MASTER OF BUSINESS ADMINISTRATION

(MBA)

Module Guide

Entrepreneurship and Small Business Management

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INTRODUCTION

ENTREPRENEURSHIP

Introduction

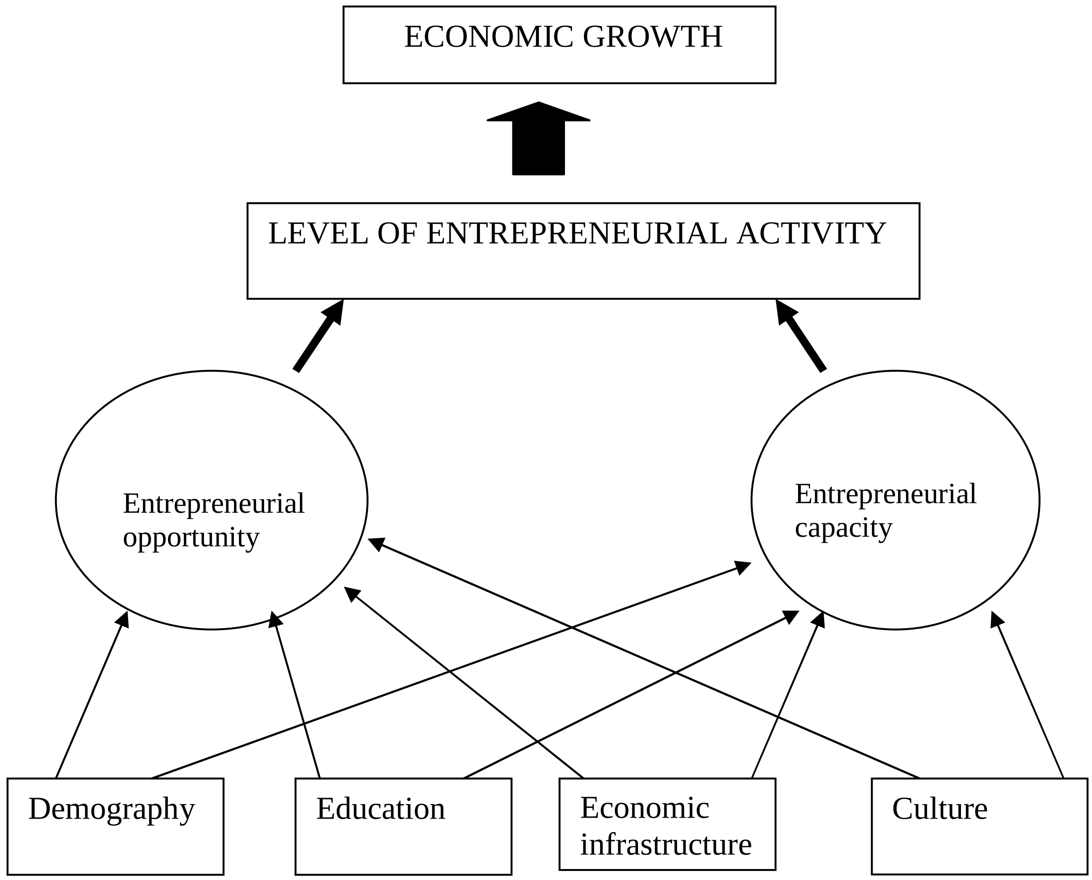
Over the past ten years, the subject of entrepreneurship has moved from the periphery to the centre of management thinking and education. The entrepreneurial approach is regarded as the *only* option for managers seeking to enhance the performance of their organizations. This is so whether the organization is a new start-up striving to establish itself in the marketplace, an established business seeking to reinvigorate itself or a governmental or non-profit organization meeting the opportunity and the challenge of the shifting boundaries between the public and private sectors (Wickham, 2001:xi). Wickham (2001:xi) takes the view that entrepreneurship is a type of management, particularly a form of strategic management. Entrepreneurship is therefore a style of management that can be learnt.

Holt (2002: xv) makes the point that entrepreneurs do things that are not generally done in the ordinary course of business. According to Burke (2006:10), entrepreneurs are “increasingly being acknowledged by governments as the driving force behind innovative change and job creation.”

According to Nieuwenhuizen (Nieman, Hough and Nieuwenhuizen, 2003:3), economic development can be directly attributed to the level of entrepreneurial activity in a country. Large corporations retrench, automate, downsize, unbundled, outsource and become smaller. Entrepreneurs intend to grow their businesses and are responsible for growth and job creation in the economy.

The 2004 Global Entrepreneurship Monitor (GEM) study found that in the 34 countries surveyed, 9.3% (73 million) of the 784 million people comprising the population of 18 to 64 year olds were nascent entrepreneurs or the owner /manager of a new business. 41% of these entrepreneurs were women (Timmons, 2007: x). Timmons (2007:x) contends that entrepreneurship is exploding in countries like India and China and affecting positive social and economic change in such diverse countries as Korea, Mexico, South Africa, El Salvador and Ireland.

According to Burns (2007:21), GEM is a research programme that started in 1999 in 10 countries and extended to 39 countries by 2005. It is an assessment of the level of national entrepreneurial activity in each of the countries. Central to the GEM approach is the hypothesis of a causal relationship between entrepreneurial activity in the economy and the level of economic growth. The GEM model is shown as follows:



(Burns, 2007:22)

The twenty-first century has dawned with entrepreneurship as a major force shaping the global economy. The future growth of this economy lies in the hands of men and women committed to achieving success through innovative customer-focused new products and services. At the heart of this global movement are entrepreneurs who demonstrate their willingness to assume the risks associated with creating new business ventures.

READINGS

This module should be studied using this manual and the recommended textbooks. You should read about the topic that you intend to study in the chapter, together with its accompanying section(s).

Prescribed Readings:

Rwigema, Henry. and Venter, Robert. (2004) Advanced Entrepreneurship. Oxford University Press

Nieman, Gideon, Hough, Johan and Nieuwenhuizen, Cecile (editors). (2003) Entrepreneurship: A South African Perspective. Pretoria. Van Schaik

? THINK POINT

A think point asks you to stop and think about an issue. Sometimes you are asked to apply a concept to your own experience or to think of an example.

Module Assessment

Assignment

You will be required to complete and submit an assignment. This assignment is assessed as part of your coursework. Therefore, it is very important that you complete it.

Examination

An examination will be written at the end of each semester. The assessment strategy will focus on application of theory to practice.

Module Objectives

This module examines entrepreneurship as the driving force behind the business organisation. It also examines the nature of entrepreneurship and the role of entrepreneurs and small businesses in the economy

The main objectives of this module are:

1. to explore the concept of entrepreneurship and an entrepreneurial style of management
2. to provide insights into the entrepreneurial process
3. to develop an understanding of the issues, possibilities and challenges in the field of entrepreneurship.
4. to encourage those with entrepreneurial aspirations that it is never too late or entirely inappropriate to think of themselves as potential entrepreneur.

Learning Outcomes

At the end of this module, the learner should be able to:

- Define entrepreneurship
- Outline the characteristics of entrepreneurs
- Discuss the entrepreneurial process
- Distinguish between entrepreneurship and intrapreneurship
- Evaluate the role of innovation and creativity in recognizing ideas and business opportunities
- Prepare and evaluate business plans
- Distinguish between and evaluate various paths to entrepreneurship
- Discuss the dynamics of business growth
- Describe the nature of family business
- Discuss the link between e-commerce and entrepreneurship
- Evaluate franchising as a means of entrepreneurial development
- Outline the role of small businesses in the economy

CHAPTER ONE

NATURE OF ENTREPRENEURSHIP

Chapter One

NATURE OF ENTREPRENEURSHIP

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Define entrepreneurship
- Describe the benefits and drawbacks of entrepreneurship
- Describe the ten deadly mistakes of entrepreneurship
- Explain how entrepreneurship influences economic development and productivity
- Discuss small business as a dimension of entrepreneurship
- Distinguish between entrepreneurial and managerial functions

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 15

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 13

What is entrepreneurship?

There are a number of definitions of entrepreneurship.
Rwigema and Venter (2004:6) offer the following definition:
"*Entrepreneurship is the process of conceptualizing, organizing, launching and - through innovation - nurturing a business opportunity into a potentially high growth venture in a complex, unstable environment*."

Rwigema and Venter (2004:5) also offer a sample of definitions of entrepreneurship:

- ‘Entrepreneurship is the act of forming a new organization of value’
  (Bateman and Snell 1996:208)
- ‘Entrepreneurship is the seemingly discontinuous process of combining resources to produce new goods or services’
  (Stoner, Freeman and Gilbert 1995:160)
- ‘Entrepreneurship is the creation of new enterprise’
  (Bartol and Martin 1998:672)
- ‘Entrepreneurship is the creation of an innovative economic organization (or network of organizations) for the purpose of gain under conditions of risk and uncertainty’ (Dollinger 1995:7)

Holt (1992:7) uses Ronstadt’s (1984) definition of entrpreneurship:

> *“Entrepreneurship is the dynamic process of creating incremental wealth. This wealth is created by individuals who assume the major risks in terms of equity, time and/or career commitment of providing value for some product or service. The product may or may not be new or unique but value must somehow be infused by the entrepreneur by securing and allocating the necessary skills and resources.”*

The word *entrepreneur* has its origin in the 17th century French word *entreprendre* which referred to individuals commissioned to undertake a particular commercial project. Entrepreneurship is then what the entrepreneur does.

Wickham (2001:29) considers the entrepreneur as:

- a *manager* undertaking particular *tasks*
- an *economic agent* generating particular *economic effects*
- an *individual* of a particular *personality*.

According to Zimmerer and Scarborough (2005:5) anyone, regardless of age, race, gender, colour, national origin, or any other characteristic can become an entrepreneur. There are no limitations on this type of economic expression. “Entrepreneurship is not a mystery; it is a practical discipline. Entrepreneurship is not a genetic trait; it is a skill that most people can learn” (Zimmerer and Scarborough)

The Benefits of Entrepreneurship

Zimmerer and Scarborough (2005:6) describe the benefits of entrepreneurship as follows:

- Opportunity to create your own destiny – entrepreneurs attain independence and the opportunity to achieve what is important to them
- Opportunity to make a difference – entrepreneurs combine their concerns for social issues with their desire to earn a good living
- Opportunity to reach your full potential – the business becomes an instrument for self-expression and self-actualisation. Work and play become synonymous
- Opportunity to reap impressive profits – potential profit earnings are an important motivation factor for entrepreneurs
- Opportunity to contribute to society and be recognized for your efforts
- Opportunity to do what you enjoy and have fun at it.

According to Kroon (1998:2), the advantages of entrepreneurship are

- Independence
- The opportunity to realize your full potential
- The opportunity to realize a big profit
- The opportunity to contribute to society

The Drawbacks of Entrepreneurship

Some of the disadvantages of entrepreneurship, as identified by Zimmerer and Scarborough (2005:8) are:

- Uncertainty of income
- Risk of losing your entire investment
- Long hours and hard work
- Lower quality of life until the business gets established
- Complete responsibility

Entrepreneurship subjects the entrepreneur to the following personal and financial risks:

- Reputation and self confidence
- Uncertain income

- Risk of losing all capital
- Decreased quality of life
- Total responsibility (Kroon 1998:3)

The Ten deadly mistakes of entrepreneurship

Zimmerer and Scarborough (2005:22) describe ten deadly mistakes of entrepreneurship as:

- Management mistakes
- Lack of experience
- Poor financial controls
- Weak marketing efforts
- Failure to develop a strategic plan
- Uncontrolled growth
- Poor location
- Improper inventory control
- Incorrect pricing
- Inability to make the 'entrepreneurial transition'

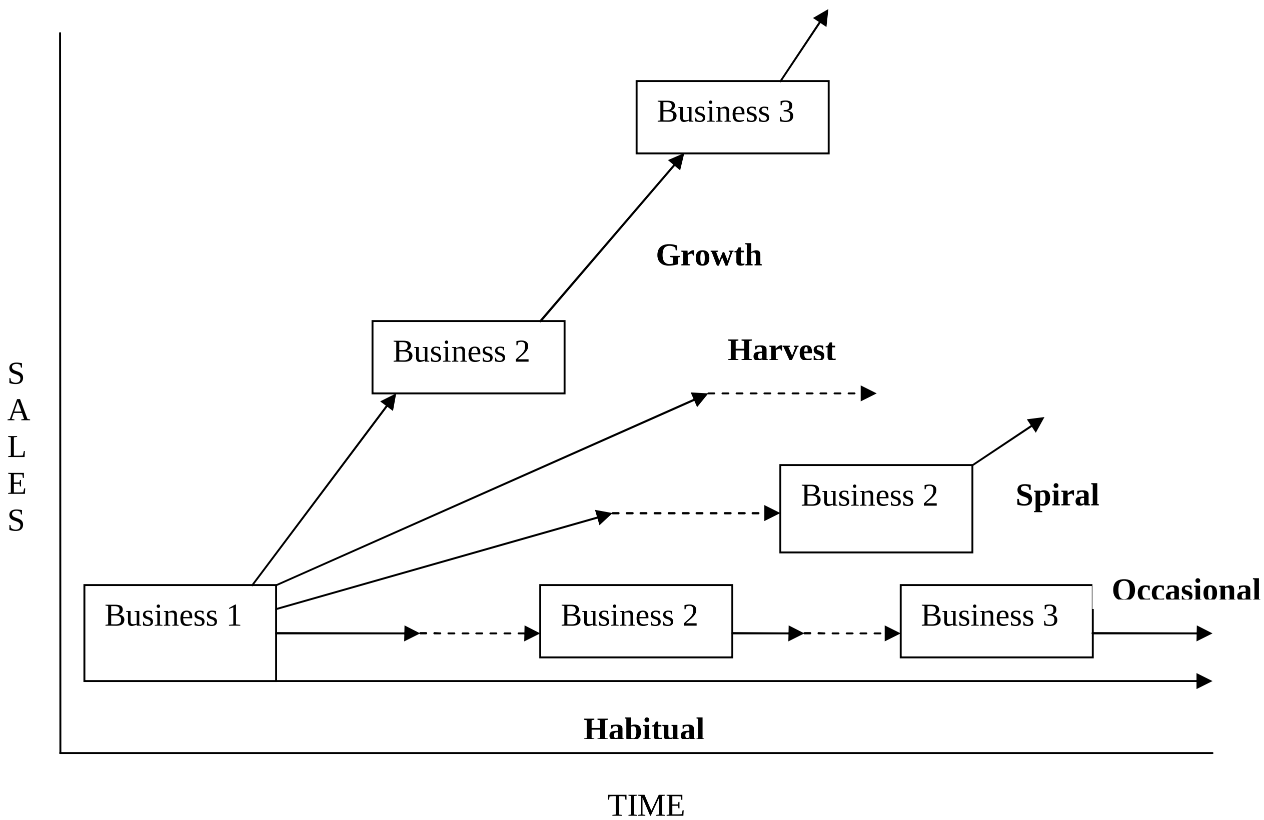
ACTIVITY:

Consider the ten deadly mistakes of entrepreneurship and explain how they can be avoided.

Katz and Green (2007:62) outline five typical career paths for entrepreneurs:

- Habitual entrepreneurs – are owners for a lifetime, sometimes in one business, sometimes across several businesses. The goal is personal satisfaction first, income second. Usually there is no succession plan.
- Growth entrepreneurs – also lifetime owners whose goal is major success.
- Harvest entrepreneurs – are owners with an exit plan.
- Spiral or helical entrepreneurs – alternate periods of growth and stability, which are determined by personal or family needs.
- Occasional entrepreneurs – people who have another job and pursue entrepreneurship periodically.

This can be illustrated as follows:



The importance of entrepreneurship in small businesses

The importance and benefits of small businesses today

Introduction

Most people are familiar with the names of large businesses such as Marks & Spencer and Heinz. Although some may not realise many of today's famous large companies were initially very small. They were started by either one person or a small group of people. This article demonstrates the vital role performed by small businesses and is sponsored by The Network For Teaching Entrepreneurship (NFTE). www.nfte.co.uk

Importance

Many businesses start as one person's idea. The creator is often an entrepreneur who spots a gap in the market or a commercial opportunity. S/he turns the idea into a marketable product or service. There are four main types of business: manufacturing, wholesale, retail and service.

Some characteristics found in successful entrepreneurs, show they are:

- prepared to take risks
- driven by achievement
- not put off by failure
- self motivated
- determined to stay ahead of the competition.

For example, Simon Woodroffe opened up his first Yo Sushi restaurant by copying an idea he saw in Japan. The business grew into a chain of successful restaurants with a novel approach to serving Japanese food and drink.

Henry John Heinz's first product in 1869 was horse-radish, followed by pickles, sauerkraut, and vinegar. All were delivered by horse-drawn wagons to grocers in and around Pittsburgh. Heinz developed many of the world's best known branded products e.g. tomato ketchup, baked beans, and baby foods. Today's small business sector creates many of the new ideas and innovations future generations will take for granted e.g. ingenious website designs, clockwork radios.

Small businesses are vital to the success of the economy. Not only as they provide the success stories of the future, but also because they meet local needs (e.g. hairdresser, financial consultant, emergency plumber). They serve the requirements of larger businesses e.g. for photography services, printed stationery, catering and routine maintenance.

Of course, you don't have to set up your own enterprise to be enterprising. Being entrepreneurial simply means developing the right skills, attitudes and initiatives to make an innovative contribution to an organisation. This case study gives you some idea of what is involved and how exciting it can be.

