BUILDING A POWERFUL MARKETING PLAN

A business plan must contain both financial plan and marketing plan. Financial plan focuses on cash flow, net income, and owner's equity. **A marketing plan focuses on customers.**

Marketing is a process of creating and delivering desired goods and services to customers. It involves all of the activities associated with winning and retaining loyal customers. As competition for customers becomes more intense, small business owners must understand the importance of developing creative marketing strategies as their success and survival depend on it.

Guerrilla Marketing Strategy is an unconventional, low-cost creative marketing techniques that allow a small company to wring more bang from its marketing bucks that do larger rivals. An entrepreneur need not require to spend large amounts of money, but does demand to have creativity, ingenuity, and an understanding of customers' buying habits. *Its purpose is to build a strategy of success for a business – but from the customer's point of view.*

Building a Guerrilla Marketing Plan

A guerrilla marketing plan should accomplish **four objectives:**

1. **Pinpoint the specific target market the company will serve**

   Target market is the specific group of customers at whom the company aims its goods or services. The more a business knows about its local markets, its customers, and their buying habits and preferences, the more precisely it can focus its marketing efforts on the group(s) of customers who are most likely to buy its products or services. Mass marketing techniques no longer work. *Without a clear image of its target market, a small company* ***tries to reach almost everyone*** *and ends up* ***appealing to almost no one.***

2. **Determines customer needs and wants through Market Research**

   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 the company's market, customers, and competitors. The objectives of market research is to learn how to improve the level of satisfaction for existing customers and to find ways to attract new customers. The most common and worst mistakes entrepreneurs make is *assuming* that a market exists for their product or service. Market research can tell entrepreneurs whether a sufficient customer base exists and how likely those customers are to purchase their products or services.

   Market research does not have to be time consuming, complex, or expensive to be useful. (web-based market research – online surveys, trend-tracking)

How to Conduct Market Research

i. **Define the objective**

   Defining the research objective clearly and concisely is the first and most crucial step.

ii. **Collect the data**

   The marketing approach that dominates today is **individualized (one-to-one) marketing.** It gathers data on individual customers and then develops a marketing program designed specifically to appeal to their needs, tastes and preferences. Companies following this approach know their customers, understand how to give them the value they want, and, know how to make them feel special and important.

How to become an effective one-to-one marketer

- Identify your best customers
- Collect information on these customers, linking their identities to their transactions
- Calculate the long-term value of customers so you know which ones are more profitable
- Know what your customers' buying cycle is and time your marketing efforts to coincide with it (JIT)
- Make sure the company's product and service quality will astonish the customers
- Encourage complaints and then fix them – a chance to improve the service and quality
- Enhance the products and services by giving customers information about them and how to use them

Entrepreneurs collect such valuable market and customer information using primary and secondary researches.

Another approach for data collection is data mining. **Data mining** is a process in which computer software that uses statistical analysis, database technology, and artificial intelligence finds hidden patterns, trends, and connections in data so that business owners can make better marketing decisions and predictions about customers' behavior.

iii. Analyze and interpret the data

Entrepreneurs must use judgment and common sense to determine what the results of their research mean. There is no hard-and-fast rules for interpreting market research results.

iv. Draw conclusions and act

The owner must decide how to use the survey results and information in the business. For example, the owner of a retail shop discovered from a survey that her customers preferred evening shopping hours over early morning hours. She made the schedule adjustment, and sales began to climb.

3. Analyze firm's competitive advantages and build a guerrilla marketing strategy around them

A competitive advantage is crucial for business success. A small company has a competitive advantage when customers perceive that its products or services are superior to those of its competitors.

Successful entrepreneurs often use the special advantages that flow from their companies' smallness to build a competitive edge over their larger rivals. They can become more effective than their larger rivals at **relationship marketing (customer relationship management)**

<u>**Customer Relationship Management (CRM) / Relationship marketing**</u>

It is the process of developing, maintaining, and managing long term relationships with customers so they will keep coming back to make repeat purchases. Steps for CRM are:

Analyze: Conduct detailed customer intelligence to pinpoint most valuable customers and learn all about them including their lifetime value to the company.

