partners who share in owning, operating and managing a business and who have unlimited personal liability for the partnership's debts
- Limited partners: partners who do not take an active role in managing a business and whose liability for the partnership's debts is limited to the amount they have invested.

- A limited partnership can attract investors by offering them limited liability and the potential to realize a substantial return on their investments if the business is successful.

vi. Little government regulation

vii. Flexibility

viii. Taxation (not subject to federal taxation; like the proprietorship, avoids the "double taxation" disadvantage associated with the corporate form of ownership)

Disadvantages of the Partnership

i. Unlimited liability of at least one partner (at least one member of every partnership must be a general partner, and every general partner has unlimited personal liability).

ii. Capital accumulation (not as effective as corporate form of ownership which can raise capital by selling shares).

iii. Difficulty in disposing of partnership interest without dissolving the partnership (when a partner withdraws from the partnership, it ceases to exist unless there are specific provisions in the partnership agreement)

iv. Lack of continuity (if a partner dies, partnership interest is often nontransferable through inheritance because the remaining partners may not want to be in a partnership with the person who inherits the deceased partner's interest).

v. Potential for personality and authority conflicts (No matter how compatible partners are, friction among them is inevitable. The demise of many partnerships can often be traced to interpersonal conflicts and the lack of a procedure to resolve those conflicts).

Other forms of partnerships

i. Limited partnership a partnership composed of at least one general partner and at least one limited partner.

ii. Limited liability partnership (LLP) a special type of limited partnership in which all partners, who in many states must be professionals (e.g. attorneys, physicians, dentists and accountants), are limited partners.

iii. Master limited partnership (MLP) a partnership whose shares are traded on stock exchanges, just like a corporation's; behave much like a corporation, and in 1987 U.S. legislation provided that any MLPs not involved in natural resources or real estate be taxed as corporations).

III) Corporations

-Most complex of the three major forms of business ownership

- A Corporation is a separate legal entity apart from its own owners that receives the right to exist from the state in which it is incorporated.

- A domestic corporation is one doing business in the state in which it is incorporated.

- A foreign corporation is one doing business in a state other than the one in which it is incorporated

- An alien corporation is one formed in one country and doing business in another country.

How to Incorporate

- Every state requires a certificate of incorporation or charter to be filed with the secretary of state,

- The following information is generally required to be included in the certificate of incorporation:

i) The corporation's name

ii) The corporation's statement of purpose
iii) The corporation's time horizon (mostly formed with no specific termination date)
iv) Names and addresses of the incorporators
v) Place of business
vi) Capital stock authorization (The articles of incorporation must include the amount and type of capital stock the corporation wants to be authorized to issue; a corporation can issue any number of issues up to the amount authorized).
vii) Capital required at the time of incorporation (some states require a newly formed corporation to deposit in a bank a specific percentage of the stock's par value prior to incorporating)
viii) Restrictions on transferring shares
- Many closely-held corporations (those owned by a few shareholders, often family members) require shareholders interested in selling their stock to offer it first to the corporations.
- Treasury stock: the shares of its own stock that a corporation owns
- Right to first refusal: a provision requiring shareholders who want to sell their stock to offer it first to the corporation.

ix) Names and addresses of the officers and directors of the corporation
x) Rules under which the corporation will operate (Bylaws)

The Advantages of the Corporation

i. Limited liability of stockholders(because it is a separate legal entity, a corporation allows investors to limit their liability to the total amount of their investment in the business
ii. Ability to attract capital
iii. Ability to continue indefinitely
iv. Transferable ownership

The Disadvantages of Corporations

i. Cost and time involved in the incorporation process
ii. Double taxation (corporation's profits are taxed twice: at the corporate rate and at the individual rate [on the portion of profits distributed as dividends]).
iii. Potential for diminished managerial incentives
- Professional managers the entrepreneur brings in to help run the business as it grows do not always have the same degree of interest in or loyalty to the company. As a result, the business may suffer without the founder's energy, care, and devotion.
- One way to minimize this potential problem is to link managers' compensation to the company's financial performance through a profit-sharing or bonus plan.

iv. Legal requirements and regulatory red tape
v. Potential loss of control by the founder
- When entrepreneurs sell shares of ownership in their companies, they relinquish some control.
- When large amount of capital is needed, entrepreneurs may have to give up significant amounts of control, so much, in fact, that the founders become minority shareholders.