Most UK businesses today are small. Two thirds are owned and run by one person. Nearly 90% employ less than 6 people. They are also an important source of employment. Just over 2.5 million UK workers are self employed; one in eight of all workers. It is from these small companies that tomorrow's big names will probably arise.

Benefits

Small businesses survive and prosper for many different reasons:

- Developing personal relationships

Small businesses are well placed to build personal relationships with customers, employees, and suppliers. With a small business you know who you are dealing with; you can 'put a face' to the person you are in contact with. Person-to-person interaction is as important as ever in building strong relationships.

- Responding flexibly to problems and challenges

In a small business there is little hierarchy or chain of command. Large businesses may have set ways of operating and establish procedures that are hard to change. Small businesses are often far more flexible. It can also reach a quick decision on whether or not it can do what is required.

- Inventiveness and innovation

Small businesses are well positioned to introduce and develop new ideas. This is due to their owners not having to report or seek approval from anyone else. For example, when Anita Roddick set up The Body Shop, she developed a range of environmentally friendly cosmetics in unsophisticated packaging. This would have been frowned on in a conventional cosmetics company.

- Low overheads

Due to the small scale of operation, small businesses have lower overhead costs. They operate in small premises with low heating and lighting costs, and limited rent and rates to pay. Low costs result in lower prices for consumers.

- Catering for limited or niche markets

Large firms with high overheads must produce high levels of output to spread costs. By contrast, small firms are able to make a profit on much lower sales figures. They can therefore sell into much smaller markets: e.g. a local window cleaner serving a few hundred houses, a specialist jewellery maker with personal clients.

The main reason many people choose to set up a small business, is because it gives them independence. They also reap the rewards for themselves; these are two powerful incentives.

Challenges of a small business

Small businesses do have some disadvantages. Running an enterprise on your own involves hard work and making most decisions on your own. Initially there is little time for holidays and considerable risks involved.

Also, as the business is small, it is harder to find the economies of scale from which big firms are able to benefit. For example, because small businesses tend to buy relatively small quantities of raw materials and other supplies, they receive lower discounts than larger firms. The small firm cannot afford to employ a range of specialists and also find it more costly to raise finance.

Setting up and running a business is something to be tackled by people who are energetic and enthusiastic. These people like hard work, enjoy challenges, are adaptable and are not put off by failure. Perhaps you are like that! Starting up on your own is a big step. It is vital to carry out careful research and think things through thoroughly, rather than rushing into it.

Planning is one of the most important steps at the start. Not only is the plan useful to the person setting up the business; it is also very important to anyone wanting to invest in it, or lend the business money. It needs to be based on detailed research e.g. market research.

Market research is the process of systematically gathering and recording information about the market for a product or service. This can be carried out by using questionnaires, or bringing together people in small groups to discuss their views on the goods or services being offered. Alternatively, market research can draw on information already published e.g. surveys. One purpose of market research is to identify and provide evidence of market opportunities and challenges. It helps someone starting a new business to get to know the environment they will be trading and competing in.

Other key ingredients of the business plan include:

- details of the business idea
- where the business will be run from
- the expected sales
- costs of running the business.

Types of ownership

One of the first decisions to be made in starting a business is how the business will be owned.

The main choices are between setting up:

- on your own (as a sole trader)
- with a small number of partners (partnership)
- as a private company, with shareholders (limited company).

The advantage of sole ownership is that you make all the decisions and take all the profits. However, the sole trader has a lot of responsibility and will need to work extremely hard. Forming a partnership makes it possible to share the workload, but profits have to be shared and there may be disagreements between partners.

Forming a private company makes it possible to raise extra capital for the business by selling shares, but setting up a company requires time and paperwork. Also, shareholders take a share of the profits. When Michael Marks started trading he was a sole trader. Later he took on a partner, Tom Spencer. When the business expanded nationally, it became a public company, with its shares traded on the Stock Exchange.

Funding and the importance of profit

New businesses need money to:

- get started: e.g. buy fixtures and fittings, machinery and equipment, often referred to as 'initial one-off costs'
- pay the costs of operating the business e.g. wages, rent, rates, heating and lighting.

Start up finance includes:

- the owner's (or owners') own funds (including share capital in the case of a private company)
- bank loans, or loans from individuals
- a bank overdraft
- a mortgage to buy property
- trade credit, where suppliers offer a set period (usually between one and three months) to pay for supplies
- hire purchase and leasing agreements, under which firms rent items such as photocopiers and vehicles.

Sources of finance need to be matched to the time period of the finance e.g. mortgages can be for up to 25 years whereas overdrafts and trade credit are for much shorter periods. Entrepreneurs must always make sure that they have enough cash coming into the business to pay back money they have borrowed both in the short and long term.

An effective marketing plan usually covers 4 key elements known as the 4 Ps:

- Price
- Product
- Place and
- Promotion

Making a profit is always important in running a business. Without profits, a business is not able to expand, and cannot take on more employees, or make contributions to the community. Eventually it will cease to exist.

Michael Marks made a profit from selling small items at a penny each, therefore he was able to expand. He would have worked out what is called gross profit by deducting the overall cost of all of the stock he bought from the income he generated from sales.

So his gross profit was:

Gross Profit = Sales - Cost of Sales

However, the gross profit is not the final profit. It is simply the profit from trading before all the operating costs of running the business have been taken away.

To get a figure for net profit we must deduct these operating costs from gross profit. Examples of operating costs would include the cost of lighting, heating, salaries, advertising, rents and business rates.

Net Profit = Gross Profit - Operating Costs

Promoting a business

New businesses have to be promoted. Promotion is a cost to the business, but without promotion most people will not know of its existence. The best form of promotion is recommendation from a satisfied customer. Other forms include local newspaper and cinema advertising, flyers through people's doors and signs in a shop window.

To promote your business effectively you need to be continually aware of your customers' needs, your market place and your competitors' activities. These factors are all important in maintaining, developing and expanding your business.

Conclusion

In the modern world people can no longer expect large enterprises to guarantee them jobs for life.

Individuals are increasingly expected to seek out their own opportunities, actively create value and behave ethically, rather than faithfully follow rules and routines set by others. In particular, today's young people need to learn to be enterprising, both when working for others and when setting up their own businesses.

Being enterprising involves taking responsibility for decision making, becoming increasingly self reliant, pioneering, adventurous, daring, dynamic, progressive, opportunist, ambitious and holding your values, as well as being able to initiate ideas and see them through into action.

Source: www.times100.com

CHAPTER TWO

ENTREPRENEURIAL TRAITS

Chapter Two

ENTREPRENEURIAL TRAITS

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Outline the characteristics of an entrepreneur
- Discuss popular myths of entrepreneurship
- Evaluate personal factors that impact upon entrepreneurial direction
- Recognise the skills which enhance entrepreneurial performance

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 15

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 13

Entrepreneurs are widely thought to require certain qualities.

Kuratko and Hodgetts (2001:99) list the following as prominent:

- the ability to recognize and exploit opportunities
- resourcefulness
- creativity
- vision
- independent thought
- energy
- optimism
- innovativeness
- calculated risk taking
- leadership skills

Rwigema and Vorster (2004:60) outline the characteristics successful entrepreneurs are broadly thought to exhibit:

(i) Commitment, self-reliance and tenacity
(ii) A need to achieve
(iii) Opportunity drive
(iv) Initiative
(v) Responsibility
(vi) Problem-solving abilities
(vii) Team building abilities
(viii) Internal locus of control
(ix) High ambiguity tolerance
(x) Integrity and consistency
(xi) Creativity and innovation

Steyn (in Kroon, 1998:4) contends that consensus exists about six dominant themes of entrepreneurial success. Steyn refers to the following as primary characteristics for entrepreneurial success:

- Commitment and determination – commitment to the opportunity implies sacrifices as far as quality of life, lifestyle and family life are concerned. Determination implies succeeding in spite of set-backs
- Leadership – implies that entrepreneurs are visionaries as well as executors of plans. Entrepreneurial leadership is dependent on an internal locus of control innate to entrepreneurs and their accompanying ability of self-motivation.
- Opportunity orientation – entrepreneurs examine and screen ideas to identify opportunities and pursue feasible opportunities relentlessly
- Tolerance of risk, ambiguity and uncertainty – entrepreneurs take calculated risks and expose themselves to financial and personal risks. They can also tolerate conflict and uncertainty.
- Creativity, self-confidence and adaptability – successful entrepreneurs are restless initiators who are dissatisfied with the status quo.
- Motivation to excel – successful entrepreneurs are driven by by their own need to attain self-defined goals.

Steyn (in Kroon, 1998:6) also outlines secondary characteristics for entrepreneurial success, maintaining that they "facilitate the road to entrepreneurial success":

- Energy, health and emotional stability
- Creativity and inventiveness
- Intelligence
- Ability to inspire
- Values

Steyn (in Kroon, 1998:11) points out that researchers find it difficult to understand entrepreneurship because it is difficult to generalize. He lists certain myths which arose in the course of time and have been proved wrong by reality:

- Entrepreneurs are born, not made
- Anyone can establish a successful business
- Entrepreneurs are action-oriented risk takers
- Entrepreneurs are inventors or innovators
- Entrepreneurs want everything for themselves
- Entrepreneurs are academic and social outcasts
- Entrepreneurs are their own bosses and independent
- Entrepreneurs experience unbearable tension
- New businesses fail within five years
- Capital is the most important prerequisite
- Business success is instant
- Too much planning creates problems

Rwigema and Vorster (2004:66) also detail "a plethora of myths and half-truths" about entrepreneurs:

- Entrepreneurs are born, not made
- Entrepreneurs are doers, not thinkers
- Entrepreneurs are inventors
- Entrepreneurs are social misfits
- Money is the decisive resource
- Entrepreneurs depend on luck
- Entrepreneurs are gamblers
- Entrepreneurs seek success but are prone to failure

Bolton and Thompson (2000: 21) examine ten key action roles associated with entrepreneurs and entrepreneurship, “regardless of the context”:

- Entrepreneurs are individuals who make a significant difference
- Entrepreneurs are creative and innovative
- Entrepreneurs spot and exploit opportunities
- Entrepreneurs find the resources required to exploit opportunities
- Entrepreneurs are good networkers
- Entrepreneurs are determined in the face of adversity
- Entrepreneurs manage risk
- Entrepreneurs have control of the business
- Entrepreneurs put the customer first
- Entrepreneurs create capital

ACTIVITY

Test your potential as an Entrepreneur

Below is a list of 20 personality traits. Consider each carefully – and then rate yourself by placing a tick or cross under the appropriate number with 0 being the lowest and 7 being the highest. Add your score and find out what kind of entrepreneur you would make, using the key below

	0	1	2	3	4	5	6	7
I have the ability to communicate								
I have the ability to motivate others								
I have the ability to organize								
I can accept responsibility								
I can easily adapt to change								
I have decision-making capability								
I have drive and energy								
I am in good health								
I have good human relations skills								
I have initiative								
I am interested in people								
I have good judgment								
I am open minded and receptive to new ideas								
I have planning ability								
I am persistent								
I am resourceful								
I am self confident								
I am a self starter								
I am a good listener								
I am willing to be a risk taker								

Key: 110 -140 Very strong

85 – 109 Strong

55 - 84 Fair

54 or below Weak

Source: Prepared by Sherron Boone and Lisa Aplin of the University of Mobile, in Megginson, Byrd and Megginson (2006:5)

A comparison between male and female entrepreneurs

Characteristic	*Male entrepreneurs*	*Female entrepreneurs*
Motivation	• Achievement – strive to make things happen • Personal independence • Job satisfaction arising from the desire to be in control	• Achievement – the accomplishment of a goal • Independence – to do it alone
Departure point (activities when venture is started)	• Dissatisfaction with present job • Discharge or retrenchment • Opportunity for acquisition	• Job frustration • Interest in and recognition of opportunity in the area • Change in personal circumstances
Sources of funds	• Personal assets and savings • Bank financing • Investors • Loans from friends and family	• Personal assets and savings • Personal loans
Occupational background	• Experience in line of work • Recognized specialist • Competent in a variety of business functions	• Experience in area of business • Middle management or similar level of experience in the field • Service-related occupational background
Personality characteristics	• Opinionated and persuasive • Goal oriented • Innovative and idealistic • High level of self-confidence • Enthusiastic and energetic • Must be own boss	• Flexible and tolerant • Goal oriented • Creative and idealistic • Medium level of self-confidence • Ability to deal with social and economic environment
Background	• Age when starting venture 25 – 35 • Father was self employed • College educated – degree in business or technical • First born child	• Age when starting venture, usually 35 - 45 • Father was self employed • College educated – degree in liberal arts or similar • First born child
Support groups	• Friends and professional colleagues • Business associates • Family and networks	• Close friends • Spouse
Type of business	• Manufacturing or construction	• Service – related – educational, consulting or public relations

Source: Hisrich and Peters (1998) in Beaver (2002: 145)

CASE STUDY

SOURCE: Paul Burns (2005) Corporate Entrepreneurship

Richard Branson comes from a well-off background. His father was a barrister and he went to a leading private school. However, he was never academic and suffered from dyslexia. Nevertheless this did not dent his self-confidence. His mother encouraged this, commenting that " bringing him up was like riding a thorough bred horse. He needed guiding but you were afraid to pull the reins too hard in case you stamped out the adventure and wildness."

He left school at the age of 16 to launch his first business – Connaught Publications – and publish *Student* magazine. This was based in his parents' house in Bayswater, London. He wrote to well-known personalities and celebrities – pop and film stars and politicians – and persuaded many to contribute articles or agree to interviews. He persuaded a designer to work for no fee, negotiated a printing contract for 50 000 copies and got a well-known designer to draw the cover picture.

The venture was not a success, so in 1970 he set up Virgin Records, originally selling records by mail order, at discount prices in order to undercut the competition. But this was also beset by problems, not least some allegedly 'dubious' dealings with the tax authorities. He decided he needed to move to a retail site and persuaded the owners of his first store, above a shoe shop in London's Oxford Street, to let him have it rent free because it would generate more customers for the shoe shop.

Richard Branson may have been lucky to find someone willing to let him have the premises for his first Oxford Street record shop rent-free, but when he launched Virgin Atlantic he showed that he understood that high capital costs lead to high risks. He minimized these risks by leasing everything and then being able to offer a good quality service at attractive prices.

Richard Branson's main skills are said to be networking, finding opportunities and securing the resources necessary for their exploitation. His network of personal influence and contacts is legendary. Equally important is his ability to bring out the best and motivate people. He does this with an informal style and system of communication, facilitated by the company being structured into many relatively independent smaller companies, although all under the Virgin umbrella. He hates formal meetings and has no central headquarters, not even a boardroom, as the company does not hold regular board meetings. Instead he prefers to make decisions on a face-to-face basis, albeit sometimes over the phone, but always developing and testing his personal relationships.

"I have always lived my life by thriving on opportunity and adventure. Some of the best ideas come out of the blue, and you have to keep an open mind to see their virtue."

1. Consider the personality and behavioural characteristics of Richard Branson and discuss whether or not they are similar to the characteristics and approach of an entrepreneur.
2. Evaluate Branson's approach to the entrepreneurial process from the information supplied in the excerpt.