Connect and Collect: Make contact with most valuable customers and begin building a customer database using data mining and data warehousing techniques.

Learn: Learn from customers by encouraging feedback; develop a thorough customer profile and constantly refine it.

Build Relationships: Based on what is learned, contact customers with an offer designed for them and make them feel valued and special.

Sell, Service and Satisfy: After completing all the steps successfully, superb customer service is the best way to retain the most valuable customers.

<u>**Guerrilla Marketing Strategies**</u>

i. Find a niche and fill it

Many successful small companies choose their niches carefully and defend them fiercely rather than compete head to head with larger rivals. Focusing on niches that are too small to be attractive to large companies is a common recipe for success among thriving small companies.

ii. Don't just sell; Entertain

Entertailing – A marketing concept designed to draw customers into a store by creating a kaleidoscope of sights, smells, and activities, all designed to entertain – and to sell of course. The primary goal of entertaining is to catch customers' attention and engage them in some kind of entertaining experience so that they shop longer and buy more goods or services. For example, Disney

iii. Strive to be Unique

Entrepreneurs can achieve a unique place in the market in variety of ways, including through products and services they offer, marketing and promotional campaigns they use, the store layouts they design, and the business strategies they employ. The basic goal to be unique is to stand out from the crowd.

iv. Connect with Customers on an Emotional level

Companies that establish a deeper relationship with their customers usually win because customers receive an emotional boost every time they buy these companies' products or services. Building ongoing relationship with customers establishes trust, which is a vital component of every marketing effort.

Another aspect of connecting with customers is defining the company's **unique selling proposition (USP),** a key customer benefit of a product or service that sets it apart from the competition; it answers the critical question every customer asks, "What's in it for me?"

v. Create an Identity of your business through Branding

The most effective ways for entrepreneurs to differentiate their businesses from the competition is to create a unique identity for it through branding. **Branding** involves communicating a company's unique selling proposition to its target customers in a consistent and integrated manner. Companies that build brands successfully benefit from increased customer loyalty, the ability to command higher prices, greater visibility, and increased name recognition.

vi. Start a Blog

A blog is a frequently updated online personal journal that contains a writer's ideas on a multitude of topics and links to related sites. Companies post their blogs, promote them on their web sites and on other blogs, and then watch the viral nature of the Web takes over with visitors posting comments and messaging their friends about the blog. Blogs can serve many business purposes, including keeping customers updated on new products, enhancing customer service, and promoting the company.

vii. Focus on the customer

Treating customers indifferently or poorly costs the average company from 15% to 30% of gross sales. Replacing lost customers is expensive as it costs seven to nine times as much to attract a new customer as it does to sell to an existing one. About 70% of company's sales come from existing customers. Although winning new customers keeps a company growing, keeping existing ones is essential to success. So, the companies that are successful at retaining their customers constantly ask themselves and their customers these four questions: What are we doing is right? How can we do that even better? What have we done wrong? And What can we do in the future?

viii. Devotion to Quality

In this competitive global business environment, quality goods and services are a prerequisite for success and survival. Customers expect and demand quality products and services and those businesses that provide them consistently have a distinct competitive advantage.

Total Quality Management (TQM) is the philosophy of producing a high-quality product or services and achieving quality in every aspect of the business and its relationship with the customer. Its focus is on continuous improvement in the quality delivered to customers.

ix. Pay attention to Convenience

Successful companies go out of their way to make sure that it is easy for customers to do business with them. For boosting the convenience levels of the business, the entrepreneurs can make following questions:

Is your business conveniently located near customers?
Are your business hours suitable to your customers?
Would customers appreciate pickup and delivery services?
Do you make it easy for customers to buy on credit or with credit cards?
Are your employees trained to handle business transactions quickly, efficiently, and politely?
Does your company handle telephone calls quickly and efficiently?

x. Concentrate on Innovation

Innovation is key to future success. It is one of the greatest strengths of entrepreneurs as it shows up in the new products, techniques, and unusual approaches they introduce. Their ability to concentrate their efforts and attention in one area gives small businesses an edge in innovation.

xi. Dedication to Service and Customer Satisfaction

Superior customer service is only an intermediate step toward the goal of customer satisfaction. Successful business companies seek to go beyond customer satisfaction, striving for customer astonishment. They concentrate on providing customers with quality, convenience, and service as their customers define those terms.