Franchising

- Franchising is a system of distribution in which semi-independent business owners (franchisees) pay fees and royalties to a parent company (franchiser) in return for the right to become identified with its trademark, to sell its products or services, and often to use its business format and system.
- Franchisees do not establish their own autonomous businesses; instead they buy a “success package” from the franchiser, who shows them how to use it.

- Franchisees, unlike independent business owners, don't have the freedom to change the way they run their businesses, but they do have a formula for success that the franchiser has worked out.

Types of Franchising

i. Trade-name franchising: a system of franchising in which a franchisee purchases the right to use the franchiser's trademark without distributing particular products under the franchiser's name.

ii. Product distribution franchising:
- A system of franchising in which a franchiser licenses a franchisee to sell its products under the franchiser's brand name and trademark through a selective, limited distribution network.
- This system is commonly used to market automobiles (Toyota, Peugeot), gasoline products (Mobil, Texaco), soft drinks, etc.

iii. Pure franchising:
- A system of franchising in which a franchiser sells a franchisee a complete business format and system,
- Franchiser provides the franchisee with a complete business format, including a license for a trade name, the products or services to be sold, the physical plant, the methods of operation, a marketing strategy plan, a quality control process, a two-way communications system, and the necessary business services.
- Most common among fast-food restaurants, hotels, and many others.

Benefits of Buying a Franchise

i. Management training and support (Franchisers often offer managerial training programs to franchisees prior to opening a new outlet).

ii. Brand-name Appeal (Franchisees have the advantage of identifying their businesses with a widely recognized trademark, which usually provides a great deal of drawing power.

iii. Standardized Quality of Goods and Services (In order to maintain reputation, franchisers demands franchisees to comply with uniform standards of quality and services throughout the entire chain.

iv. National Advertising Programs (Franchisers usually require franchisees to contribute a percentage of their gross revenues for a national advertising campaign. These funds are pooled together and used for a cooperative advertising program, which has more impact than if the franchisees spent the same amount of money separately.)

v. Proven Products and Business Formats (What a franchisee essentially purchases is a franchiser's experience, expertise and products. A franchise owner does not have to build the business from scratch.

vi. Centralized Buying Power (A significant advantage a franchisee has over an independent small business owner is participation in the franchiser's centralized and large-volume buying power)

vii. Site Selection and Territorial Protection
- A proper location is critical to the success of any small business. Many franchisers will make an extensive location analysis for each new outlet.
- Some franchisers offer franchisees territorial protection, which gives existing franchisees the right to exclusive distribution of brand name goods or services within a particular geographic area.

viii. Greater Chance for Success (Available statistics suggest that franchising is less risky than building a business from the ground up.)

The Drawbacks of Buying a Franchise

i. Franchise fees and profit sharing
ii. Strict adherence to standardized operations
iii. Restrictions on purchasing (in the interest of maintaining quality standards, franchisees may be required to purchase products, special equipment or other times from the franchiser of from an “approved” supplier).
iv. Limited product line
v. Less freedom

CHAPTER 4: DEVELOPING MARKETING STRATEGIES

Building a Guerrilla Marketing Plan

- Marketing is the process of creating and delivering desired goods and services to customers, and involves all of the activities associated with winning and retaining loyal customers.
    - The secret to successful marketing is to understand what your target customers' needs, demands, and wants are before your competitors can; offer them the products and services that will satisfy those needs, demands and wants; and provide customers service, convenience and value.
    - Guerrilla marketing strategies are unconventional, low-cost, creative marketing strategies designed to give small companies an edge over their larger, richer, more powerful rivals.
    - A guerilla marketing plan should accomplish four objectives:
    1. It should pinpoint the specific target markets the small company will serve.
    2. It should determine customer needs and wants through market research.
    3. It should analyze the firm's competitive advantages and build a guerrilla marketing strategy around them.
    4. It should help create a marketing mix that meets customer needs and wants.

Pinpointing the Target Market

- Target market is the specific group of customers at whom a company aims its goods or services.
    - To be customer driven, an effective marketing program must be based on a clear, concise definition of a company's target customers.
    - A sound market research helps the owner pinpoint his target market.

- The most successful businesses have well defined portraits of the customers they are seeking to attract.