CHAPTER THREE

THE ENTREPRENEURIAL PROCESS

Chapter Three

THE ENTREPRENEURIAL PROCESS

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Name the elements of entrepreneurship
- Describe the entrepreneurial process
- Discuss the driving forces of entrepreneurship – the entrepreneur, the opportunity and the resources.
- Describe the stages in the entrepreneurial process

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 15

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 13

According to Rwigema and Venter (2004:25), the elements of entrepreneurship are:

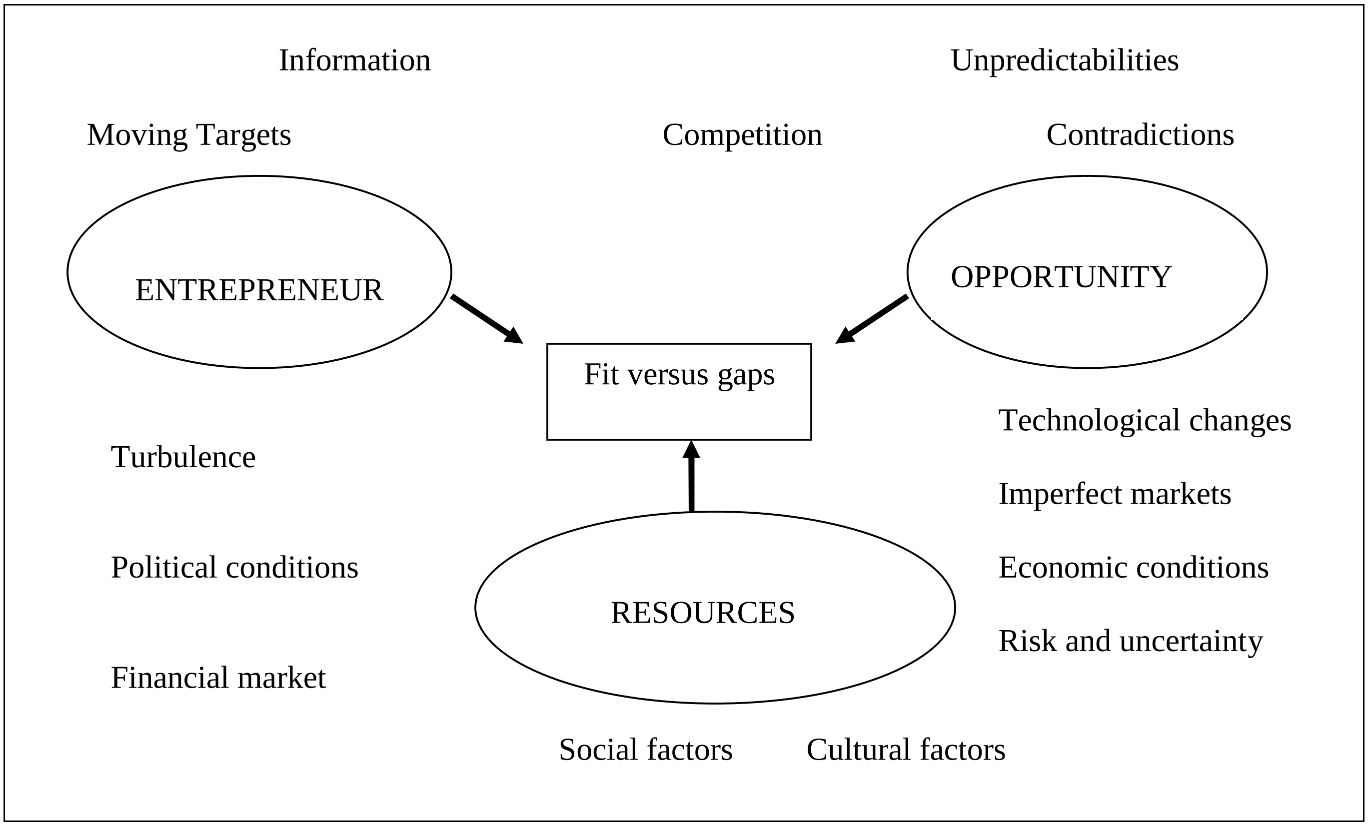
- an opportunity focus
- a business plan
- an appropriate structure and a motivated team, and
- a founder or lead entrepreneur

The entrepreneurial process involves founding (or reinventing) a business venture and growing it into a thriving, agile enterprise. Specific steps include:

- identifying, measuring and refining an opportunity from multiple ideas
- formulating a business plan
- marshalling the resources
- organizing and mobilizing the entrepreneurial team
- overseeing new venture creation and growth

Human (Kroon, 1998:85) examines the entrepreneurial process in terms of a framework based on the “driving forces of entrepreneurship.” The driving forces are the entrepreneur, the opportunity and the resources.

This is illustrated in the following diagram, adapted from Timmons (1994:17):



The degree of fit between the driving forces and the timing of the venture are two important elements of the process. Fit refers to the degree to which the three driving forces are compatible. Opportunities in business are always related to timing so that timimg is crucial in any entrepreneurial activity.

Of the three forces, the entrepreneur is the most critical factor; the characteristics of entrepreneurs have been outlined in the previous chapter. The opportunity or the market potential is the next extremely important factor. A good opportunity is:

- attractive,
- sustainable,
- timely, and
- anchored in a product or service that
- adds value to the customer

The third driving force in the entrepreneurial process is identifying, obtaining and managing the resources necessary to utilize the opportunity. The entrepreneur uses a variety of resources such as capital, human resources, equipment and knowledge. The emphasis is on control over resources rather than the ownership thereof. (Human, Kroon 1998:28)

Kaplan (2004:7) describes the five-stage entrepreneurial process as follows:

Stage 1: Conducting Opportunity Analysis – the opportunity is identified and a vision is created.

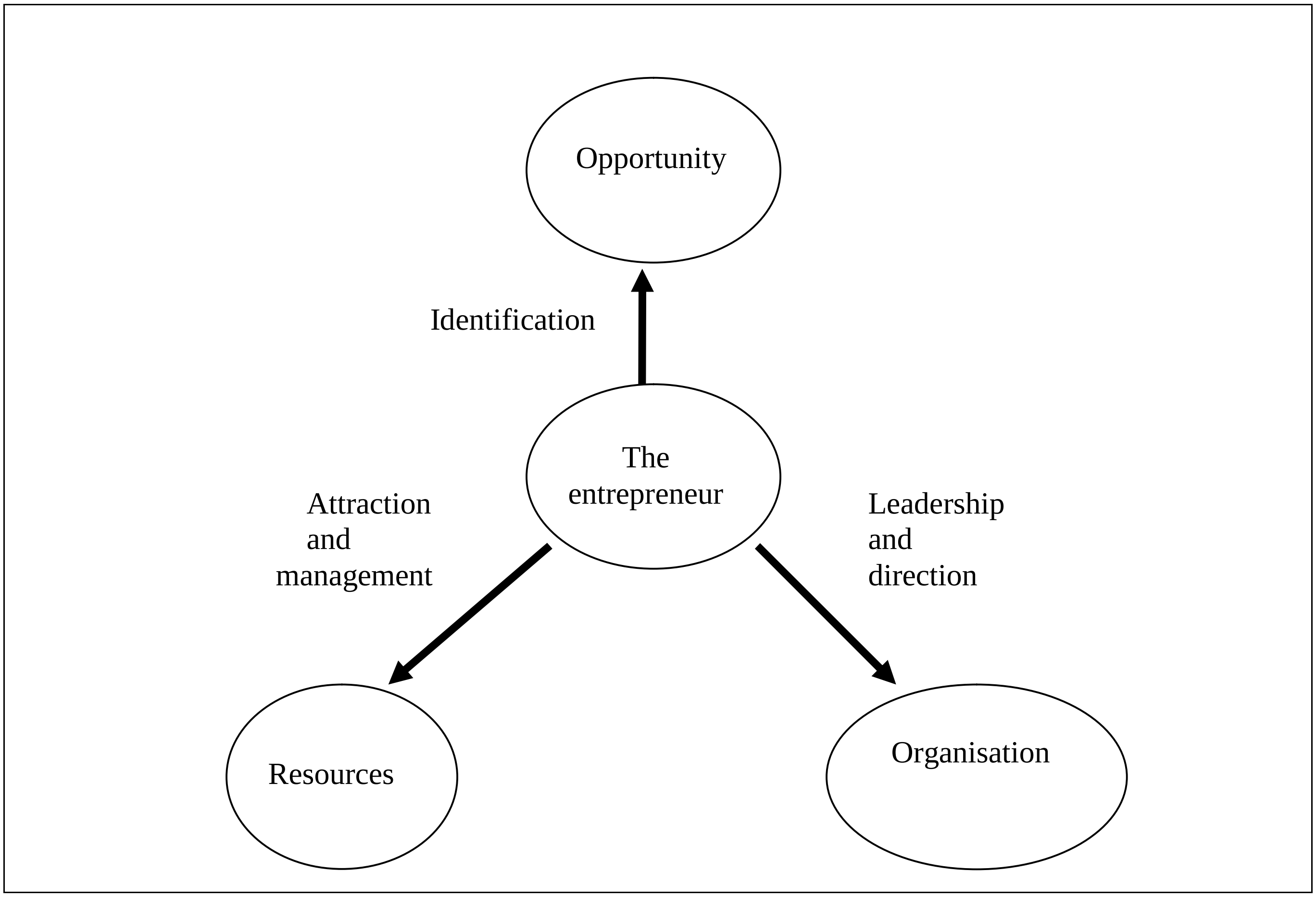
Stage 2: Developing the plan and setting up the company – strategies are documented and converted to a business plan.

Stage 3: Acquiring financial partners/sources of funding – acquiring financial investors and partners

Stage 4: Determining the resources required and implementing the plan

Stage 5: Scaling and harvesting the venture

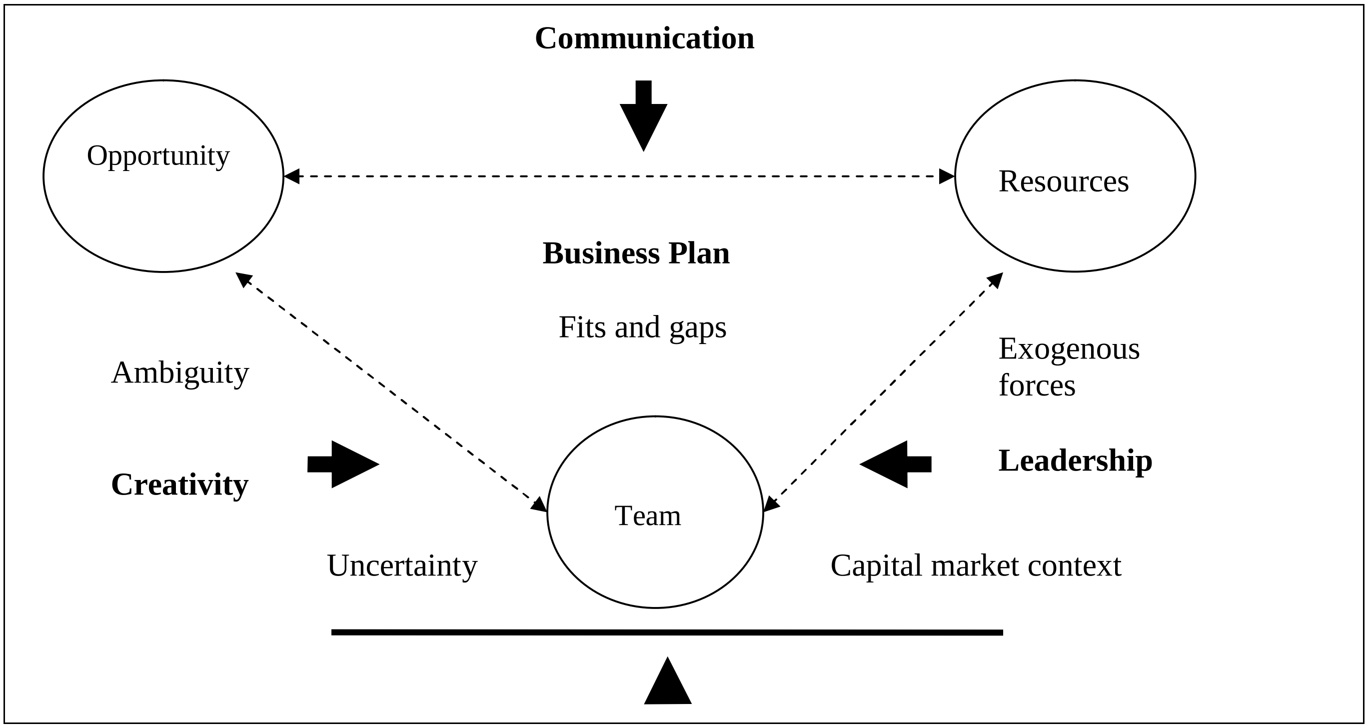
Wickham's (2001:37) approach to the entrepreneurial process is based on four interacting contingencies. The entrepreneur is responsible for bringing these together to create new value. A contingency is defined as something which must be present in the process but can make its appearance in a variety of ways. The four contingencies in the entrepreneurial process are the entrepreneur, a market opportunity, a business organization and resources to be invested. This is illustrated as follows:



The entrepreneurial process is dynamic. Success comes from the four contingencies coming together and supporting each other over time.

The *entrepreneur* lies at the heart of the entrepreneurial process. An *opportunity* is the gap left in a market by those who currently serve it. It represents the potential to serve customers better than they are being served at present. The entrepreneur scans the business landscape for unexploited opportunities or possibilities that something can be done both differently from the way it is currently being done, and better than it is at the moment. The improvement is the innovation the entrepreneur presents to the market. In order to supply the innovation to the market, the activities of a number of people must be coordinated. This is the function of the *organization*. Entrpreneurial organizations are characterized by strong, often charismatic leadership. The final contingency in the entrepreneurial process is *resources*. This includes money invested, the people who contribute efforts, knowledge and skills, physical assets (equipment and machinery) and intangible assets (brand names, company reputation and customer goodwill).

Timmons and Spinelli (2207:89) depict the entrepreneurial process in terms of the Timmons Model, which has three key elements:



Timmons and Spinelli (2007:89) make several points with regard to the entrepreneurial process:

- The process is opportunity driven.
- Resources need to be understood and marshalled.
- An entrepreneurial team is a critical ingredient for success.
- The fit and balance between and among the three driving forces is very important.
- Equally important is the timing of the entrepreneurial process.

CHAPTER FOUR

INTRAPRENEURSHIP

Chapter Four
INTRAPRENEURSHIP

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Define intrapreneurship
- Indicate the characteristics of intrapreneurs
- Identify the elements of intrapreneurship
- Differentiate between entrepreneurs and intrapraneurs
- Discuss the intrapreneurial process
- Explain the process of establishing intrapreneurship in an organisation

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 4

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 19

Rwigema and Venter (2004:76) define intrapreneurs as innovative employees who either rejuvenate existing organizations or create new ventures within a corporate structure. Intrapreneurs are often described as internal or corporate entrepreneurs.

Intrapreneurship is described by Bartol and Martin (1998: 694) as “the practice of innovating by developing new products, processes or services while one is part of an organization” (cited in Rwigema and Venter, 2004: 76).

Four elements characterize intrapreneurship:

- Internal new venture creation
- Innovation
- Self-renewal (internal rejuvenation)
- Anticipation or pro-action (Hisrich and Peters, 2002:46)

Dollinger (2003:334) contends that intrapreneurship provides a corporation with the ability to:

- Adapt quickly to changes in the macroenvironment
- Diversify from the core business
- Conduct market experiments
- Train new managers and leaders
- Establish new channels of distribution
- Invest in and profit from new venture creation

Struwig (in Nieman, Hough and Niewenhuizen, 2003:347) emphasises that intrapreneurs are people who put new ideas into action within established businesses. The following distinctions between start up entrepreneurs and intrapreneurs are made:

Start-up entrepreneur	Intrapreneur
Takes the risk	Business assumes the risk, other than career-related risk
‘Owns’ the concept and business	Business owns the concept, and typically the intellectual rights surrounding the concept.
Owns all or much of the business	Intrapreneur may have no equity in the business, or a very small percentage
Potential rewards are theoretically unlimited	Clear limits are placed on the rewards
One misstep can mean failure	More rool for errors; business can absorb failure
Vulnerable to outside influence	More insulated from outside influence.
Independence (although the successful entrepreneur is usually backed by a strong team)	Interdependence of champion with many others; may also have to share credit with several people.
Flexibility in changing course, experimenting or trying new directions	Rules, procedures and bureaucracy hinder the intrapreneur’s ability to manoeuvre
High speed of decision making	Longer approval cycles
Little security	Job security
No safety net	Dependable benefits package
Few people with whom to talk	Extensive network for bouncing around ideas
Limited scale and scope (at least initially)	Potential for sizeable scale and scope is achieved fairly quickly
Severe resource limitations	Access to finances, research and development, production facilities for trial runs, an established sales force, an existing brand, existing distribution channels, existing databases and market research resources, and an established cutomer base

[Adapted from Pinchot (2000) by Struwig in Nieman, Hough and Niewenhuizen, 2003:349]

Hisrich and Peters (2002: 48) present a modified version of Pinchot's (1985) comparison of entrepreneurs, intrapreneurs and traditional managers:

	Traditional Managers	Entrepreneurs	Intrapreneurs
Primary motives	Promotion and other traditional corporate rewards	Independence, opportunity to create, and money	Independence and the ability to advance in the corporate rewards
Time orientation	Short term – meeting quotas and budgets	Survival and achieving 5 – to 10-year growth of business	Depends on urgency to meet self-imposed and corporate timetable
Activity	Delegates and supervises more than direct involvement	Direct involvement	Direct involvement more than delegation
Risk	Careful	Moderate risk taker	Moderate risk taker
Status	Concerned about status symbols	No concern about status symbols	Not concerned about traditional status symbols – desires independence
Failure and mistakes	Tries to avoid mistakes and surprises	Deals with mistakes and failures	Attempts to hide risky projects from view until ready
Decisions	Usually agrees with those in upper management positions	Follows dream with decisions	Able to get others to agree to help achieve dream
Family history	Family members worked for large organizations	Entrepreneurial small business, professional or farm background	Entrepreneurial small business, professional or farm background
Relationship with others	Hierarchy as basic relationship	Transactions and deal making as basic relationship	Transactions within hierarchy

Struwig (in Nieman, Hough and Niewenhuizen, 2003:352) cites Pinchot (2000) discussion of the three stages in the intrapreneurial process:

- Stage 1: Choosing an idea – customer needs and the needs of the organization are considered when evaluating an intrapreneurial idea
- Stage 2: Planning the business – the intrapreneur has to turn the idea into business reality through business planning.
- Stage 3: identifying sponsors – an active sponsor will ensure that the required resources are received.

According to Dollinger (2003:337), there are five recognizable stages in the process of intrapreneurship:

- Problem definition – problems or opportunities may come from sources within the company or industry
- Coalition building – the intrapreneur must develop relationships that help support the innovative project especially through its early development
- Resource mobilization – the intrapreneur looks for physical, technological, financial, organizational, human and reputational resources; some may be 'borrowed' resources.
- Project execution – the actual execution of the project (implementation)
- Venture completion – if the venture was less than successful, it can be dismantled and its resources reabsorbed by the company. If it has been successful, it can be continued and additional investment can be made.