Customer astonishments can be obtained by listening to customers, defining superior service, setting standards and measuring performance, hiring the right employees, training and empowering employees to deliver superior service, using technology to provide improved service, treating employees with respect and showing them how valuable they are, rewarding superior service, *viewing customer service as an investment, not an expense.*

xii. Emphasis on Speed

Today's customers expect businesses to serve them at the speed of light. Providing a quality product at a reasonable price once was sufficient to keep customers happy, but that is not enough for modern customers, who can find dozens of comparable products with just few mouse clicks.

The philosophy of speed is based on **time compression management (TCM),** which involves three principles:

Speeding new products to market
Shortening customer response time in manufacturing and delivery
Reducing the administrative time required to fill an order

4. Creates a Marketing Mix that meets customer needs and wants

The major elements of a marketing strategy are the four P's of marketing. These four elements are interconnected, and when properly coordinated with a solid marketing plan, increase the sales appeal of a product or service. Small business managers must integrate these elements to maximize the impact of their product or service on the consumer.

<u>The Four P's of Marketing</u>

Product: A product is any item or service that satisfies the need of a customer. Products travel through various stages of development, known as product life cycle.

Product life cycle allows managers to make decisions about whether to continue selling the product, when to introduce new follow-up products, and when to introduce changes to an existing product.

Introductory stage: Product or service must break into the market and overcome customer inertia. Advertising and promotion help the new product to become recognized more quickly. The cost of marketing product is high, and profits are generally low.

Growth and Acceptance stage: In growth stage, customers begin to purchase the product in large enough numbers for sales to rise and profits to materialize. If in introductory or the growth stage the product fails to meet consumer needs, it does not sell and eventually disappears from the marketplace.

Maturity and Competition stage: The stage in which sales rise, but profits peak and then fall as competitors enter the market. This causes reduction in product's selling price to meet competition and to hold its share of the market.

Market Saturation stage: The stage in which sales peak, indicating the time to introduce the next-generation product.

Product decline stage: The stage in which sales continue to fall and profit margins decline drastically.

Place: Any activity involving movement of goods to the point of consumer purchase provides place utility. Place utility is directly affected by the marketing channels of distribution, the path that goods or services and their titles take in moving from producer to consumer.

Channel of Distribution of consumer goods	Channel of Distribution of industrial goods
Manufacturer to consumer	Manufacturer to industrial user
Manufacturer to retailer to consumer	Manufacturer to wholesaler to industrial user
Manufacturer to wholesaler to retailer to consumer	
Manufacturer to wholesaler to wholesaler to retailer to consumer	

Price: It is a key factor in decision to buy any product or service. Price affects both sales volume and profits, and without a right price, both sales and profit will suffer. Right price for a product or service depends on three factors:

Company's cost structure
An assessment of what the market will bear
The desired image the company wants to create in its customer's minds

Promotion: It involves both advertising and personal selling. Its goal is to inform and persuade consumers. A small company's promotional program can play a significant role in creating a specific image in its customers' mind.

PRICING STRATEGIES

Price is the monetary values of a product or service in the marketplace. It is a measure of what the customer must give up to obtain various goods and services. Setting prices in a business decision is governed both by art and science. Entrepreneurs must determine prices for their goods and services that will draw customers and produce a profit. Price is an important factor in building long-term relationships with customers.

<u>Three Potent Forces: Image, Competition and Value</u>

Price Conveys Image

A company's pricing policies communicate important information about its overall image to customers. Customers look at prices to determine what type of store they are dealing with. High prices frequently convey the idea of quality, prestige, and uniqueness to the customers.