<u>Determining Customer Needs and Wants Through Market Research</u>

- Market research is the vehicle for gathering the information that serves as the foundation for the marketing plan.
  - It involves systematically collecting, analyzing, and interpreting data pertaining to a company's market, customers and competitors.
  - The objective of market research is to learn how to improve the level of satisfaction for existing customers and to find ways to attract new customers.
  - Market research does not have to be time consuming, complex or expensive to be useful. By applying the same type of creativity that they display when creating their businesses, entrepreneurs can perform effective market research at reasonable costs.
  - The steps in conducting market research include:
  1. Defining the objective
  - The first and most crucial step.
  - It answers the question, "What do we want to know?"
  2. Collect the data
  - The marketing approach that dominates today is individualized (one-to-one) marketing, a system based on gathering data on individual customers and developing a marketing program designed to appeal specifically to their needs and wants.
  - How can entrepreneurs collect such valuable market and customer information? Two basic methods are available: conducting primary research (data you collect and analyze yourself) and gathering secondary research (data that have already been compiled and are available, often at a very reasonable cost.
  3. Analyze and Interpret the Data
  - Entrepreneurs must use judgment and common sense to determine what the results of their research mean.
  4. Draw Conclusions and Act
  - The market research process is not complete until the business owner acts on the information collected.

<u>Plotting a Guerilla Marketing Strategy: How to Build a Competitive Edge</u>

- When plotting a marketing strategy, owners must strive to achieve a competitive edge-some way to make their companies different from, and better than the competition.
  - Successful entrepreneurs rely on the following effective guerilla marketing strategies to develop a competitive edge:
  1. Find a Niche and Fill it
  - A niche strategy allows a small company to maximize the advantages of its size and to compete effectively even in industries dominated by giants.
  - Focusing on niches that are too small to be attractive to large companies is a common recipe for success among thriving small companies.
  2. Don't Just Sell Entertain
  - Winning customers today requires more than low prices and wide merchandise selection; increasingly, businesses are adopting strategies based on entertailing.
  - Entertaining is a marketing concept designed to draw customers into a store by creating a kaleidoscope of sights, sounds, smells and activities, all designed to entertain- and of course sell.

3. Strive to be Unique
- Entrepreneurs can achieve a unique place in the market in a variety of ways, including through the products and services they offer, the marketing and promotional campaigns they use, the store layouts they design, and the business strategies they employ.
4. Create an Identity for your business
- Some of the most powerful marketers are those companies that have a clear sense of who they are, what they stand for, and why they exist.
5. Connect with Customers on an Emotional Level
- Companies that establish a deeper relationship with their customers than one based merely on making a sale have the capacity to be exceptional guerrilla marketers.
- They connect with their customers emotionally by supporting causes that are important to their customer base, taking exceptional care of their customers, surpassing customers' expectations in quality and service, or making it fun and enjoyable to do business with them.
6. Focus on the Customer
- Businesses must realize that everything in the business even the business itself depends on creating a satisfied customer.
7. Devotion to Quality
- World-class companies treat quality as a strategic objective an integral part of a company's strategy and culture.
- This philosophy is called total quality management (TQM) quality not just in the product or service itself but in every aspect of the business and its relationship with the customer and continuous improvement in the quality delivered to customers.
8. Attention to Convenience
- Successful companies go out of their way to make sure that it is easy for customers to do business with them.
9. Concentration on Innovation
- Innovation is the key to success.
- Markets change too quickly and competitors move too fast for a small company to stand still and remain competitive.
- Because y cannot outspend their larger rivals, small companies often turn to superior innovation as the way to gain a competitive edge.
10. Dedication to Service and Customer Satisfaction
- Success businesses recognize that superior customer service is only an intermediate step towards the goal of customer satisfaction.
- These companies seek to go beyond customer satisfaction, striving for customer astonishment.
- Certainly the least expensive and the most effective - way to achieve customer satisfaction is through friendly, personal service.
11. Emphasis on Speed
- World-class companies recognize that reducing the time it takes to develop, design, manufacture, and deliver a product reduces costs, increases quality, improves customer satisfaction, and boosts market share.

<u>Marketing on the World Wide Web</u>

- The Web offers small business owners tremendous marketing potential on a par with their larger rivals.