Du Preez (in Kroon, 1998:16) outlines certain characteristics of intrapreneurs:

- Vision – intrapreneurs have the ability to visualize ideas and then to transform them into products. Closely related to vision is the long time horizons of intrapreneurs.
- Orientation for action – they start transforming ideas into concrete products and services. Intrapreneurs are both action and vision- oriented.
- Fanatic approach and dedication – fanatic dedication enables the intrapreneur to assimilate resistance to ideas and overcome problems.
- Risk profile – the intrapreneur is a venturesome acceptor of risk. While avoiding high-risk situations, intrapreneurs accept the challenge of calculated or fair risk.
- Managerial ability – the task of the intrapreneur is closely related to change; the intrapreneur has a general approach to management.
- Achievement motivation – the primary motivation of intrapreneurs is the need for success.

Dollinger (2003:341) outlines the following barriers to intrapreneurship:

- Corporate bureaucracy
- Internal product competition
- Competing demands for resources
- Resistance to change
- Absence of ‘internal venture capitalists’ for guidance
- Employees’ lack of ownership reduces commitment
- Corporate environment not as free to creative people as entrepreneurial environment.

Hisrich and Peters (2002:50) propose the following characteristics of a good intrapreneurial environment:

- Organization operates on frontiers of technology
- New ideas are encouraged
- Trial and error is encouraged
- Failures allowed
- No opportunity parameters
- Resources available and accessible
- Multidiscipline teamwork approach
- Long time horizon
- Volunteer programme
- Appropriate reward system
- Sponsors and champions available
- Support of top management

According to Burns (2007:482), entrepreneurial leadership is about encouraging opportunity seeking and innovation in a systematic way throughout the organization, always questioning the established order, seeking ways to improve and create competitive advantage.

Entrepreneurial leadership is about a different set of imperatives to traditional management, which Burns (2003:483) summarises as follows:

Traditional management	Entrepreneurial management
• Encouraging control • Encouraging discipline • Encouraging uniformity • Encouraging conformity • Encouraging efficiency • Encouraging effectiveness • Encouraging contractual relationships only • Encouraging long-term planning • Encouraging ‘training’ • Encouraging managing functionally • Compartmentalizing knowledge and information • Trying to create certainty and clarify ambiguity • Avoiding risk • Discouraging failure • Seeing change as a threat	• Encouraging opportunity seeking • Encouraging innovation • Encouraging questioning of the status quo • Encouraging vision • Encouraging drive • Encouraging relationships within and outside the organization • Encouraging strategizing at all levels in the organization • Encouraging learning • Encouraging the rapid transfer of knowledge and information • Encouraging cooperation • Tolerating uncertainty and ambiguity • Taking risks • Allowing failure • Accepting and embracing change • Not controlling too strongly

CHAPTER FIVE

CREATIVITY, OPPORTUNITY AND FEASIBILITY

Chapter Five

CREATIVITY, OPPORTUNITY AND FEASIBILITY

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Explain the link between ideas and opportunities
- Evaluate the role of innovation and creativity
- Discuss the approach taken to recognize opportunities
- Discuss the importance of innovation as a dimension of entrepreneurship
- Describe the steps in the creative process
- Explain the components of a feasibility plan

Reading:

Burns, Paul (2007). Entrepreneurship and Small Business. Second edition
New York. Palgrave Macmillan – Chapters 3 and 4

Kroon, J. (editor) (1998). Entrepreneurship. Start your own Business
Cape Town. Kagiso Education

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 3

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 5

According to Burns (2007:56), the ability to spot opportunities arising from change and to innovate are the two most important distinguishing features of entrepreneurs.

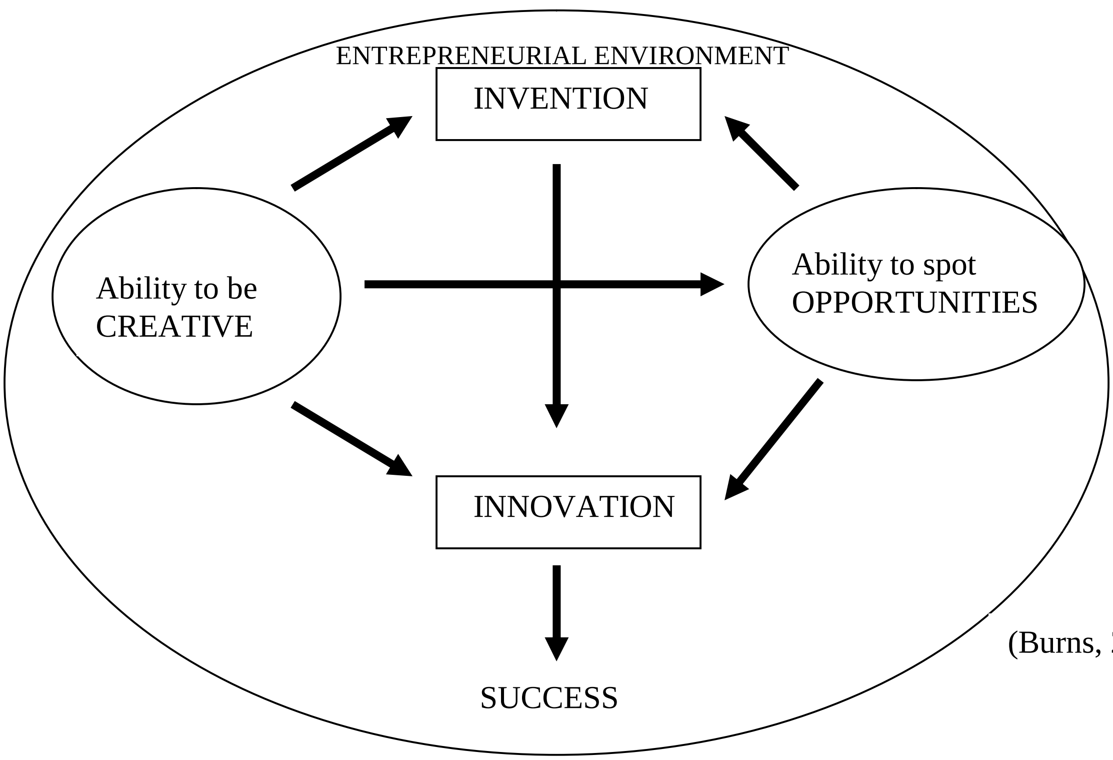
Innovation is regarded as the prime tool used to create or exploit opportunity and organizations that grow do so because they innovate in some way. Creativity is linked to innovation; creativity may contribute to innovation and is part of the process of innovation.

Burns (2007:56) provides three definitions of innovation:

- Kanter (1983) – "the generation, acceptance and implementation of new ideas, processes, products and services ….(which) involve creative use as well as original invention"
- Mintzberg (1983) – "the means to break away from established patterns"
- Mellor (2005) – "creativity + application" or "invention + application"

Thus innovation is more than just invention and is not necessarily just the product of research.

Bolton and Thompson (2000:239) stress the importance of creativity in the process of invention and innovation. They contend that creativity is the starting point whether it is associated with invention or opportunity spotting. Creativity and invention, however, need the entrepreneurial context in order to become a business reality. The links between creativity, invention and innovation, opportunity perception and entrepreneurship can be represented as follows:



(Burns, 2007:63)

Zimmerer and Scarborough (2005:35) define creativity as the ability to develop new ideas and to discover new ways of looking at problems and opportunities. They define innovation as the ability to *apply* creative solutions to those problems and opportunities to enhance or enrich people's lives. Thus creativity is *thinking* new things, and innovation is *doing* new things. Entrepreneurs succeed by *thinking and doing* new things or old things in new ways. Having an idea is not enough; transforming the idea into a tangible product, service or business venture is the essential next step. Successful entrepreneurship is a constant process that relies on creativity, innovation, and application in the marketplace (Zimmerer and Scarborough, 2005:35).

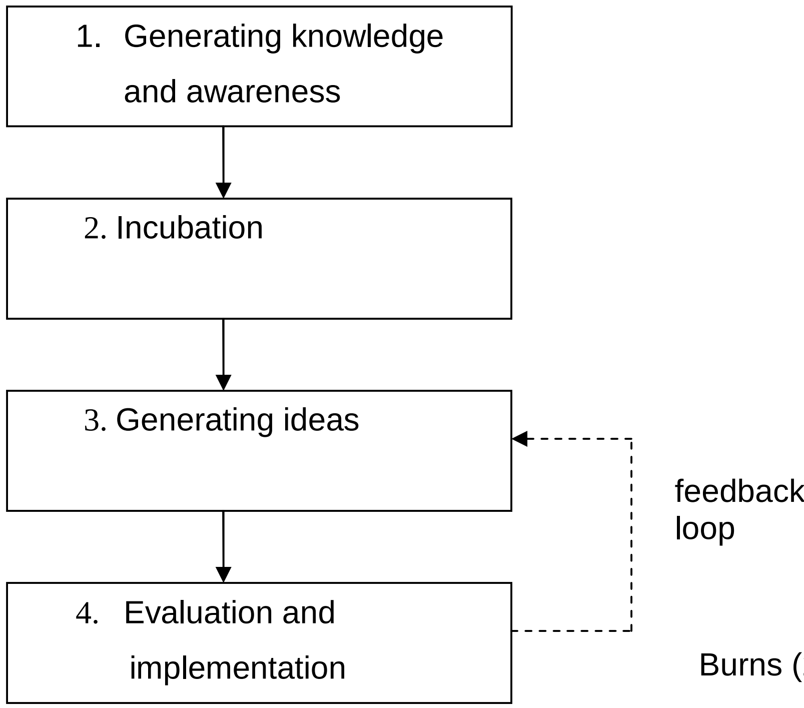
Zimmerer and Scarborough (2005:36) stress that innovation must be a constant process because "most ideas don't work and most innovations fail". Burns (2007:64) cites Drucker (1985) who believes that innovation can be systematically practiced through a creative analysis of change in the environment and the opportunities generated by this. Drucker listed seven sources of opportunity for businesses:

- The unexpected – the ability to react quickly to changes is a commercial advantage and information and knowledge are invaluable.
- The incongruity – unexpected outcomes produce opportunities for businesses who are able to spot them
- The inadequacy in underlying processes – can be improved upon and changed (process engineering)
- Changes in industry or market structure – unexpected change can create an advantage for the 'first-mover'.
- Demographic changes
- Changes in perception, mood and meaning
- New knowledge (Burns, 2007:64)

Bolton and Thompson (2000:240) suggest three basic approaches to innovation:

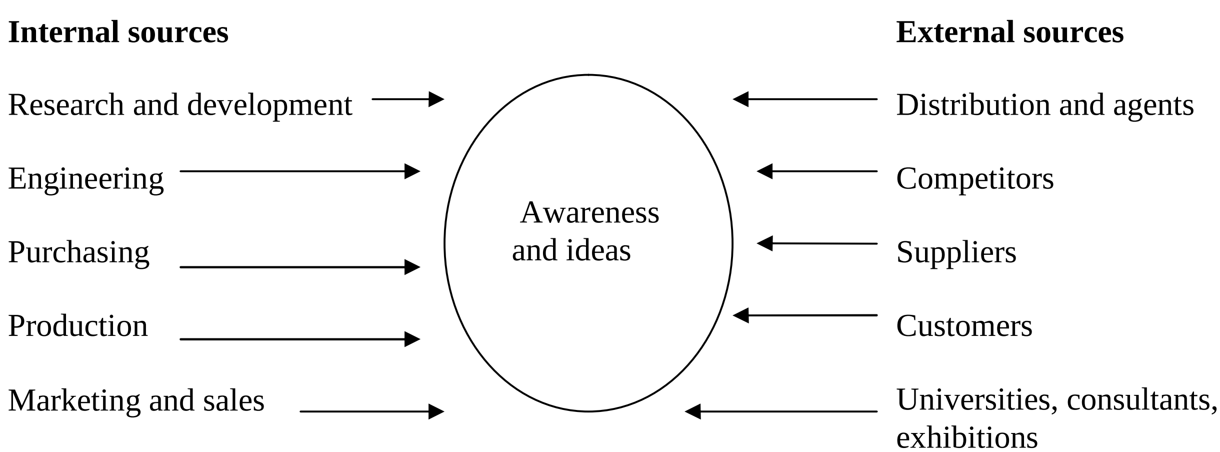
- Have a problem and seek a solution
- Have a solution and seek a problem
- Identify a need and develop a solution

According to Burns (2007:91), creativity is a right brain activity that involves lateral as opposed to vertical thinking. It is intuitive, imaginative and rule breaking. It requires interpersonal and emotional skills and is people focused. The creative process involves four steps and can be represented as follows:



Burns (2007:81)

Burns (2007:81) lists the sources of awareness and ideas as follows:



Antonites (in Nieman, Hough and Nieuwenhuizen, 2005:53) outlines the following stages in the creative process (adapted from Williams, 1990 and Nystrom, 1979):

Stages	Requirements
1. Awareness and interest	• Recognition of a problem or situation • Curiosity
2. Preparation	• Openness to experience • Analysis of how the task might be approached • Tolerance of ambiguity • Willingness to redefine concepts • Divergent thought processes (explore many possibilities) • Intuitive ability
3. Incubation	• Imagination • Absorption • Seeking ideas, possible answers and solutions • Independence • Psychological freedom
4. Illumination (insight)	• Ability to switch from intuitive to analytical patterns of thought • Eureka! • A-ha!
5. Verification	• Critical attitude • Analytical ability • Testing

Burns (2007:83) cites the work of Van Oech (1998) relating to the blocks or barriers to creativity. These are:

- The fallacy that there is only one correct solution to a problem
- The fallacy that logic is important in creativity
- The tendency to be practical
- The tendency to follow established rules unquestioningly
- The tendency to avoid ambiguity in viewing a situation
- The tendency to assign blame for failure
- The unwillingness to recognize the creative power of play
- The tendency to think too narrowly and with too much focus
- The unwillingness to think unconventionally because of the fear of appearing foolish
- The lack of belief that you can be creative

Antonites (in Nieman, Hough and Nieuwenhuizen, 2005:51) also list the following barriers to thinking and acting creatively:

- Environmental barriers – from the social, economic and physical environments
- Cultural barriers
- Perceptual barriers
- Intellectual barriers
- Emotional barriers
- Time barriers

Get Great Ideas

Aubrey Daniels says that creativity is the key to business and offers ways to motivate employees to share their ideas

An important thing that employees can be taught is that creativity is behaviour. It's not a brain thing. It's not a mysterious process. It's not something that only some people have. And being weird and eccentric doesn't necessarily mean you possess it. Creativity as an output of human behaviour follows the same laws of behaviour as other accomplishments. If this is understood, managers will be able to increase the creativity of employees in the organization who are responsible for creative products and services. Managers will also be able to increase the number of employees who contribute to creativity in the organization.

Here are a few things managers can do to increase creativity and motivate people who need to be innovative on the job:

- Positively reinforce all ideas
- Make it easy for employees to get new ideas into the system
- React to ideas as soon as possible
- Look to unlikely people as a source of fresh ideas – invite ideas from the widest range of experience, education, social status and age.
- Give employees experiences that are far removed from their usual activities – variation is the mother of creativity
- Don't discount chance – when an environment is created using techniques that favour innovation and creativity, things 'just happen' to come along at the right time.

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Antonites (in Nieman, Hough and Nieuwenhuizen, 2005:52) illustrates the process of creative thinking (from Couger, 1995) as follows:

Generating ideas	Developing ideas	Changing an idea into a product, service or process	Protecting the result
Discovery (creativity) →	Invention (creativity) →	Innovation (creativity) →	Patent / copyright

Zimmerer and Scarborough (2005:63) provide three techniques that are useful for improving the creative process:

- Brainstorming is 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.
- Mind-mapping is 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.
- Rapid prototyping is 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 design.

Antonites (in Nieman, Hough and Nieuwenhuizen, 2005:52) stresses that it is important to distinguish between an idea and an opportunity. Resources may be wasted when an idea is incorrectly perceived to be an opportunity.

Opportunities occur in real time and their duration is called the window of opportunity. In order to seize an opportunity and achieve market-required returns, the window must be open and remain open long enough (Timmons and Spinelli, 2007:125)

Pretorius (in Kroon, 1998:115) lists the following questions that can be asked to evaluate or screen opportunities:

- *What is the scope of the window of opportunity?*
- *Is the profit potential adequate to provide a satisfactory return on investment, time and opportunity costs?*
- *Does the opportunity open up additional options for expansion, diversification or integration?*
- *Will the profit stream be durable in spite of possible obstacles?*
- *Does the product or service satisfy a real need?*

A start-up can be prevented not by a lack of ideas but the inability to convert an idea into a workable sustainable plan. A good feasibility plan will identify the essential information needed by funders to make decisions about financing. The feasibility plan is meant to be an initial effort to show that a business idea can be realized and to give reasons why it will succeed. The plan will describe the crucial assumptions underpinning projections for success.
O'Neill (in O'Neill, Terblanche and Keyter, 1997:163) says that all business ideas must pass a crucial test called the feasibility study before they are implemented in practice. The feasibility study determines whether a business idea has the potential to exist as an independent economic entity in the market and the potential to achieve the desired profitability level in the long term.

The total feasibility study can be broken down into five areas of investigation:

- Technical feasibility
- Organizational feasibility
- Analysis of competition
- Market feasibility
- Financial feasibility

ENTREPRENEUR MAGAZINE SPECIAL FEATURE: JANUARY 2007 ISSUE

Driving Innovation for Business Growth by Greg Fisher

In 2005 and 2006, Apple Computer was identified as the world's most innovative company through research conducted by Boston Consulting Group, pipping other innovative organizations such as Google, 3M and Toyota at the post. Innovation is playing a hugely important role in value creation and success in business. The question is how business owners and CEOs embrace the concept of innovation in a meaningful and practical way in order to drive profit and growth?