Common mistake that small business owners make is that they fail to recognize the extra value, convenience, service, and quality they give to their customers, and hence, underprice their goods and services, believing that low prices are the only way they can achieve a competitive advantage. But only 15 to 35 percent of customers consider price to be the chief criterion while selecting a product or service. *People want quality and value, but if you lower the prices, they think that you are lowering the quality and value.* Small companies fall into a trap when trying to compete solely on the basis of price when they lack sales volume.

Competition and Pricing

When setting prices, entrepreneurs should take into account their competitors' prices, but it is not always necessary to match or to beat them. Two factors are vital to studying the effects of competition on the small company's pricing policies: location of the competitors and the nature of the competing goods and services. Entrepreneurs must monitor competitors' prices on products that are identical to or are close substitutes for those they sell and then strive to keep their prices in the line with them.

Attempting to undercut competitors' prices may lead to a price war, one of the most dangerous games small business can play. Price wars can eradicate companies' profit margins and scar an entire industry for years. The best way to survive a price war is to stay out of it by emphasizing the unique features, benefits, and value, the company offers to its customers.

Focus on Value

Right price for a product or service depends on the value it provides for a customer. Two aspects of value are:

Objective Value: the price customers would be willing to pay if they understood perfectly the benefits that a product or service delivers for them

Perceived Value: the price customers are willing to pay for products or services

Customers respond to the prices by seeing whether the prices they perceive to be fair exchange for the value they receive from the product or service.

Customized of Dynamic pricing: A pricing technique that sets different prices on the same products and services for different customers using the information that a company collects about its customers.

Pricing Strategies and Tactics

<u>Introducing a New Product</u>

If a new product's price is excessively high, it is in danger of failing because of low sales volume. If its price is too low, the product's sales revenue might not cover costs. When pricing any new product, the owner should try to satisfy three objectives:

Getting the product accepted: No matter how unusual a product is, its price must be acceptable to a company's potential market. *Revolutionary products* are so new and unique that they transform existing markets. *Evolutionary products* offer upgrades and enhancements to existing products. *Me-too products* offer the same basic features as existing products in the market.

Maintaining market share as competition grows: If a new product is successful, competitors will enter the market, and the small company must work to expand or at least maintain its market share. Continuously setting the product's price with special advertising and promotion techniques helps to retain a satisfactory market share.

Earning a profit: A small company must establish a price for the new product higher than its cost. Entrepreneurs should not introduce a new product at a price below cost because it is much easier to lower the price than to increase it once the product is on the market.

New product’s pricing strategies

Market Penetration: If a small business introduces a product into a highly competitive market in which a large number of similar products are competing for acceptance, the product must penetrate the market to be successful. To gain quick acceptance, entrepreneurs should introduce the product at low price or should set the price just above total unit cost to develop wedge in the market and quickly achieve high volume of sales. The objectives of the penetration strategy are:

To break into the market quickly, generate a high sales volume as soon as possible, build market share

Many consumer products like soap, shampoo, light bulbs, are introduced through penetration pricing strategies.

Skimming: A skimming pricing strategy often is used when a company introduces a new product into a market with little or no competition. Here the company uses a higher-than-normal price in an effort to quickly recover the initial developmental and promotional costs of the product. The idea is to set a price well above the total unit cost and to promote the product heavily to appeal to the market segment that is not sensitive to price. Advantage of this strategy is that manager can correct pricing mistakes quickly and easily. Successful skimming strategies require a company to differentiate its products or services from those of the competition, justifying the above-average price.

Sliding Down the Demand Curve: Using this tactic, a small company introduces a product at high price. Then, technological advances enable the firm to lower its costs quickly and to reduce the product’s price before its competition can. By beating other businesses in a price decline, the small company discourages competitors and gradually over time, becomes a high-volume producer. For example, in 1999, HD-TVs were sold for $19,000; today, they are priced at $1000 or even less.

Pricing Established Goods and Services

Odd pricing: A pricing technique that sets prices that end in odd numbers to create the psychological impression of low prices.