- Establishing a presence on the Web is important for companies targeting educated, wealthy, young customers.
- Successful Web sites are attractive, inviting, easy to navigate, interactive, and offer users something of value.

The Marketing Mix

- The major elements of a marketing strategy are the four Ps of marketing product, place, price and promotion.

1. Product
- A product is any item or service that satisfies the need of a customer.
- Products can have form and shape, or they can be services with no physical form.
- The product life cycle describes the stages of development, growth, and decline in a product's life.
- Stage 1: introductory stage the stage in which a product or service must break into the market and overcome customer inertia.
- Stage 2: growth and acceptance stage the stage in which sales and profits materialize
- Stage 3: maturity and competition stage the stage in which sales rise, but profits peak and then fall as competitors enter the market.
- Stage 4: market saturation stage stage in which sales peak, indicating the time to introduce the next generation product.
- Stage 5: product decline stage the stage in which sales continue to fall and profit margins decline drastically.

2. Place
- Refers to method of distribution of products
- The focus here is on choosing the appropriate channel of distribution and using it most efficiently.

3. Price
- Almost everyone agrees that the price of the product or service is a key factor in the decision to buy.
- Price affects both sales volume and profits, and without the right price, both sales and profits will suffer.
- The right price for a product or service depends on three factors: (1) a small company's cost structure, (2) an assessment of what the market will bear, and (3) the desired image the company wants to create in the customer's mind.

4. Promotion
- Involves both advertising and personal selling
- The goal is to inform and persuade customers
- Advertising communicates to potential customers through some mass medium the benefits of a good or service.
- Personal selling involves the art of persuasive sales on a one-to-one basis.

CHAPTER 5: MANAGING CASH FLOW

Cash Management

- A survey by the National Federation of Independent Businesses found that 67% of small business owners say they have at least occasional problems managing cash flow; 19% report cash flow as a continuing problem.
  - The only way to avoid this potentially business-crushing predicament is by using the principles of cash management.
  - Cash management is the process of forecasting, collecting, disbursing, investing and planning for the cash a company needs to operate smoothly.
  - Cash management is a vital task because cash is the most important yet least productive asset that a small business owns.
  - A business must have enough cash to meet its obligations or it will be declared bankrupt.
  - The first step in managing cash flow more effectively is to understand the company's cash flow cycle.
  - Cash flow cycle is the time lag between paying suppliers for merchandise or materials and receiving payment from customers; the longer this cash flow cycle, the more likely the business owner is to encounter a cash crisis
  - The next step in effective cash management is to analyze the cash flow cycle, looking for ways to reduce its length.

5 Cash Management Roles of the Entrepreneur

1. Cash Finder:

- This is the entrepreneur's first and foremost responsibility.
- You must make sure there is enough capital to pay all present and future bills.
- This is not a one-time task, it is an ongoing job.

2. Cash Planner:

- As cash planner, an entrepreneur makes sure the company's cash is used properly and efficiently.
- You must keep track of its cash, make sure it is available to pay bills, and plan for its future use.

3. Cash Distributor:

- This role requires you to control the cash needed to pay the company's bills and the priority and the timing of those payments.
- Forecasting cash disbursements accurately and making sure the cash is available when payments come due are essential to keeping the business solvent.

4. Cash Collector:
- As cash collector, your job is to make sure your customers pay their bills on time.
- Too often, entrepreneurs focus on pumping up sales, while neglecting to collect the cash from those sales.
- Having someone n your company responsible for collective accounts receivable is essential.
- Uncollected accounts drain a small company's pool of cash very quickly.

5. Cash Conserver
- This role requires you to make sure your company gets maximum value for the dollars it spends.
- Whether you are buying inventory to resell or computers to keep track of what you sell, it is important to get the most for your money.
- Avoiding unnecessary expenditures is an important part of this task.
- The goal is to spend cash so it will produce a return for the company.

<u>Cash and Profits are not the same</u>

- When analyzing cash flow, entrepreneurs must understand that cash and profits are not the same.
- Profit (or net income) is the difference between a company's total revenue and its total expenses. It measures how efficiently a business is operating.
- Cash is the money that is free and readily available to use in a business.
- Cash follow measures a company's liquidity and its ability to pay its bills and other financial obligations on time by tracking the flow of cash into and out of the businesses over a period of time.
- Profitability does not guarantee liquidity, as profits can be tied up in many forms such as accounts receivable, inventory, computers or machinery.
- Decreases in cash occur when the business purchases on credit or for cash, goods for inventory or materials for use in production.
- When a company takes in cash or collects payments on accounts receivable, its cash balance increases.