Types of innovation

There are different types of innovation and different opportunities for innovation within an organisation's sphere of activities. Traditionally, new ideas have been classified as product innovation, process innovation or business model innovation. Two additional types of innovation are branding innovation and management innovation. Innovations can also be classified as radical or incremental.
Product innovation – focuses on the creation of new products or services, or on improving the features of a current product or service.
Process innovation – is the creation or improvement of a process by which a product or service is produced or delivered.

Business model innovation – is the creation of new business models or the successful change in an element of a business model that substantially enhances a company's ongoing performance in delivering benefits to customers and shareholders.
Branding innovation – is the creation of value within a business through the development of a powerful brand; where an organization differentiates itself or its offerings by building a unique brand.
Management innovation – is the discovery and implementation of new ways of organizing, leading, co-ordinating and motivating employees; where managers use a range of new and different practices to enhance the performance of people working under them.

Making innovation part of the business DNA

There are some distinctive practices that are common to all businesses that seem to be getting innovation right. These provide a guide for making a innovation a core competency:
Leadership – leaders are blatant and clear in their commitment to innovation. Innovation is openly stated as a priority. Resources and time are committed to driving innovation in the organization.
Teamwork – innovative organizations consistently create opportunities for small groups of people to work together. Most teams are multi-skilled and are fairly free to determine their direction and process for addressing problems and challenges.
Values – innovation is stated as one of the organizational values. This sends a clear message to employees that innovation is important and a key part of their job.
Stimulation – people need prompting in order to be innovative. A stimulating environment can encourage people to innovate.
Recruitment – getting the right people is fundamental to an innovative culture.

How to make innovation happen

A disciplined strategic management process is required to ensure a positive outcome from an innovative idea. Canic's four-phase process of making strategy work can be applied to turning innovation into reality:
Assessment phase – leaders create the time and environment to make innovation happen.
Positioning phase – establish what the objective(s) is/are in the commitment to innovate.
Planning phase – an information-driven phase that resources the team to achieve the innovation
Implementation phase – an important phase that ensures that the factors that impact people (skills, authority, resources and incentives to processes and structure) are all aligned with the key objective. This phase includes commitment building and execution management.

Finding the Right Opportunity

Greg Fisher says that finding the right entrepreneurial opportunity depends on two important questions to ask: Is there a gap in the market? And am I the right person to fill the gap?

Market demand

The starting point for sourcing an opportunity is to look for a gap in a market. By becoming aware of people's under-served needs, on can develop an opportunity-oriented mindset. In order to foster this mindset, it is useful to engage in these practices:

- Observe – look for people who are under-served
- Write – keep an "ideas" notebook; write down business thoughts and ideas, reflect on them, eliminate bad ideas, link ideas with potential and build on good ideas
- Discuss – engage in exploratory chats with other people.
- Explore – explore trends and concepts

Effectively combining these practices will provide a diverse set of ideas which must be refined and researched. The research should attempt to gauge:

- The size of the market – how big is the market and is there room for another competitor?
- The likely competitors in the market – who are the competitors and how is the idea different from what they do?
- Is it possible to reach the customer? – how to get to the customer to sell and distribute the product or service.

This quick market research will indicate whether or not there is a gap in the market.

Passion

Building a business around an activity or product about which you are passionate can give a huge advantage. Passion increases the ability and confidence to sell it to others. Passion also makes it easier to endure the tough times of building a business.

Skills

Using unique skills that have developed during one's lifetime can give a competitive advantage in setting up a business.

Resources

As ideas are reviewed, consideration must be given to the available resources that will provide a head start when implementing the idea. Effective entrepreneurs leverage the opportunities that arise from the resources they have access to.

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CHAPTER SIX

BUSINESS PLANS

Chapter Six

BUSINESS PLANS

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Define a business plan
- Explain the reasons why a business plan is necessary
- Explain the key elements of a business plan
- Prepare a business plan
- Explain how the business plan works as a management tool
- Critique a business plan

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 10

Dollinger, Marc J. (2003). Entrepreneurship Strategies and Resources.Third edition
Singapore. Pearson Education - Chapter 5

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 5

Timmmons, Jeffry A. and Spinelli, Stephen, Jr. (2007).
New Venture Creation. Entrepreneurship for the 21st century. Seventh edition
Boston. Mc-Graw Hill – Chapter 6

Struwig (in Nieman, Hough and Nieuwenhuizen, 2003:90) defines the business plan as “a written presentation that carefully explains the business, its management team, its products or services and its goals, together with strategies for reaching the goals.”

Beaver (2002:90) outlines Richardson and Jennings (1988) explanation of what constitutes a business plan. They state that a business plan:

- Is many things depending on the specifics and operating context of the business
- Is a set of related assumptions about what the future will contain, with outcomes often expressed in financial terms
- Integrates strategic, operational and administrative issues
- Is a mixture of quantitative and qualitative data and information
- Is an articulate bargaining strategy to obtain the necessary resources

Dollinger (2003:127) defines the business plan as "the formal written expression of the entrepreneurial vision, describing the strategy and operations of the proposed venture".
According to Dollinger (2003:129), a business plan:

- explains the entrepreneur's vision in writing
- demonstrates implementation (strategy and operations)
- may function as a financing proposal or an investment prospectus.

There are three primary reasons for compiling a business plan:

(a) To obtain funding – the business plan is considered vital for approaching and capturing financial resources

(b) To serve an inside purpose – the business plan provides
  - a focus
  - an objective
  - a tool for measuring performance against
  - a marketing tool for obtaining finance
  - a road map to direct the business
  - a method for determining the risks facing the business

(c) To be used as a tool for reducing the risk – drawing up a business plan forces the entrepreneur to carefully consider each aspect of the business.

(Struwig in Nieman, Hough and Nieuwenhuizen, 2003:91)

According to Wickham (2001:190), the activity of creating a formal business plan consumes both time and resources. There are four ways in which a business plan assists the performance of a business:

(a) By working as a tool for analysis – a business plan contains information. Creating the plan guides and disciplines the entrepreneur in gathering this information.

(b) By working as a tool for synthesis – the business plan synthesizes the vision of the entrepreneur with a definite plan of action in a unified way. This converts the vision into a strategy and then into appropriate actions to pursue the strategy.

(c) By working as a tool for communication – the business plan provides a vehicle for communicating the potential of the business. The business plan is particularly important as a tool for coomunicating with potential investors.

(d) By working as a call for action – the business plan is a call for action; it provides a list of the activities that must be undertaken. (Wickham, 2001:191)

These four ways in which the business plan contributes to the success of the business do not operate in isolation. They underpin and support each other.

Rwigema and Venter (2004:251) contend that the benefits of business planning are multiple:

- It forces the entrepreneur to be disciplined, think through every facet of the plan and collect the necessary information.
- This process allows critical and impartial scrutiny of the strategies to secure the long-term future of the business
- Investors require to see the plan
- The plan serves as a benchmark for control when deviations appreciably exceed expectations.
- Entrepreneurs use the plan for self-evaluation
- The plan serves as an early warning system so that entrepreneurs may turn threats into opportunities
- The business plan is a powerful communication tool.

The elements of a business plan are captured in the following tables, which present the variations of what goes into a successful business plan:

Struwig (in Nieman, Hough and Nieuwenhuizen, 2003:92)	**Rwigema and Venter (2004:251)**	**Dollinger (2003:131)**
Cover Sheet • Full name of business • Full street address • Mail address • Phone, fax and email • Contact name and title • Date of plan **Table of Contents** • Lists main headings • Includes graphs, charts and tables **Summary** Highlights important aspects of plan **Products and/or Services plan** • The business • The products • The industry **Marketing plan** • Outline the 4P's (product, price, promotion and place) • Competitive advantage • Customers, market size, competition and market evaluation **Operations plan** • Focus on facilities, manufacturing, capability and equipment • The steps and time taken to bring the business up to full speed	**Executive Summary** **Proposed Venture** • Business concept • The industry • Company background • Mission, goals and landmarks • Product/ service uniqueness **Marketing** *Market analysis* • Target market • Customers and need • Market size and growth patterns • Competitor analysis • Projected market share *Marketing plan* • The product and/or service • Pricing • Promotion • Distribution **Research, design and development** • Development and design plans • Technical progress to date • Outstanding research • Costs **Manufacturing (or operations)** • Location: pros and cons • Facilities and equipment • Raw materials and procurement	**PRELIMINARY SECTIONS** **Cover page** **Table of Contents** **Executive summary** 1. Type of business 2. Company summary 3. Management 4. Product/service and competition 5. financial history, financial projections 6. Funds requested, collateral **MAJOR SECTIONS** **I Background and Purpose** • History • Current situation **II Objectives** • Short term • Long term **III Market Analysis** • Overall market • Specific market • Competitive factors • Micro environmental influences **IV Development and Production** • Production processes • Resource requirements • Quality assurance

Management plan The management team. List all directors, consultants, advisers and key professional who will be involved in the business. Attach detailed CVs as appendices **Financial plan** • Start-up capital • Projected income • Projected balance sheet • Projected cash flow statement • Projected capital equipment **Appendices** All pieces of evidence, such as CVs, product brochures, testimonials and news articles	• Labour: availability and quality • Manufacturing / operations costs **Venture team** • Key staff • Ownership structure • Board of Directors, advisers **Risks and challenges** • Potential problems and the impact of these • Bottlenecks and risks • Potential solutions **Financial issues** *Financial projection* • Profit and loss statements for the next three to five years • Cash flow for the next three years • Break-even analysis • Cost controls *Sources of funds and finance charges* • The budget **Plan schedule** • Timing of key milestones • Deadlines • Plan coordination **Concluding remarks** **Appendix and/or references**	**V Marketing** • Overall concept and orientation • Marketing strategy and resources • Sales forecasts **VI Financial Plans** • Financial statements • Financial resources • Financial strategy **VII Organisation and Management** • Key personnel resources • Human resource management strategy **VIII Ownership** • Form of business • Equity positions **IX Critical Risks and Contingencies** **X Summary and Conclusions** **XI Scheduling and Milestones** • Appendixes

TABLE 1

According to Struwig (in Nieman, Hough and Nieuwenhuizen, 2003:92), the Internet can be used as a tool for drawing up a business plan by serving as:

- An important source of information for such components as the industry analysis, competitor analysis and measurement of market potential
- A good marketing tool for any business
- A valuable source of information on competitors
- A means of gathering information through online groups
- A source of software to be used in drawing up the business plan.

Timmons and Spinelli (2007:225) outline some “Do’s and Don’ts” for preparing a business plan:

Do

Involve all of the management team in the preparation of the business plan

Make the plan logical, comprehensible, readable, and as short as possible

Invest a significant amount of time and some money in preparing the plan

Articulate what the critical risks and assumptions are and how and why these are tolerable

Disclose and discuss any current or potential problems

Be creative in gaining the attention and interest of potential investors

Remember that the plan is not the business

Let realistic market and sales projections drive the assumptions underlying the financial spreadsheets, rather than the reverse

Don’t

Have unnamed, mysterious people on the management team

Make ambiguous, vague, or unsubstantiated statement

Describe technical products or manufacturing processes using jargon or in a way that only an expert can understand

Spend money on developing fancy brochures, elaborate presentations and other ‘sizzle’

Struwig (in Nieman, Hough and Nieuwenhuizen, 2003:105) also lists the possible problems experienced when drawing up business plans:

- Lack of proven market demand
- Lack of objectivity
- Ignoring competition
- Inappropriate market research
- Inability to produce according to quantity and quality required
- Underestimating financial requirements
- Insufficient proof that loan repayments will be made timeously
- Lack of a unique product or service
- Disregard for legal requirements
- Ignoring the potential influence of the external environment
- Lack of sufficient financial commitment by the founders
- Lack of appropriate business experience by management and staff
- Failure to anticipate obstacles

- Lack of a logical sequence
- Failure to indicate the stage in the product life cycle at market entry

The following points made by Timmons and Spinelli (2007:230) are important in terms of business plans:

- The business plan is more of a process and work in progress than an end in itself
- Given the pace of change in all areas affecting a business, the plan is obsolete the moment it emerges from the printer.
- The business plan is a blueprint and flight plan for a journey that converts ideas into opportunities, articulates and manages risks and rewards, and articulates the likely flight and timing for a venture.
- The numbers in a business plan do not matter, but the economics of the business model and the value proposition matter enormously.
- The plan is not the business.

CHAPTER SEVEN

PATHS TO ENTREPRENEURSHIP

Chapter Seven

PATHS TO ENTREPRENEURSHIP

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Describe ways in which people become owners/ managers of businesses
- Discuss the advantages and disadvantages of starting a new business
- Be aware of the opportunities and pitfalls of buying an existing business
- Display knowledge of methods for valuing a business
- Examine the issues that may affect the valuation process
- Explain the different types of franchising arrangements
- Outline the advantages and disadvantages of franchising
- Define the role of franchisors

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapters 11 and 14

Kroon, J. (editor) (1998). Entrepreneurship. Start your own Business
Cape Town. Kagiso Education - Chapters 20 and 21

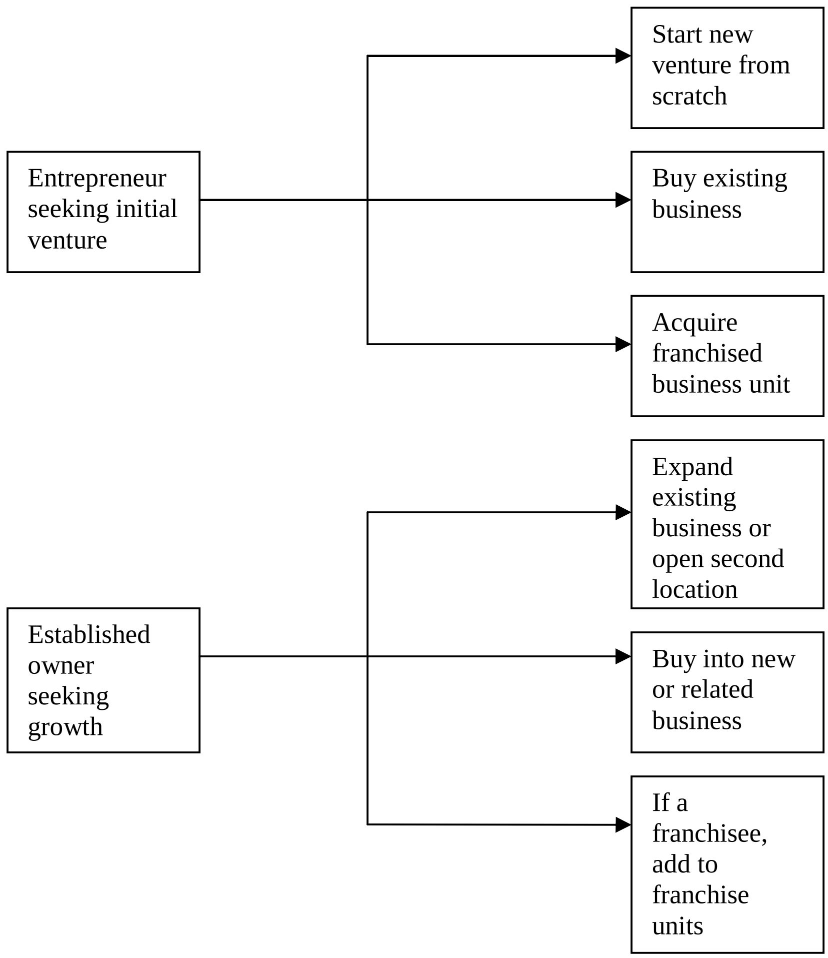
Katz, Jerome A. and Green, Richard P. (2007). Entrepreneurial Small Business
Boston. Mc-Graw Hill Irwin - Chapter 6

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapters 11 and 12

Katz and Green (2007:138) state that there are five ways to “get” into business:

- Start a new business
- Buy an existing business
- Franchise a business
- Be appointed as a manager in a business
- Inheriting a business

Holt (2002:385) outlines the primary alternatives in acquisition decisions as follows:



Starting a New Business

Katz and Green (2007:139) make the point that starting a new business is "at once the most risky path into business and the path that promises the greatest rewards for success". They are adamant that the rewards, both financial and personal, of starting a successful new business can be most impressive.

Some of the advantages of "start-ups" are:

- A start-up begins with a 'clean slate'. There are no existing employee problems, debts, contracts, lawsuits or other legal commitments.
- A start-up provides the owner with the opportunity to use the most up-to-date technology. There are no 'legacy' locations, buildings, equipment or software that can hamper productivity
- A start-up can provide new, unique products or services that are not available from existing businesses.
- A start-up can be kept small deliberately to limit the magnitude of possible losses.

(Katz and Green, 2007:139)

Katz and Green (2007:140) also list the disadvantages of starting a new business:

- A start-up has no initial name recognition.
- A start–up will require time to become established and provide positive cash flow
- A start-up can be very difficult to finance
- A start-up may not have experienced managers and employees.

The first step in creating a start-up business is to determine what the business should be. The vast majority of start-up businesses are "me-too' enterprises – where the business idea is to create another occurrence of a common business. This provides some protection from failure as it is not necessary to define the business to the market. The downside of such a strat-up is the difficulty in differentiating it from other similar businesses. Often, the only competitive advantage may be the location of the start-up.