Price lining: A pricing technique that greatly simplifies a pricing function by pricing different products in a product line at different price points, depending on their quality, features, and cost. Example: CDs and DVDs

Leader pricing: A technique that involves marking down the normal price of a popular item in an attempt to attract more customers who make incidental purchases of other items at regular prices. Example: Grocery stores

Zone pricing (geographic): A technique that involves setting different prices for customers located in different territories because of different transportation costs.

Delivered pricing (geographic): A technique in which a firm charges all of its customers the same price regardless of their location.

FOB-Factory (geographic): A pricing method in which a company sells merchandise to customers on the condition that they pay all shipping costs.

Opportunistic pricing: A pricing method that involves charging customers unreasonably high prices when goods or services are in short supply.

Discounts or markdowns: Reductions from normal list prices that allows to move stale, outdated, damaged, or slow-moving merchandise.

Multiple-unit pricing: A technique offering customers discounts if they purchase in quantity.

Bundling: A pricing method that involves grouping together several products or services, or both, into a package that offers customers extra value at special price.

Optional product pricing: A technique that involves selling the base product for one price but selling the options or accessories for it at much higher price.

Captive-product pricing: A technique that involves selling a product for a low price and charging a higher price for the accessories that accompany it.

Byproduct pricing: A technique in which the revenues from the sale of byproducts allow a company to be more competitive in its pricing of the main product.

Suggested retail price: Manufacturers print suggested retail prices on their products or give wholesale catalogs. Small business owners follow these prices as it eliminates the need to make a pricing decision.

Pricing Strategies and Methods

For Retailers: Pricing for the retailer means pricing to move merchandise. Markup is the difference between the cost of a product or service and its selling price. Most retailers compute their markup as a percentage of retail price, but some retailers put a standard markup on all their merchandise using flexible markup.

$$Dollar\ markup = Retail\ price - Cost\ of\ merchandise$$

$Percentage\ (of\ retail\ price)\ markup = \frac{Dollar\ markup}{Retail\ price}$ $Percentage\ (of\ cost)\ markup = \frac{Dollar\ markup}{Cost\ of\ unit}$

Once the business owner has a financial plan, including sales estimates and anticipated expenses, he or she can compute the firm's initial markup, which is, the average markup required on all merchandise to cover the cost of items, all incidental expenses, and a reasonable profit.

$$Initial\ dollar\ markup = \frac{Operating\ expenses + Reductions + Profits}{Net\ sales + Reductions}$$

Operating Expenses: cost of doing business, such as rent, utilities, and depreciation

Reductions: employee and customer discounts, markdowns, special sales, cost of stock outs

Once an owner determines the desired markup percentage, he or she can compute the appropriate retail price. Markup of particular item represents 40 percent of the retail price.

$$Cost = retail\ price - markup$$
$$= 100\% - 40\% = 60\%\ of\ retail\ price$$

For Manufacturers: Direct costing and price formulation

Most commonly used pricing technique for manufacturers is cost-plus pricing. Using this, the manufacturer establishes a price that is composed of direct materials, direct labor, factory overhead, selling and administrative costs, plus the desired profit margin. Its main advantage is simplicity. Given the proper cost accounting data, computing a product's final selling price is relatively easy. In addition, they add a profit onto the top of their companies' costs, manufacturers are guaranteed the desired profit margin.

Absorption costing is the traditional method of product costing in which all manufacturing and overhead costs are absorbed into the product's total cost. Includes direct materials, direct labor, plus a portion of fixed and variable factory overhead in each unit manufactured.

Variable (or direct) costing is a method of product costing that includes in the product's cost only those costs that vary directly with the quantity produced. Includes direct materials, direct labor, and factory overhead costs that vary with the level of firm's output of finished goods. Those factory overhead costs that are fixed like rent, depreciation, insurance are *not included* in the costs of finished items.