<u>The Cash Budget</u>

- The need for a cash budget arises because in every business the cash flowing in is rarely “in sync” with the cash flowing out of the business.
- This uneven flow of cash creates periodic cash surpluses and shortages, making it necessary for entrepreneurs to track the flow of cash through their businesses so they can project realistically the cash available throughout the year.
- The cash budget is a “cash map” showing the amount and the timing of cash receipts and cash disbursements on a daily, weekly or monthly basis.

<u>Preparing a Cash Budget</u>

There are five basic steps in completing a cash budget:

1. Determining an adequate minimum cash balance
    - The most reliable method of deciding cash balance is based on past experience.
    - Past operating records should indicate the proper cash cushion needed to cover any unexpected expenses after all normal cash outlines are deducted from the month's cash receipts.

2. Forecasting sales
    - The heart of the cash budget is the sales forecast.
    - It is the central factor in creating an accurate picture of the firm's cash position because sales ultimately are transformed into cash receipts and cash disbursements.
    - For an established business, a sales forecast is based on past sales, but owners must be careful not to be excessively optimistic in projecting sales.
    - The task of forecasting sales for the new firm is more difficult but not impossible. For example, the new owner might conduct research on similar firms and their sales patterns in the first year of operation to come up with a forecast.
    - No matter what techniques entrepreneurs use, they must recognize that even the best sales estimates will be wrong.
    - Many financial analysts suggest that the owner create three sales estimates an optimistic, a pessimistic, and a most likely sales estimate and then make a separate cash budget for each forecast.

3. Forecasting Cash Receipts
    - When a firm sells goods and services on credit, the cash budget must account for the delay between the sale and the actual collection of the proceeds.
    - Collecting accounts receivable promptly poses problems for many small companies, and is often cited by small business owners as the primary cause of cash flow problems.

4. Forecasting Cash Disbursements
    - The key factor in forecasting disbursements for a cash budget is to record them in the month in which they will be paid, not when the obligation is incurred.
    - Usually an owner's tendency is to underestimate cash disbursements, which can result in a cash crisis. To prevent this, wise entrepreneurs cushion their cash disbursement accounts, assuming they will be higher than expected.

5. Estimating the End-of-Month Cash Balance
    - Begin by determining the cash balance at the beginning of the month (cash in hand, and cash in savings or checking account)
    - Add forecasted cash receipts and decrease forecasted cash disbursements to estimate end-of-month cash balance.

<u>The “Big Three” of Cash Management</u>

- The big three of cash management are accounts receivable, accounts payable and inventory.
    - A good cash management “recipe” involves collecting your company's cash as quickly as possible, economizing to keep costs low, and paying out your company's cash as slowly as possible.

- Business owners must also monitor inventory carefully to avoid tying up valuable cash in an excessive stock of inventory.

1. Accounts Receivable:

- Controlling accounts receivable requires business owners to establish clear, firm credit and collection policies and to screen customers before granting them credit.
- Sending invoices promptly and acting on past-due accounts quickly also improve cash flow.
- The goal is to collect cash from receivables as quickly as possible.

2. Accounts Payable:

- When managing accounts payable, a manager's goal is to stretch out payables as long as possible without damaging the company's credit rating.
- Other techniques include verifying invoices before paying them, taking advantage of cash discounts, and negotiating the best possible credit terms.

3. Inventory:

- Inventory frequently causes cash headaches for small business managers.
- Excess inventory earns a zero return of return and ties up a company's cash unnecessarily.
- Owners must watch for stale merchandise.

Avoiding the Cash Crunch

By utilizing the following techniques, entrepreneurs can get maximum benefit from their companies' pool of available cash:

1. Barter
   - Bartering is the exchange of goods and services for other goods and services rather than for cash
2. Trim Overhead costs
   - Simple cost-cutting measures can save big money.
   - Examples include: i) periodically evaluating expenses, ii). Leasing instead of buying when practical, iii) Avoiding nonessential outlays and iv) hiring part-time and freelance specialists whenever possible.
3. Be on the lookout for employee theft
4. Keep your business plan current
5. Invest surplus cash

Sources of financing: debt and equity

- Raising the money to launch a new business has always been a challenge for entrepreneurs.
  - Rather than rely primarily on a single source of funds as they have in the past, entrepreneurs must piece together capital from multiple sources, a method known as layered financing.
  - This chapter will guide you through the many financing options available to entrepreneurs, focusing on both sources of equity (ownership) and debt (borrowed) financing.