The specific concept that leads to a start-up business usually comes from the experience of the person starting the business (The founder). Many start-ups are based on ideas from prior work experience, hobbies and family businesses. The level of experience of the founder(s) is one of the best predictors of success of the start-up. (Green and Katz, 2007:141).

Green and Katz (207:141) also list the Top 12 Indicators of Start-up success:

- Starting the business in a business indicator
- Taking part in a mentoring programme
- Having a detailed start-up budget
- Producing a product or service for which there is proven demand
- Securing outside investment
- Starting with more than one founder
- Having experience managing small businesses
- Having industry experience
- Having previous experience in creating a start-up business
- Choosing a business that produces high margins
- Starting the business with established customers
- Building trust – convincing suppliers, employees and customers that the business is successful.

Beaver (2002:18) offers the following list of critical success factors that have been compiled from research findings as being instrumental in determining business start-up success:

- Owner's goals
- Owner's operational abilities
- Owner's management abilities
- Owner's strategic abilities
- Financial resources
- Personnel resources
- Information technology and systems capabilities
- Business resources

Buying an Existing Business

Buying an existing business has important advantages over creating a start-up. However, purchasing a business has its own, unique set of risks. According to Steyn (in Kroon, 1998:255), buying an existing business carries a great deal of risk.

The advantages of buying an existing business are:

- Established customers provide immediate sales and cash inflows – i.e. successful businesses may continue successfully
- Business processes are already in place
- The best location has already been found
- Employees and suppliers are allied
- Equipment is installed and production capacity is known
- Stock levels are known and trade credit is current
- The business is operational
- The experience of the seller is available
- It may be a bargain (Steyn, in Kroon, 1998:256 and Green and Katz, 2007:147)

The dangers of purchasing an existing business include:

- Finding a successful business for sale that is appropriate to the experience, skills and education of the purchaser is difficult and time consuming
- The value of an existing business can never be known with certainty
- Existing managers and employees may resist change – change may be difficult to implement
- The reputation of the business may be a hindrance to future success
- The business may be declining because of changes in technology
- The facilities and equipment may be inadequate, or obsolete or in need of repair.
- Hasty decision-making (i.e. buying the business without careful evaluation)
- Non-profitability is disguised by accounting methods
- Bad relationships of the seller damage the business
- Employees are not suitable
- The location is not suitable
- Stock is obsolete
- Debtors are over-valuated
- The business may lose key employees
- Strategic limitations – the existing financial structure as well as the method by which the buyer finances the purchase may limit alternative strategies
- Judicial limitations – pre-conditions, rights and obligations may place limitations on the business

(Steyn, in Kroon, 1998:256 and Green and Katz, 2007:147)

Steyn (in Kroon, 1998:258) advocates a logical and methodical approach to the successful buying of an existing business. This approach includes the following steps:

- Determine the skill levels and field of interest of the buyer
- Compile a list of potential businesses
- Evaluate potential candidates
- Value potential candidates
- Consider alternative forms of financing
- Make a specific offer to the seller
- Ensure a smooth transition

Due diligence is the process of investigating to determine the full and complete implications of buying a business. During the process of due diligence, every aspect of the prospective acquisition is examined in detail. Green and Katz (2007:150) also advocate a “clear order of steps” that should be followed when a business is acquired:

- Conduct interviews with the seller
- Study the financial reports and other records of the business
- Examine the site (or sites) of the business
- Interview customers and suppliers
- Develop a detailed business plan for the acquisition
- Negotiate an appropriate price, based on the business plan projections
- Obtain sufficient capital to purchase and operate the business.

According to Steyn (in Kroon, 1998:259), evaluation of the business to be acquired must consider:

- History and general information
- Reason(s) why the business is being sold
- Physical condition (tangible and intangible assets)
- The market
- Competition
- Logistics
- Marketing
- Manufacturing structure
- Employees
- Ownership
- Management

- Legal aspects – including possible restraint of trade agreement and potential obligations flowing from employment safety legislation, product liability and labour legislation.

Holt (2002:395) outlines three primary methods of valuation:

Book Value	Derived net worth of business (assets minus liabilities)	Sets value of assets but may not account for future income
Multiple of earnings	Recaptures future value of net income (net income times multiplier factor)	Provides a rule of thumb to value future income but may not account for asset value
Discounted future earnings	Accounts for time value of future net income (present values calculated for future income)	Risk-adjusted value includes income and net worth of business

Green and Katz (2007:151) explain the methods for determining the value of a business:

(a) Discounted cash flows – based upon estimates of future cash inflows and outflows on the concept that the longer one has to wait to receive money, the less valuable it is right now. The use of discounted future earnings explicitly recognizes that the value of a business is its future earnings.

(b) Asset valuation methodology is based on the assumption that a business is worth the value of its assets minus the value of any liabilities. Book value, net realizable value or replacement value may be used to estimate the value of the assets of a business. Book value is the original acquisition cost of the asset, less depreciation to date. Net realizable value is an estimation of the amount for which an asset would sell, less the costs of selling the asset. Replacement value is an estimate of what an essentially identical asset would cost to be acquired and readied for service.

(c) Earnings multiple – the ratio of the value of a business to its annual earnings
In some cases, buyers may buy a failing business with the intention of turning it around. Kaplan (2004:360) emphasizes that it is important for the skills and capital needed to succeed be in place when buying a troubled or turnaround business.

Entrepreneurs should evaluate three categories of a business that are important in any turnaround plan:

- The business assets (evaluated in terms of book or market value)
- The business operations (to examine sales trends, credit policies, pricing, promotional activities, and distribution systems). Human resources issues, including how the owner's personal skills and abilities influence operations and whether capable employees will stay after acquisition, should also be analysed.
- The business environment, including external market trends, competition, industry characteristics, consumer profiles and buying patterns, economic conditions, financial trends, and costs related to operating the business. (Kaplan, 2004:360)

Franchising

Franchising is a legal agreement that allows one business to be operated using the name and business procedures of another. The most ubiquitous franchise, worldwide, is Macdonald's, which has over 30 000 restaurants in more than 100 countries. Approximately 73% of these are owned by independent businesspeople who operate them in a franchise agreement (Katz and Green, 2007:155)

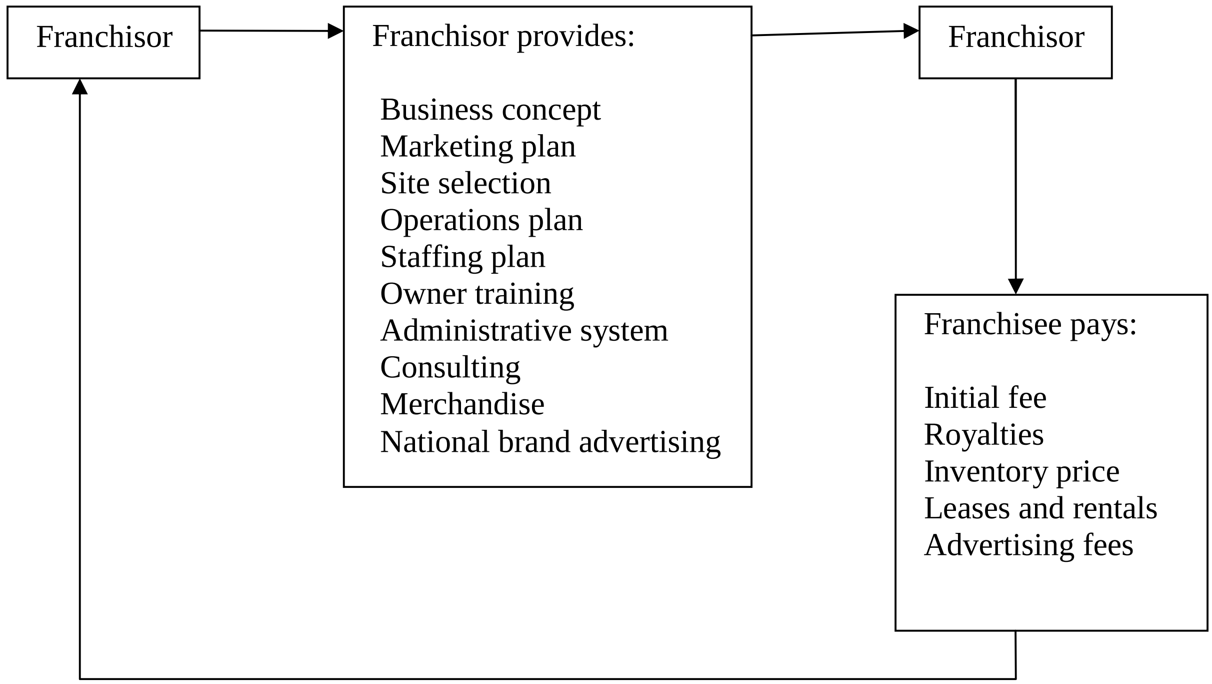
Katz and Green (2007:156) define franchises as agreements between two entities,

(1) the franchisor who sets conditions and standards and who grants operating permissions, and

(2) the franchisee, who pays a fee for the rights, and who agrees to abide by the conditions and standards.

According to Dollinger (2003:352), franchising is marketing system by which the owner of a service, trademarked product, or business format grants exclusive rights to an individual for the local distribution and/or sale of the service or product, and in turn receives payment of a franchise fee, royalties, and the promise of conformance to quality standards.

Holt (2002:406) represents the franchise system as follows:



According to Katz and Green (2007:156), there are three basic forms of franchising:

1. Trade name franchising – an agreement that provides only the rights to use the franchisor's trade name and/or trademarks
2. Product distribution franchising – provides the franchisee with specific brand named products, which are resold by the franchisee in a specified territory.
3. Business format franchising – an agreement which includes the right to use trade names, specifications of the product to be sold, operating methods, marketing plan and national advertising. Franchisee pays both an up-front fee to obtain the franchise rights and a percentage of gross sales.

Terblanche (in Kroon, 1998:242) describes four types of franchising arrangements:

1. *Original service/trade mark holder – retailer*. The franchisee acquires the use of the franchisor's trademark, architectural designs, logos, operation manual and other business practices. Examples are most common in the fast food industry (McDonalds, Wimpy, Spur).
2. *Manufacturer-retailer.* A manufacturer enters into an agreement with independent retailers who undertake to exclusively market his product(s) to the final consumer. Examples are petrol stations and new car dealers.

3. *Manufacturer-wholesaler*. A manufacturer sells product(s) to wholesalers who sell the product(s) to retailers Coca Cola manufacturers sell the soft drink concentrate to franchised wholesalers who bottle and distribute soft drinks to retailers.
4. *Wholesaler-retailer.* The retailer is independent, but trades under the name of the wholesaler and benefits from the wholesalers bulk buying.

Hisrich and Peters (2002:546) refer to three types of franchises:

- The first type is the dealership – commonly found in the car industry, where the dealerships act as retail stores for the manufacturer
- The most common type is that which offers a name, image and method of doing business, such as McDonalds.
- A third type of franchise offers services. These include personnel agencies and estate agencies.

One of the most important elements of the franchise concept is the franchise contract, which is also called the franchise agreement. This contract specifies all the terms on which the relationship between the franchisor and franchisee is based. It specifies all the rights and obligations of both parties and how the franchise is to be operated.

The advantages and limitations of franchising can be detailed as follows:

	Advantages	Disadvantages
From the franchisee's viewpoint	• A proven system is being acquired • Start-up assistance is provided • Ongoing assistance is provided • Access to training and support • Advertising and purchasing is taken care of • Easier to obtain finance • Leverage • Risks associated with product acceptance, management expertise, meeting capital requirements, knowledge of the market and operating and structural controls are minimized. • Probably require less capital than setting up independently • Independence is retained • Franchisor strives to improve business with ongoing R&D programmes	• Increased set-up costs • Rigid operating procedures • No control over marketing and operations • Bad decisions by the franchisor • Restrictions on freedom to act • Limited control and flexibility • Reliability of franchisor • Costs • Erosion of name and reputation and brand image of franchise • Success is determined to a large extent by the success of the franchise • Franchisee cannot sell business to anyone • Royalties have to be paid •
From the franchisor's viewpoint	• Allows rapid expansion using little capital • Dedicated owner-operators • Economies of scale result in cost advantages • Risk management • Fewer employees are required	• High operating costs • Reduced income per unit • Restrictions on freedom to act • Maintaining a working relationship with the franchisee • Quality control • Threat of competition • Individual franchises can fail despite the training and controls

(Hough, in Nieman, Hough and Nieuwenhuizen, 2003:198-199) (Rwigema and Venter, 2004:302-305) (Hisrich and Peters, 2002:546) (Katz and Green, 2007:159) (Terblanche in Kroon, 1998:242)

Certain types of business are appropriate for franchising. The first and primary requirement is a successful series of pilot stores, locations or operating units. The franchisor bears the cost of developing the formula during the pilot period. The franchisor must learn enough about how to make the business a success to be able to train others to be successful, too. This means learning the key elements of accurate site selection, efficient operations, internal and external financial ratios, operating cost control, a consistent and workable pricing policy, and training procedures for both potential franchisees and their employees. In addition to perfecting each of these areas, the potential franchisor must be sure that after all costs are met, enough is left over for the franchisee to earn a reasonable return and pay royalties to the franchisor.

Businesses suitable for franchising generally have a product or service that is able to satisfy a continuing demand. Because it will take 2 to 3 years for both the franchisor and franchisee to earn a return on their investment, the franchise idea cannot be based on a fad or ‘quick-money’ opportunity. The format of the franchiseable business needs to be simple and mechanical. Uniform standards of quality and appearance for the stores or outlets are important. The franchisor must give serious thought to what quality means to the customer and be able to define and measure it accurately.

The franchisor looks for a simple and easy-to-remember name for the business. Strong advertising and promotional support are needed. The franchisee locations must be good enough to support the business but not so expensive that they absorb all the profits. Accurate site selection is therefore vitally important.

The administration of the franchise system should be kept simple. The franchisor needs a method to ensure that sales and profits of the franchisee are accurately reported and royalty payments are correct and timely. (Dollinger, 2003:355)

Dollinger (2003:356) argues that the franchise system engages in two simultaneous sets of competitions: The franchisor competes to sell franchises, and the franchisee competes locally to sell the product or service. These are interrelated problems. If franchisees face competition, the franchisor will find it difficult to sell franchises. Conversely, if the franchisor is having trouble selling franchise, this decreases the brand value, name recognition, advertising support, and purchasing economies of scale that the franchisee relies on for marketing and operations. The dependency can run in the other direction, too. Franchisors depend on their franchises for cooperation. A franchisee rebellion can be a serious problem for the franchisor.
Although a franchisor can discipline individual franchisees who fail to live up to quality standards of contractual agreements, when the entire franchisee system rebels, the franchisor may have to negotiate or capitulate. However, power is generally held by the franchisor, who screens and selects the franchisee, draws up the contracts, and collects the royalties. (Dollinger, 2003:356)

Franchising is the process of creating networks of business systems with consistent and repeatable operations. Franchisors sell business concepts and the collective support of operational systems necessary to succeed. They offer brand merchandise, image, stock and distribution systems, training and various options for administrative and consulting services. More importantly, they provide a marketing plan. Combined, these support systems reduce the risk associated with a new venture and the likelihood of start-up mistakes. In return, the franchisor collects franchise fees, royalties and profits from merchandise and services provided to the franchisee (Holt, 2002:412)

? THINK POINT

According to Timmons and Spinelli (2007:374), franchising is an inherently entrepreneurial endeavour in that opportunity, scale and growth are at the heart of the franchise experience.
Do you agree? Justify your answer

What to ask the Franchisor?

Laura Tiffany offers the following advice:

Don’t be afraid to ask questions and don’t be afraid to appear foolish.

- Ask what the pre-tax net profits of existing operations are and compare them against the earnings statement or pro forma that the franchisor has given you
- Find out what is included in the training programme, as well as about the field assistance, store design, facility construction, site selection and feasibility studies
- Will there be any additional working capital required after the initial fee and investment, and if so, how much?
- Ask if the company has any plans for further expansion in the region.
- What kind of financing is available from the franchisor, if any?
- How will the franchisor arrange for the supply of product to the business?
- Ask the franchisor to detail exactly what the territorial restrictions and protections are
- Find out how many franchises have been sold in the region in which you will be operating during the past 12 months
- If purchasing a current franchise, ask to see the operating books and records of the business for the past two years
- What type of support will the franchisor provide once your franchise has opened it doors?
- Find out if any franchisees have been terminated. If some have find out why from the franchisor. Have any franchisees failed or gone bankrupt? If so, find out why
- Find out if there are any current lawsuits pending against the franchisor
- Find out how disputes between the franchisor and franchisees are settled
- Will the franchisor assist in site selection?

ENTREPENEUR MAGAZINE, APRIL 2006 ISSUE

CASE STUDY 1

The Accidental Franchisors

Roger Hugo admits to having a passion for movies. He shares his passion with his younger brother, Mike, and the two have successfully translated their enthusiasm into a thriving business. How did they do it?

“It was easy,” they both reply. In 1982 video was still a new concept. The Hugo brothers were alert to the opportunities this offered; they were also greatly attracted to the idea of creating a ‘spot’ where people would come to meet, mingle and choose videos. “Although we didn’t have much industry-specific experience, we’d both run our own businesses before,” says Roger. This was enough to give them the confidence to “see the opportunity and jump”.