Computing Break-Even Selling Price

The manufacturer's contribution percentage tells what portion of total revenues remains after covering variable costs to contribute toward meeting fixed expenses and earning a profit. The manufacturer's contribution margin is 36.5 percent, which means that variable costs absorb 63.5 percent of total revenues. Variable costs make up 63.5 percent of the product's selling price.

$$Total\ variable\ cost = Material + Direct\ Labor + Variable\ factory\ overhead$$

$$Selling\ Price = \frac{Profit + (Variable\ cost\ per\ unit\ \times Quantity\ Produced) + Total\ fixed\ cost}{Quantity\ Produced}$$

For break even, the manufacturer assumes $0 profit.

For Service Firms: Service firms often suffer from the effects of vague unfounded pricing procedures, and frequently charge the going rate without any idea of their costs. A service firm must set a price based on the cost of materials used, labor involved, overhead, and a profit. The proper price reflects the total cost of providing a unit of service.

CREATING A SUCCESSFUL FINANCIAL PLAN

Financial management is a process that provides entrepreneurs with relevant financial information in an easy-to-read format on a timely basis. It allows entrepreneurs to know not only how their businesses are doing financially but also why they are performing that way.

Common mistake among business owners is failing to collect and analyze basic financial data. Financial planning is essential to running a successful business and is not that difficult.

Basic Financial Statements

Balance Sheet: It is a financial statement that provides a snapshot of a business's financial position, estimating its worth on a given date. It is built on the fundamental accounting equation:

$$Assets = Liabilities + Owner's\ equity$$

The first section of the balance sheet lists the company's assets and shows total value of everything the business owns.

Current assets consists of cash and items to be converted into cash within one year or within the normal operating cycle of the company such as accounts receivable and inventory.

Fixed assets are those acquired for long-term use in the business.

Intangible assets include items such as goodwill, copyrights, and patents, although valuable, but are not tangible.

The second section shows the business's liabilities and owner's equity. **Liability** is the creditor's claim against company's assets.

Current liabilities are those debts that must be paid within one year or within the normal operating cycle of the company.

Long-term liabilities are those that come due after one year.

Owner's equity is the value of owner's investment in the business.

Income Statement: It is also known as a profit and loss statement. It is a financial statement that represents a "moving picture" of a business, comparing its expenses against its revenue over a period of time to show its net profit or loss.

$$Net\ Income = Sales\ Revenue - Expenses$$

Costs of goods sold represents the total cost, including shipping, of the merchandise sold during the accounting period. Manufacturers, wholesalers, and retailers calculate cost of goods sold by adding purchases to beginning inventory and subtracting ending inventory.

$$Gross\ profit = Net\ sales\ revenue - Cost\ of\ goods$$

$$Gross\ profit\ margin = \frac{Gross\ profit}{Net\ sales\ revenue}$$

Monitoring the gross profit margin over time and comparing it to those of other companies in the same industry are important steps to maintaining a company's long-term profitability.

Operating expenses are those costs that contribute directly to the manufacture and distribution of goods.

Statement of Cash Flows: It is a financial statement showing the changes in the company's working capital from the beginning of the year by listing both the sources and the uses of those funds.

Ratio Analysis: It is a method of expressing the relationships between any two elements on financial statements that allows business owners to analyze their companies' financial performances.

Twelve Key Ratios: enables most business owners to monitor their companies' financial positions.

Liquidity Ratios tells whether a small business will be able to meet its short-term financial obligations as they come due.

1. **Current Ratio:** Measures a small firm's solvency by indicating its ability to pay current liabilities out of current assets.

$$Current\ Ratio = \frac{Current\ Assets}{Current\ Liabilities}$$

2. **Quick Ratio:** Shows the extent to which a firm's most liquid assets cover its current liabilities.

$$Quick\ Ratio = \frac{Quick\ Assets}{Current\ Liabilities}$$

Leverage Ratios measure the financing supplied by a firm's owners against that supplied by its creditors.