Planning For Capital Needs

- Becoming a successful entrepreneur requires one to become a skilled fund-raiser, a job that requires more time and energy than most business founders think.
  - Capital is any form of wealth employed to produce more health.

- Entrepreneurs need three different types of capital:

1. Fixed Capital:

- Capital needed to purchase a company's permanent or fixed assets such as buildings, land, computers and equipment.
- Money invested in these fixed assets are usually large, and frozen because they cannot be used for any other purpose.

2. Working Capital:

- Capital needed to support a business's short-term operations.
- It represents a company's temporary funds
- Working capital is normally used to buy inventory, pay bills, finance credit sales, pay wages and salaries, and take care of any unexpected emergencies.

3. Growth Capital:

- Capital needed to finance a company's growth or its expansion in a new direction.

Equity Capital Versus Debt Capital

Equity Capital

- Equity Capital represents the personal investment of the owner (or owners) in a business, and is sometimes called risk capital because these investors assume the primary risk of losing funds if the business fails.
  - If a venture succeeds, however, founders and investors share in the benefits, which can be quite substantial.
  - The primary advantage of equity capital it that it does not have to be repaid like a loan does.
  - The primary disadvantage is that the entrepreneur must give up some perhaps most of the ownership in the business to outsiders.

Debt Capital

- The financing that a small business owner has borrowed and must repay with interest
  - The primary advantage is that it does not require entrepreneurs to give up ownership of the business.
  - The primary disadvantage is that it must be carried as a liability on the balance sheet as well as be repaid with interest at some point in the future.

Source of Equity Financing

1. Personal Savings: The first place entrepreneurs should look for start-up money is their own pockets.
2. Friends and Family Members
3. Angels: wealthy individuals, often entrepreneurs themselves, who invest in business start-ups in exchange for equity stakes in the companies.
4. Partners
5. Corporate Venture Capital: When large corporations finance small companies.
6. Venture Capital Companies: private, for-profit organizations that purchase equity positions in young businesses they believe have high-growth and high-profit potential.
7. Public Stock Sale (“Going Public”): In some cases, entrepreneurs can raise capital by selling shares of its stock to the general public for the first time. This is known as an initial public offering (IPO).

Sources of Debt Financing

1. Commercial Banks:
   - Offer the greatest variety of loans, although they are conservative lenders.
   - Typical short-term loans include commercial loans, lines of credit, discounting accounts receivable, inventory financing, and floor planning (a form of financing used by big-ticket item retailers like cars, boats).
2. Trade Credit:
   - Used extensively by small businesses as a source of financing.
   - Vendors and suppliers commonly finance sales to businesses for 30, 60, or even 90 days.
3. Equipment suppliers: offer small businesses financing similar to trade credit but with slightly different terms.
4. Commercial Finance Companies:
   - Offer many of same time of loans that banks do, but are more risk oriented in their lending practices.
   - They emphasize accounts receivable financing and inventory loans.
5. Savings and Loan Associations: specialize in loans to purchase real property commercial and industrial mortgages- for up to 30 years.
6. Brokerage houses: offer loans to prospective entrepreneurs at lower interest rates than banks because they have high quality, liquid collateral stocks and bonds in the borrower's portfolio.
7. Insurance Companies:
   - Provide financing through policy loans and mortgage loans.
   - Policy loans are loans extended on the basis of the amount of money a customer has paid into a policy in the form of premiums.
   - Mortgage loans are made for large amounts and are based on the value of the land being purchased
8. Credit Unions: a nonprofit financial cooperative that promotes savings and provides loans to its members.
9. Federally Sponsored Programs

A. NEEDS
- The National Economic Empowerment and Development Strategy (NEEDS) is the response to the development challenges of Nigeria established in 2003 by the Obasanjo administration.
- NEEDS focuses on four key strategies:
  i. Poverty eradication
  ii. Wealth creation
  iii. Employment generation
  iv. Value orientation.
- The major target of NEEDS is poverty eradication, which perceives entrepreneurship as a major vehicle for economic growth.