It was a jump that paid off. Video Spot’s initial premises soon proved insufficient for the outlet’s growth. Eventually the business located to its current site.

What made the business so successful? “We were able to provide material that was unavailable anywhere else,” says Mike. Perhaps more than that, the shop quickly established a name for providing personal service. Customers at Video Spot were used to walking in and sharing a joke with Mike and Roger, knowing they could count on the two for expert advice and opinions.

That careful focus on customer satisfaction became the company’s hallmark, and has remain unchanged during its expansion through franchising. “It was never our plan to franchise. However we got so many requests from people interested in owning a business like ours that it seemed the right move,” Roger recalls. The first franchise was established in 1985, and its success convinced the brothers that they had hit on a winning formula.

More franchising was definitely on the cards – but, insists Mike, only if the potential franchisee could prove that he/she would be thoroughly involved in the business. “That’s the key to making the business work for you,” he says.

Video Spot’s accent on personal service has contributed greatly to its popularity. “Part of our challenge is ensuring that we always have the right material, in the right quantities,” says Roger. That means planning for holiday seasons, when videos are in higher demand than usual, and keeping track of trends. It's also important to understand the customers of an outlet and their tastes. Mike points out that "different genres appeal to different clientele in different areas".

Also important is keeping an eye out for obscure material such as set works or for films that aren't topping any box office lists. Those are just the general prerequisites of the business. Day-to-day challenges include watching out for damaged and lost stock, as well as late returns. "Fortunately, we have a superior software system that makes control of such processes very efficient," says Roger. Slightly more difficult is the handling of customer requests, particularly during busy times. "You have to be able to handle each request swiftly, courteously and accurately; and you usually don't have much time to do that," says Mike. That's why it's important to hire staff who not only have exceptional people skills and enjoy interacting with customers, but who are also extremely knowledgeable and informed when it comes to film.

"That's the hard part," says Roger. "The easy part is that it's a fun, sociable business, ideal if you like people."

It's also a business that's thriving. The popularity of DVDs over VHS has given the shop a distinct boost. "DVDs are slimmer and easier to store, so we can accommodate greater volumes – which, of course, translates into more opportunities to satisfy our customers."

With the popularity of home entertainment growing rapidly, thanks to its convenience and affordability, piracy remains one of the only threats to the business. However, even this does little to impact on the business's growth. "We're going from strength to strength," Mike says simply.

Adapted from The Accidental Franchisors by Lisa Witepski in Entrepreneur, May 2006 issue

1. Evaluate the factors that have Video Spot a successful business.

2. Discuss the advantages and drawbacks of franchising from Video Spot's perspective

CASE STUDY 2

Franchising and entrepreneurship

Introduction

When the McDonald brothers, Dick and Mac opened their first restaurant in 1940 in San Bernardino, California, they could never have imagined the phenomenal growth that their company would enjoy. From extremely modest beginnings, they hit on a winning formula selling a high quality product cheaply and quickly. However, it was not until Ray Kroc, a Chicago based salesman with a flair for marketing, became involved that the business really started to grow. He realised that the same successful McDonald's formula could be exploited throughout the United States and beyond.

There are now more than 30,000 McDonald's Restaurants in over 119 countries. In 2002, they served over 16 billion customers, equivalent to a lunch and dinner for every man, woman and child in the world! McDonald's global sales were over $41bn, making it by far the largest food service company in the world.

In 1955, Ray Kroc realised that the key to success was rapid expansion. The best way to achieve this was through offering franchises. Today, over 70 percent of McDonald's restaurants are run on this basis. In the UK, the first franchised restaurant opened in 1986 - there are now over 1,200 restaurants, employing more than 70,000 people, of which 36 percent are operated by franchisees.

This case study examines the success of franchising and investigates the special three way relationship that exists between the franchisee, the franchisor and the suppliers.

What is franchising?

McDonald's is an example of brand franchising. McDonald's, the franchisor, grants the right to sell McDonald's branded goods to someone wishing to set up their own business, the franchisee. The license agreement allows McDonald's to insist on manufacturing or operating methods and the quality of the product. This is an arrangement that can suit both parties very well.

Under a McDonald's franchise, McDonald's owns or leases the site and the restaurant building. The franchisee buys the fittings, the equipment and the right to operate the franchise for twenty years. To ensure uniformity throughout the world, all franchisees must use standardised McDonald's branding, menus, design layouts and administration systems.

Advantages to the franchisee

a. Being their own boss

In return, the franchisee agrees to operate the restaurant in accordance with McDonald's standards of quality, service, cleanliness and value. McDonald's regularly checks the quality of the franchises output and failure to maintain standards could threaten the licence. The franchisee is also expected to become involved in local events and charities. Ray Kroc believed strongly that a business must be prepared to put something back into the community in which it operates.

The franchisee, for all the training and support McDonald's offers, is running his or her own business. They fund the franchise themselves and therefore have much to lose as well as gain. This makes them highly motivated and determined to succeed.

b. Selling a well established, high quality product

In this case, the product is recognised all over the world. A large proportion of new businesses and new products fail, often due to costs of the research and development needed. The McDonald's formula, however, has been successfully tried and tested. Ray Kroc's insistence that all McDonald's outlets sold the same products and achieved the same quality has led to a standardisation of the process and great attention to detail.

The cooking processes in McDonald's restaurants are broken down into small, repetitive tasks, enabling the staff to become highly efficient and adept in all tasks.

This division of labour and the high volume turnover of a limited menu allows for considerable economies of scale. For the franchisee, this can considerably reduce the risk of setting up their own business. There is no need to develop the product or do expensive market research. Nor will they have sleepless nights wondering if the product will appeal to the consumer. McDonald's carries out regular market research.

c. Intensive initial training

Every franchisee has to complete a full-time training programme, lasting about nine months, which they have to fund themselves. This training is absolutely essential. It begins with working in a restaurant, wearing the staff uniform and learning everything from cooking and preparing food to serving customers and cleaning.

Further training at regional training centres focuses on areas such as business management, leadership skills, team building and handling customer enquiries. The franchisees will have to recruit, train and motivate their own workforce, so they must learn all the skills of human resource management. During the final period, the trainee learns about stock control and ordering, profit and loss accounts and the legal side of hiring and employing staff. Consequently, no McDonald's franchisee would have to ask a member of his or her staff to do something that they couldn't do themselves. Knowing this can also be a powerful motivator for the staff.

d. Continuous support

McDonald's commitment to its franchisees does not end with the training. It recognises that the success and profitability of McDonald's is inextricably linked to the success of the franchises. Highly qualified teams of professional consultants offer continuous support on everything from human resources to accounting and computers. The field consultant can become a valued business partner and a sounding board for ideas.

e. Benefit from national marketing carried out by McDonald's

A brand is a name, term, sign, symbol or design, (or a combination of these) which identifies one organisation's products from those of its competitors. The phenomenal growth of McDonald's is largely attributed to the creation of its strong brand identity. McDonald's trademark, the Golden Arches, and its brand name has become amongst the most instantly recognised symbol in the world.

In the UK, McDonald's recognised the need for a co-ordinated marketing policy. In order to be successful, an organisation must find out what the customers want, develop products to satisfy them, charge them the right price and make the existence of the products known through promotion. Cinema and television advertising have played a major part in McDonald's marketing mix. McDonald's is now the biggest single brand advertiser on British television.

Radio and press advertisements are used to get specific messages across emphasising the quality of product ingredients. Promotional activities, especially within the restaurant, have a tactical role to play in getting people to return to the restaurants regularly. All franchisees benefit from any national marketing and contribute to its cost, currently a fee of 4.5 percent of sales.

The franchisees additionally benefit from the extensive national market research programmes that assess consumer attitudes and perceptions. What products do they want to buy and at what price? How are they performing compared to their competitors?

Any new products are given rigorous market testing so that the franchisee will have a reasonable idea of its potential before it is added to the menu. The introduction of new products, which have already been researched and tested, considerably reduces the risk for the franchisee.

Massive investment in sponsorship is also a central part of the image building process. Sponsorship includes:

- Football World Cup
- Olympic Games
- Community Partner of The Football Association
- The Scottish Football Association
- The Northern Ireland Football Association
- The Football Association of Wales

all of which increases awareness of McDonald's brand. However, McDonald's still follows Ray Kroc's community beliefs today, supporting the Tidy Britain Group and the Groundwork Trust, as well as local community activities.

f. Forecasting

Another major problem for a new business is predicting how much business it might enjoy, running the risk of either cashflow problems or the difficulties associated with overtrading. The turnover and profit from any outlet will vary, depending on a wide range of internal and external variables. Each franchisee is expected to take a positive approach to building up sales, although an average rate of return of over 20 percent is generally expected over the lifetime of the franchise.

The advantages for the franchisor

McDonald's recognises the benefits of a franchised operation. Franchises bring entrepreneurs, full of determination and ideas, into the organisation. Franchising enables McDonald's to enjoy considerably faster growth and the creation of a truly global brand identity. The more restaurants there are, the more McDonald's can benefit from economies of scale.

On the financial side, McDonald's receives a monthly rent, which is calculated on a sliding scale based on the restaurant's sales, i.e. the higher the sales, the higher the percentage and vice versa. There is also a service fee of 5 percent of sales in addition to the contribution to marketing. The purchase price of a restaurant is based on cashflow and is generally about £150,000 upwards. The new franchisee is expected to fund a minimum of 25 percent of this from their own unencumbered funds.

Dynamic innovation

Whilst the franchisees have to agree to operate their restaurants in the McDonald's way, there still remains some scope for innovation. Many ideas for new items on the menu come from the franchisees responding to customer demand. Developing new products is crucial to any business, even one which has successfully relied on a limited menu for many years. Consumer tastes change over time and a company needs to respond to these changes. Innovation injects dynamism and allows the firm to exploit markets previously overlooked or ignored. The introduction of the Egg McMuffin in 1971, for example, enabled McDonald's to cater initially for the breakfast trade. Filet-o-Fish, Drive-thru's and Playlands were all products or concepts developed by franchisees.

The three-legged stool - the suppliers

A third group of stakeholders, critical to the success of the franchise operation, is the suppliers. As McDonald's considers the quality of its products to be of absolute importance, it sets standards for suppliers that are amongst the highest in the food industry. McDonald's believes in developing close relationships with suppliers - everything is done on an open accounting, handshake trust basis.

The suppliers work closely with McDonald's to develop and improve products and production techniques. This close interdependency is described as a three-legged stool principle, and involves

McDonald's, the franchisees and the suppliers. Suppliers that are able to meet the quality standards set down by McDonald's have been able to share in the growth and success of McDonald's.

Conclusion

McDonald's views the relationship between franchisor, franchisee and supplier to be of paramount importance to the success of the business. Ray Kroc recognised the need very early on for franchisees that would dedicate themselves to their restaurants. He wanted people who had to give up another job to take on the franchise venture, relying on their franchise as their sole source of income and would therefore be highly motivated and dedicated. Consequently, McDonald's will not offer franchises to partnerships, consortia or absentee investors. The initial capital has to come from the franchisee as a guarantee of their commitment. The selection process is rigorous to ensure that McDonald's only recruits the right people.

Source: www.times100.com

CHAPTER EIGHT

GROWTH, FAILURE AND HARVESTING

Chapter Eight

GROWTH, FAILURE AND HARVESTING

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Explain the dimensions of business growth
- Describe the stages of growth in the business life cycle
- Distinguish between growth strategies
- Contrast business decline with business failure
- Identify early warning signs of pending trouble
- Explain the causes of business failure
- Distinguish between different methods of harvesting

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 15

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 13

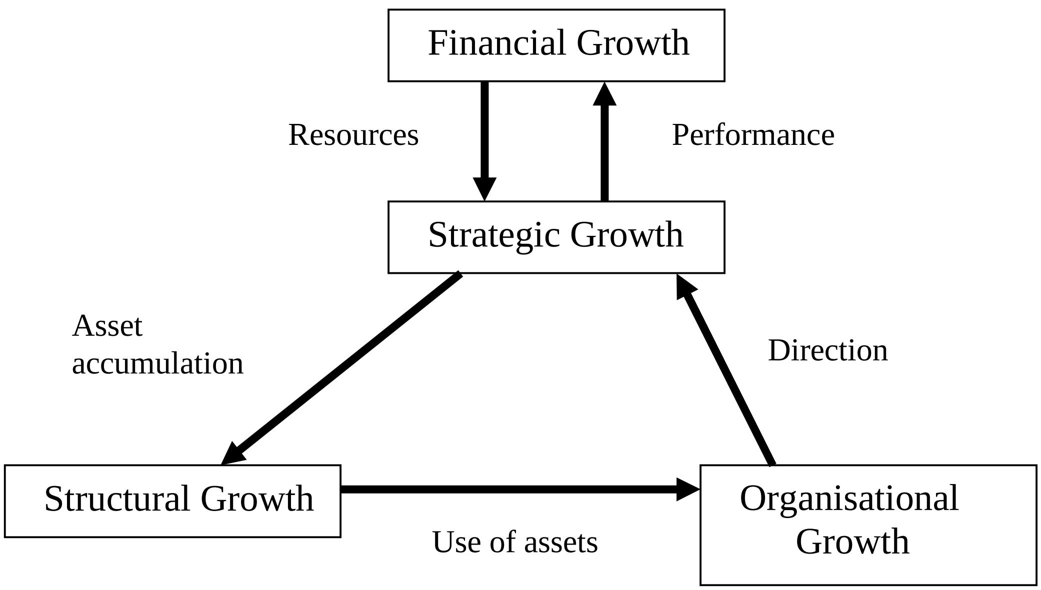
Timmmons, Jeffry A. and Spinelli, Stephen, Jr. (2007).
New Venture Creation. Entrepreneurship for the 21st century. Seventh edition
Boston. Mc-Graw Hill

Wickham, Philip A. (2001).
Strategic Entrepreneurship. A Decision Making approach to New Venture Creation and Management. Second edition
Harlow. Prentice-Hall – Chapter 20

Business growth is critical to entrepreneurial success. The potential for growth is a defining feature of the entrepreneurial venture. Growth is a dynamic process. It involves development and change within the organization, and changes in the way the organization interacts with the environment (Wickham, 2001:303).

Rwigema and Venter (2004:437) cite Wickham (1998) who says that three factors distinguish an entrepreneurial venture from conventional small business – the extent of innovative practice, the potential for growth and the presence of strategic objectives.

The dynamics of growth for the entrepreneurial venture can be viewed from four perspectives:



(Wickham, 2001:304)

Wickham (2001:304) explains that the four types of growth are not independent of each other. The four perspectives are:

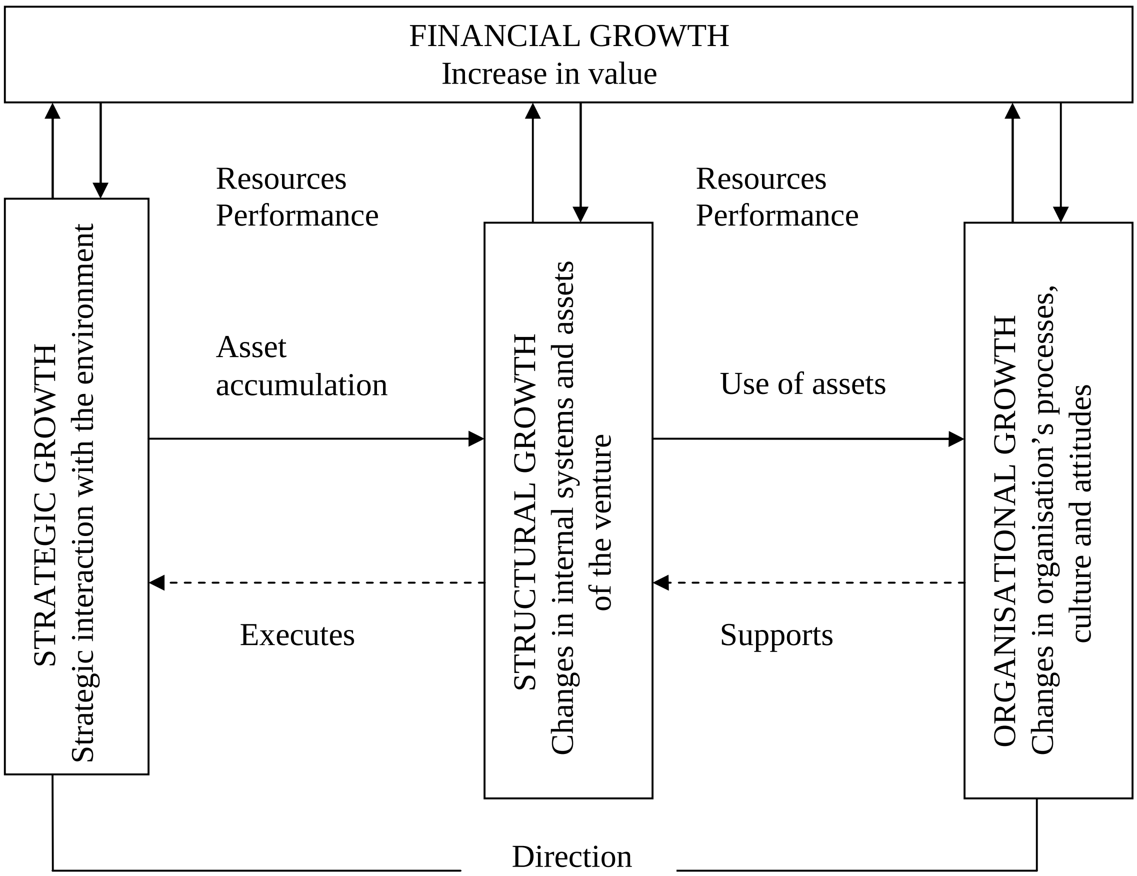
Financial growth – relates to the development of the business as a commercial entity and the increases in turnover and resulting profits, and the assets of the business. Financial growth measures the value created by the business and is an important measure of success

Strategic Growth – relates to the changes that take place as the business interacts with its environment and the way capabilities are developed in exploiting opportunities and acquiring assets to create sustainable competitive advantage.