3. **Debt Ratio:** Measures the percentage of total assets financed by creditors compared to its owners.

$$Debt\ Ratio = \frac{Total\ debt\ (or\ liabilities)}{Total\ assets}$$

4. **Debt to net worth ratio:** Compares what a business owes to what it is worth.

$$Debt\ to\ Net\ worth\ ratio = \frac{Total\ debt}{Tangible\ net\ worth}$$

5. **Times interest earned ratio:** Measures the firm's ability to make the interest payments on its debt.

$$Times\ Interest\ Earned = \frac{Earnings\ before\ interest\ and\ taxes\ (EBIT)}{Total\ interest\ expense}$$

Operating ratios help an entrepreneur evaluate a small company's overall performance and indicate how effectively the business employs its resources. The more effectively its resources are used, the less capital a small business will require.

6. **Average inventory turnover ratio:** Measures the number of times its average inventory is sold out, or turned over, during the accounting period.

$$Average\ inventory\ turnover\ ratio = \frac{Cost\ of\ goods\ sold}{Average\ inventory}$$

7. **Average collection period ratio:** Tells average number of days required to collect accounts receivable.

$$Receivables\ turnover\ ratio = \frac{Credit\ Sales}{Accounts\ receivables} \qquad Average\ collection\ period\ ratio = \frac{Days\ in\ accounting\ period}{Receivables\ turnover\ ratio}$$

8. **Average Payable period ratio:** Tells the average number of days required to pay accounts payable.

$$Payables\ turnover\ ratio = \frac{Purchases}{Accounts\ payable} \qquad Average\ payable\ period = \frac{Days\ in\ accounting\ period}{Payables\ turnover\ ratio}$$

9. **Net sales to total assets ratio:** Measures a company's ability to generate sales in relation to its asset base.

$$Total\ assets\ turnover\ ratio = \frac{Net\ Sales}{Net\ total\ assets}$$

Profitability ratios measure how efficiently a firm is operating and being managed.

10. **Net profit of sales revenue:** Measures a firm's profit per dollar of sales revenue.

$$Net\ profit\ on\ sales\ ratio = \frac{Net\ profit}{Net\ Sales}$$

11. **Net profit to assets ratio:** Tells how much profit a company generates for each dollar of assets that it owns.

$$Net\ profit\ to\ assets = \frac{Net\ Income}{Total\ Assets}$$

12. **Net profit to equity ratio:** Measures the owner's rate of return on investment (ROI) in the business.

$$Net\ profit\ to\ equity = \frac{Net\ income}{Owner's\ Equity}$$

Putting Ratios into the Test

When comparing the company's ratios to the industry's standards, following questions should be made:

Is there a significant difference in any company's ratio and the industry average?

If so, is this a meaningful difference?

Is the difference good or bad?

What are the possible causes of this difference? What is the most likely cause?

Does this cause require that I take action?

If so, what action should I take to correct the problem?

<u>Breakeven Analysis</u>

The breakeven point is the level of operation at which a business neither earns a profit nor incurs a loss. It is a useful planning tool because it shows entrepreneurs minimum level of activity required to stay in business. With one change in the breakeven calculation, the entrepreneur can also determine the sales volume required to reach a particular profit target.

Calculating Breakeven Point

1. Determine the expenses the business can expect to incur.
2. Categorize the expenses into fixed expenses and variable expenses.
3. Calculate the ratio of variable expenses to net sales and compute contribution margin.

$$Contribution\ margin = 1 - \frac{Variable\ expenses}{Net\ sales\ estimate}$$

4. Compute the breakeven point.

$$Breakeven\ Point = \frac{Total\ Fixed\ costs}{Contribution\ margin}$$

MANAGING CASH FLOW

Cash Management is the process of forecasting, collecting, disbursing, investing, and planning for the cash a company needs to operate smoothly. A business must have enough cash to meet its obligations or it will be declared bankrupt. Entrepreneurs must manage cash flow from the day they launch their businesses. More companies fail for a lack of cash than for a lack of profit.

Five cash management roles of the entrepreneur

Cash Finder: Make sure there is enough capital to pay all present and future bills. It is ongoing job.