B. SMEDAN
- Small and Medium Development Agency of Nigeria (SMEDAN) was established in 2003.
- Its aim was not to provide direct finance to small and medium enterprises, but to facilitate their access to finance and other resources.
- It has four major roles: i) provision of information and awareness creation through business sensitization activities, ii) Business Development Service (BDS) with its tripartite role of

training, counseling and mentoring, iii) Promotion of enterprise networking or cluster formation to stimulate international competitiveness, and iv) advocacy and improvement in operating environment usually in partnership with others.

Internal Methods of Financing

- Small business owners may also look inside their firms for capital.
  - This type of financing is called bootstrap financing, and includes:
  1. Factoring Accounts Receivable:
  - Instead of carrying credit sales on its own books, a small business can sell outright its accounts receivable to a factor.
  - A factor is a financial institution that buys a business's accounts receivable at a discount.
  2. Leasing:
  - By leasing expensive assets, the small business owner is able to use them without locking in valuable capital for an extended period of time.
  3. Credit cards:
  - Unable to find financing elsewhere, many entrepreneurs launch their companies using the fastest and most convenient source of debt capital available: credit cards.
  - Putting business start-up costs on credit cards is expensive and risky, but some entrepreneurs have no choice.

CHAPTER 6: CRATFTING A WINNING BUSINESS PLAN

Why Develop a Business Plan

- A business plan is a written summary of an entrepreneur's proposed business venture, its operational and financial details, its marketing opportunities and strategy, and its managers' skills and abilities.
  - A well assembled business plan serves three essential functions:
  1. Most importantly, it guides the company's operations by charting its future course and devising a strategy for success.
  2. It attracts lenders and investors
  3. It forces potential entrepreneurs to look at their business ideas in the harsh light of reality by making them assess their ventures' chances of success more objectively.
  - To get external financing, an entrepreneur's plan must pass three tests with potential lenders and investors:
  i. Reality Test
  - The external component of the reality test revolves around proving that a market for the product or service really does exist. It focuses on industry attractiveness, market niches, potential customers, market size, degree of competition, and similar factors.
  - The internal component of the reality test focuses on the product or service itself. Can the company really build or provide it for the cost estimates of the business plan. Does it offer customers something of value?
  ii. Competitive Test

- The external part of the competitive test evaluates the company's relative position to its key competitors. Ho w do the company's strength and weaknesses match up with those of the competition?
- The internal competitive test focuses on management's ability to create a company that will gain an edge over existing rivals. To pass this part of the test, a plan must prove the quality, skill and experience of the venture's management team.

iii. Value Test

- To convince lenders and investors to put their money into the venture, a business plan must prove to them that it offers a high probability of repayment or an attractive rate of return.

The Elements of a Business Plan

Although a business plan should be unique and tailor-made to suit the particular needs of a small company, it should cover these basic elements:

1. The Executive Summary
   - A concise (maximum of 2 pages) summary of all the relevant points of the business venture.
   - It should explain the basic business model and briefly describe the owners and key employees, target market, and financial highlights.
   - Although it is the first part of the business plan, it should be the last section written.
2. Mission Statement
   - The broadest expression of a company's purpose and defines the direction in which it will move.
3. Company History
   - Brief history of the operation, highlighting the significant financial and operational events in the company's life.
4. Business and Industry Profile
   - To acquaint lenders with the industry in which a company competes, an entrepreneur should describe it in the business plan.
   - This section should begin with a statement of the company's general business goals and a narrower definition of its immediate objectives.
5. Business Strategy
   - This segment of the business plan outlines the methods the company can use to meets its goals and objectives.
6. Description of Firm's Product/Service
   - An entrepreneur should describe the company's overall product line, giving an overview of how customers use its goods or services.
   - The emphasis of this section should be on defining the benefits customers get by purchasing the company's product or services rather than just a description of the features of those products and services.
   - Manufacturers should describe their production process, strategic raw materials required, sources of supply they will use, and their costs.
7. Marketing Strategy
   - Defining the target market and its potential is one of the most important and most challenging parts of building a business plan.
   - Prospective lenders and investors want to know whether or not there is a real market for the proposed good or service.
   - Questions this part of the business plan should address include: Who are the most promising customers or prospects? What are their characteristics? Where do they live? What do they buy? Why do they buy? When do they buy? What expectations do they have about the

product or service? Will the business focus on a niche? How does the company seek to position itself in its market.