Cash Planner: Make sure the company's cash is used properly and efficiently

Cash Distributor: Control the cash needed to pay the company's bills

Cash Collector: Make sure the customers pay their bills on time

Cash Conserver: Make sure the company gets maximum value for the dollars it spends by avoiding unnecessary expenditures

The "Big Three" of Cash management

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. *A sale is not a sale until you collect the money.*

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.

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

Cash and Profit

Cash and profit are not the same. More businesses fail for lack of cash than for lack of profits.

Profits are differences between total revenue and total expenses. It is an accounting concept. It furnishes resources for investing in future operations, and its absence may result in the extinction of a company.

Cash is the only thing businesses can use to pay bills. Cash flow is the flow of actual cash through a business in a continuous cycle. Cash is a ready money. Cash includes money in hand, bank account balance, customer checks.

A business can be earning a profit and be forced out of business because it runs out of cash.

SOURCES OF FINANCING: DEBT AND EQUITY

Secrets to successful financing

1. Choosing the right sources of capital is a decision that will influence a company for a lifetime.
2. The money is out there, the key is knowing where to look.
3. Raising money takes time and effort
4. Creativity counts, entrepreneurs have to be as creative in their searches for capital as they are in developing their business ideas.
5. The Internet puts vast resources of information to an entrepreneur's fingertips that can lead to financing.
6. Be thoroughly prepared before approaching lenders and investors.
7. Entrepreneurs should not underestimate the importance of making sure that the chemistry among themselves, their companies, and their funding sources is a good one.

Capital is any form of wealth employed to produce more wealth. It exists in many forms in a typical business, including cash, inventory, plant, and equipment.

Three types of Capital

Fixed Capital: It is needed to purchase a company's permanent or fixed assets such as buildings, land, computers, and equipment. Money invested in these fixed assets tends to be frozen because it cannot be used for any other purpose.

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

Growth Capital: It is needed to finance a company's growth or its expansion in a new direction.

Equity capital represents the personal investment of the owner in a business and is sometimes called *risk capital* because these investors assume the primary risk of losing their funds if the business fails. It does not have to be repaid with interests like load does.

Debt capital is the financing that a small business owner has borrowed and must repay with interest.

Sources of Equity Financing

Personal Savings: First place to look for money. Outside investors and lenders expect entrepreneurs to put some of their own capital into business before investing theirs.

Friends and Family members: Second place to look for money. They may be willing to invest in the business mainly due to the relationship with the founder.

Angels: They are private investors. They are wealthy individuals who invest in business start-ups in exchange for equity stakes in the companies.

Partners: Entrepreneurs can take on partners to expand the capital foundation of a business.

Corporate venture capital: Forming an alliance with a corporation

Venture Capital companies: They are for-profit, professional investors looking for fast-growing companies in industries. They look for competent management, competitive edge, growth industry, viable exit strategy, and intangible factors that will make the business successful.

Going public: Attract capital by taking their companies public.

CHOOSING THE RIGHT LOCATION AND LAYOUT

Entrepreneurs who choose their locations wisely – with their customers' preferences and their companies' needs in mind, can establish an important competitive advantage over rivals who choose their locations haphazardly.

Layout is the logical arrangement of the physical facilities in a business that contributes to efficient operations, increased productivity, and higher sales.

External factors of Layout

Appearance must create the proper image or personality for the business in the customer's eyes

Entrances must invite customers to come in

Create effective window display and change them often, can be powerful sales tools

Three Retail Layout Patterns

Grid layout: Arranges displays in rectangular fashion so that aisles are parallel. It is a formal layout and controls traffic flow. It uses the available selling space efficiently and creates neat and organized environment. Example: supermarkets

Free-form layout: It is informal layout which uses displays of various shapes and sizes. It provides relaxed, friendly shopping atmosphere, which encourages customers to shop longer and increase the number of purchases they make. It can cause security problems if not properly planned.

Boutique layout: Divides store into a series of individual shopping areas, each with its own theme. It provides unique shopping environment. Example: small departmental stores.