- This portion of the plan also should describe the channels of distribution that the business will use.

8. Competitor Analysis

- This section of the plan should include an analysis of each significant competitor.
- Entrepreneurs who believe that they have no competition are only fooling themselves.
- This section of the plan should also focus on demonstrating that the entrepreneur's company has an advantage over its competitors.

9. Description of the Management Team

- The most important factor in the success of a business venture is the quality of its management, and most financial officers and investors weigh heavily the ability and experience of the firm's managers in their financing decisions.
- A plan should thus describe the qualifications of business officers, key directors and any person with at least 20 percent ownership in the company.
- Resumes in a plan should summarize an individual's education, work history and relevant business experience.

10. Plan of Operation

- To complete the description of the business, the owner should construct an organizational chart identifying the business's key positions and the personnel occupying them.
- Also, a description of the form of ownership and of any leases, contracts, and other relevant agreements pertaining to the business is helpful.

11. Forecasted or Pro Forma Financial Statements

- One of the most important sections of the business plan is an outline of the proposed company's financial statements.
- Whether assembling a plan for an existing business or for a start-up, an entrepreneur should carefully prepare monthly projected financial statements for the operation for the next year using past operating data, published statistics, and judgments to derive three sets of forecasts of the income statement, balance sheet, cash budge and schedule of planned capital expenditures.

12. The Loan or Investment Proposal

- The loan or investment proposal section of the business plan should state the purpose of the financing, the amount requested, and the plans for repayment or, in the case of investors, an attractive exit strategy.

<u>Making the Business Plan Presentation</u>

- Lenders and investors are favorably impressed by entrepreneurs who are informed and prepared when requesting a loan or investment.
  - Some helpful tips for making a business plan presentation to potential lenders and investors include:

1. Demonstrate enthusiasm about the venture, but don't be overly emotional.
2. Know your audience thoroughly and work to establish rapport with them.
3. “Hook” investors quickly with an up-front explanation of the new venture, its opportunities, and the anticipated benefits to them.
4. Use visual aids.
5. Hit the highlights of your venture
6. Don't get caught up in too much detail in early meetings with lenders and investors.
7. Avoid the use of technological terms that will likely be above most of the audience.

8. Rehearse your presentation before giving it.
9. Close by reinforcing the nature of the opportunity.
10. Be prepared for questions.
11. Follow up with every investor to whom you make a presentation. Don't sit back and wait; be proactive. They have what you need investment capital.

What Lenders and Investors look for in a Business Plan

- Small business owners need to be aware of the criteria bankers use in evaluating the creditworthiness of loan applications. These criteria are referred to as the “five Cs of credit”.

1. Capital
   - Banks expect a small company to have an equity base of investment by the owner(s) that will help support the venture during times of financial strain, which are common during the start-up and growth phases of a business.
   - Lenders and Investors see capital as a risk-sharing strategy with entrepreneurs.
2. Capacity
   - Another name for capacity is cash flow.
   - The bank must be convinced of the firm's ability to meet its regular financial obligations and to repay the bank loan, and that takes cash.
   - Lenders expect small businesses to pass the test of liquidity, especially for short-term loans.
3. Collateral
   - Collateral includes any assets the owner pledges to the bank as security for repayment of the loan.
   - Bankers view the entrepreneurs' willingness to pledge collateral as an indication of their dedication to making the venture a success.
4. Character
   - Before extending a loan to or making an investment in a small business, lenders and investors must be satisfied with an entrepreneur's character.
   - The evaluation of character is frequently based on intangible factors such as honesty, integrity and competence, and it plays a critical role in the decision to put money into a business or not.
5. Conditions
   - Lenders and investors consider factors relating to a business's operation such as potential growth in the market, competition, location, strengths, weaknesses, opportunities and threats. The best way to provide this relevant information is in a business plan.
   - Another important condition influencing the banker's decision is the shape of the overall economy, including interest rate levels, inflation rate, and demand for money. Although these factors are beyond an entrepreneur's control, they still are an important component in a banker's decision.