Structural growth – relates to the changes in which managerial roles and responsibilities, reporting relationships, communication links and control systems are organized (internal systems).

Organisational growth – relates to changes in the organization's processes, culture and attitudes as it develops. According to Rwigema and Venter (2004:438), organizational growth refers to "improvement in processes, learning and knowledge; and prevailing belief systems".

An adaptation of the four major perspectives of growth and development is presented by Nieman (in Nieman, Hough and Nieuwenhuizen, 2003:236):



Nieman (in Nieman, Hough and Nieuwenhuizen, 2003:235) list eight characteristics of growing organizations according to Crijns and Ogle (1997:56). These strategic characteristics are:

- Market domination – measured in terms of relative market share in a niche market, it differentiates between good and poor performance
- Differentiation – uniqueness through being different from competitors
- Product leadership
- Flexibility – the speed and ability to gain advantage from new opportunities
- Innovation
- Future orientated

- Export
- Related growth – successful businesses strive for active cognizant growth as opposed to uncontrolled growth.

Nieman also cites Vinturella (1998) who refers to the critical success factors for growth as:

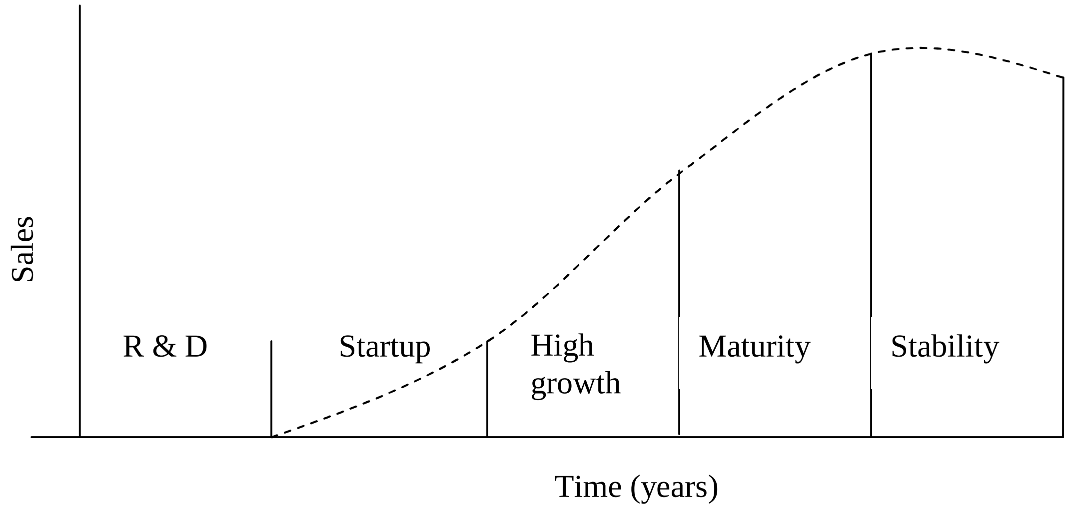
- *Market intelligence* – to be able to perceive and adapt to market changes, including future trends, competition and customer feedback
- *Strategic leadership* – to provide clear direction, delegation and decision-making.
- *Clarity of purpose and direction* – to have vision and a shared understanding of the uniqueness and identity of the business
- *Strategic planning*
- *Internal infrastructure* – to be able to support the business through internal systems and structures.

Rwigema and Venter (2004: 444) contend that it is useful to conceptualise the process by which a business grows as a series of phases following a timeline. This 'life cycle' approach illustrates the growth phases that a business traverses.

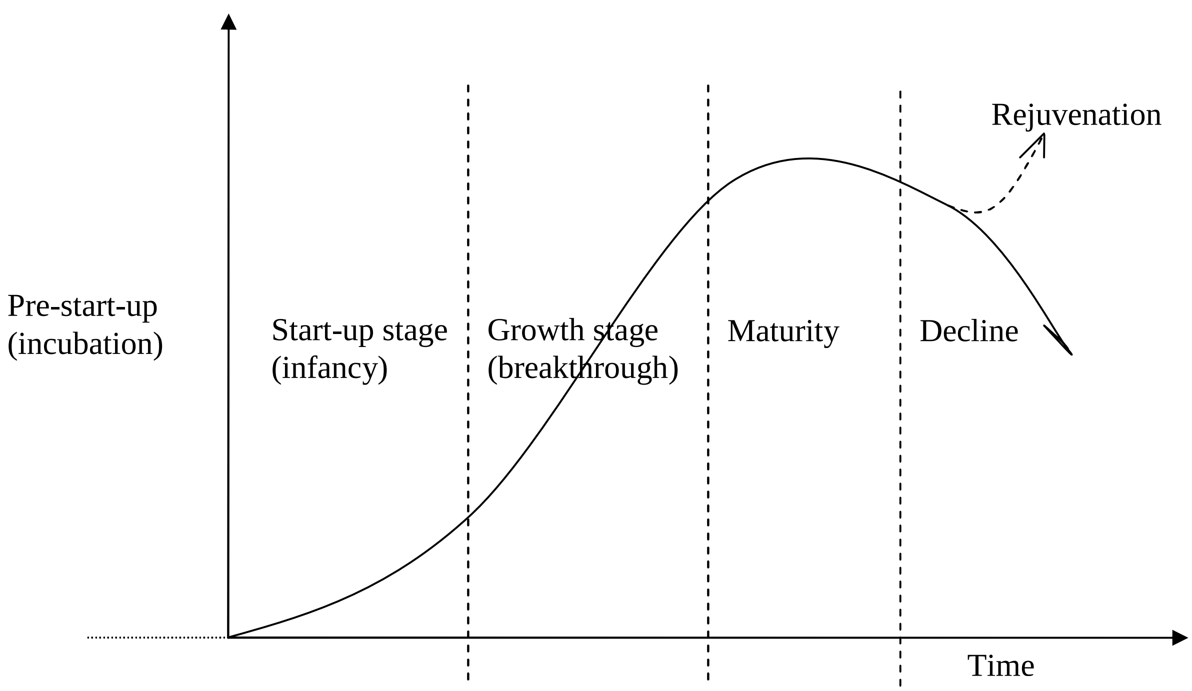
Nieman (in Nieman, Hough and Nieuwenhuizen, 2003:238) cautions that life cycle models must be used as a guide. "Although they provide an indication of what *can* happen at a certain stage, they have little power to predict what *will* happen. The defining line and time frames of each stage are not clear". Other limitations are:

- It is difficult to say at a particular time exactly what stage a venture has reached and when it can be expected to move on to the next stage
- Individual businesses will move through different stages at different rates and may miss out some stages altogether
- Not all businesses begin at the first stage and move to the last stage
- Very few businesses experience smooth and linear stages of growth. The smooth S-shape curve is rarely replicated. The progress of most businesses will actually be a ragged and jagged line with many ups and downs as companies experience periods of rapid progress followed by setbacks and accompanying crises.

Timmons and Spinelli (2007:260) illustrate the stages of venture growth as follows:



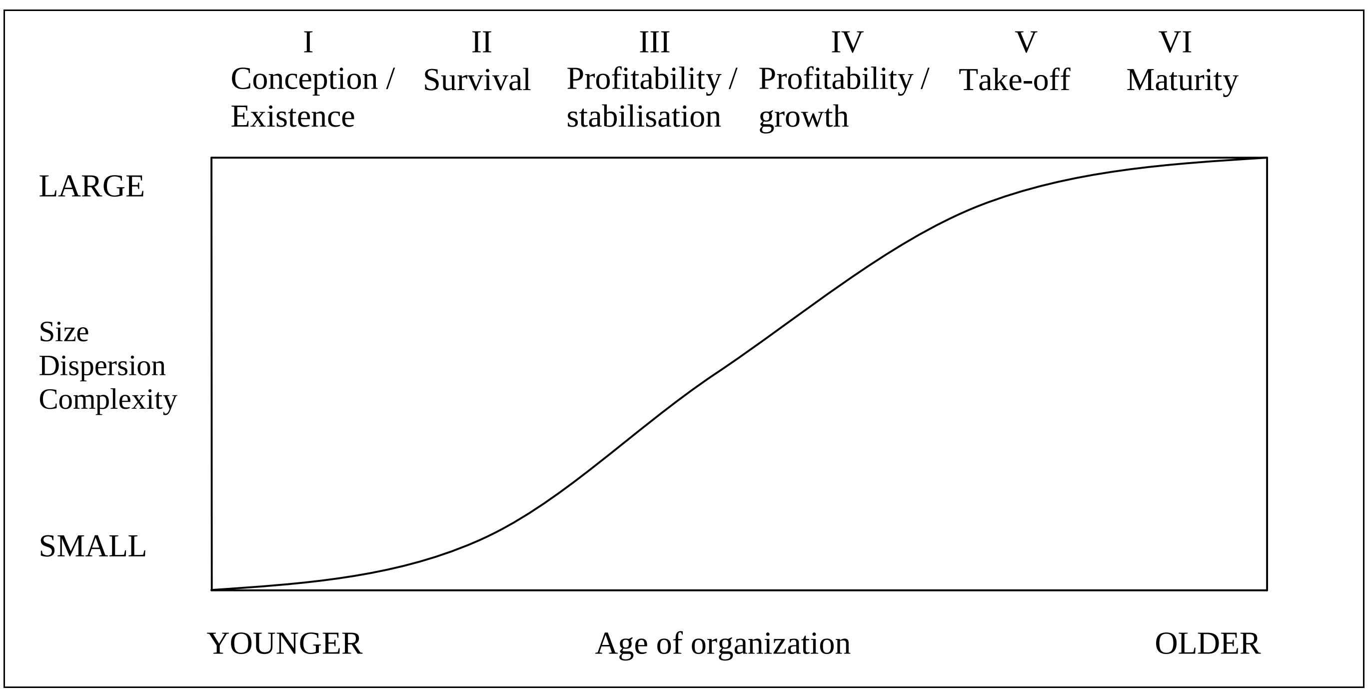
Nieman (in Nieman, Hough and Nieuwenhuizen, 2003:238) presents a similar illustration of the model:



Nieman (in Nieman, Hough and Nieuwenhuizen, 2003:241) cites Crijns and Ooghe (1997) relating to the actions and changes taking place in the different stages of the growth process. These changes are referred to as the ‘professionalisation’ of the entrepreneur and are summarized as follows:

Aspect	**Start-up**	**Early growth**	**Later growth (expansion)**	**Maturity**
Strategic objectives	Survival	Maintenance of profitability and acquiring resources	Growth via expansion	Return on investment and market value
Structure	Informal	Functional	Decentralized	Matrix or product groups
Control Systems	Direct market feedback	Standards and cost centers	Profit centres and formal reporting	Planning and investment centres
Management Style	Creative	Leading	Delegating	Coordinating
Role of the entrepreneur	Owner-worker	Owner-manager	General manager	Controller
Function of the entrepreneur	Direct supervision	Overall supervision	Indirect control	Controlling interest
Focus of the entrepreneur	Make and sell	Efficient operations	Market expansion	Consolidation and innovation

Rwigema and Venter (2004:444) illustrate six growth stages (Churchill and Lewis, 1983):



Rwigema and Venter (2004:456) acknowledge that while growth is a process that enhances value (from both a societal and individual perspective), it also poses challenges to the organization:

- *Financial implications of growth* – the act of conducting business requires cash, so that the financing requirement must be recognized.
- *Management and control issues* – a growing organization places a burden on functional capacity. There must be formality, consistency and routine.
- *Marketing and operations implications* – growth often occurs through either a production orientation or a marketing orientation. As the business grows, conflict between these two functions becomes likely.
- *Biological implications* - the advance of years raises issues of succession
- *Organizational implications* – a growing business requires more people and more managers and has to be flexible and adaptable.

Kuratko and Hodgetts (1998:504) outline four key factors about the specific managerial actions necessary during the growth stage. These factors are listed as control, responsibility, tolerance of failure, and change.

They amplify these factors as follows:

- Control – growth creates problems in command and control.
- Responsibility – as the business grows, the distinction between authority and responsibility becomes more apparent. This is because authority can be delegated, but is important for there to be a sense of responsibility. This action establishes flexibility, innovation and a supportive environment.
- Tolerance of failure – in continually innovating and growing, a business should tolerate a certain degree of failure. Three forms of failure can be distinguished – *moral failure*, resulting from a violation of internal trust, *personal failure*, brought about by a lack of skill or application, and *uncontrollable failure*, caused by external factors.
- Change – planning, operations and implementation are all subject to continual change. Flexibility regarding change allows for faster managerial response to environmental conditions.

(Kuratko and Hodgetts,1998:504)

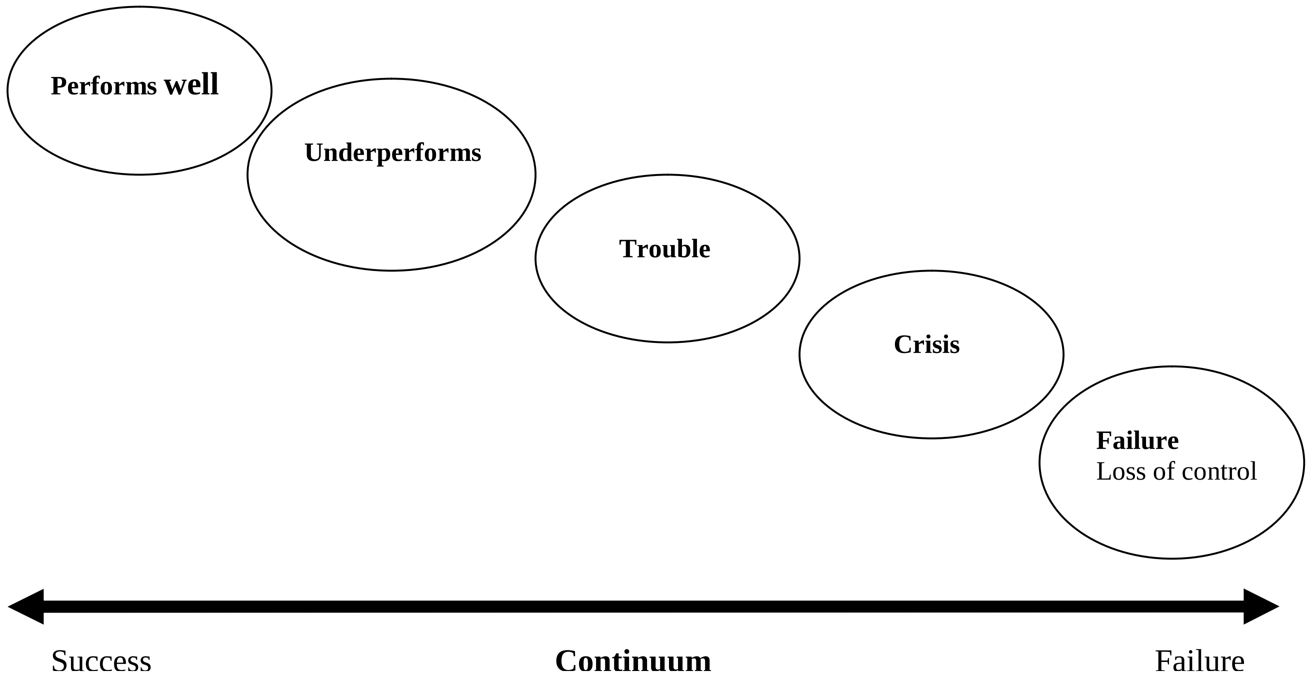
Rwigema and Venter (2004:464) offer definitions of business decline contending that the reality of business practice is that many businesses fail:

- Business decline – occurs when a business experiences a successive decline for a period of not less than two years
- Business failure – either the inability of the business to meet its financial obligations or the discontinuation of the business (lack of managerial capacity or desire to continue operating)
- Turnaround situation – a period during which the business is engaged in efforts to restore profitability

Pretorius (in Nieman, Hough and Nieuwenhuizen, 2003:262) refers to levels of failure on a continuum of success and failure:

- The business that is performing well
- The underperforming business
- Trouble or difficulty in the business
- The business in crisis
- The business that failed

These levels of failure can be illustrated as follows:



The 'signs of trouble' or the symptoms of business decline are:

- Declining profitability – decline in gross and net margins
- Decreasing sales volumes
- Declining market share
- Decline in working capital
- Rapid management turnover
- Top management fear
- Irregular cash flows
- Confidence levels drop
- Core employees leave

(Rwigema and Venter, 2004: 464; Pretorius in Nieman, Hough and Nieuwenhuizen, 2003:262)

Rwigema and Venter(2004: 466) outline the causes of business failure as:

- Poor management
- Inadequate financial control
- Competition
- Relatively high cost structure
- Changes in market demand

- Marketing problems
- Capital projects
- Acquisitions
- Overtrading

Pretorius (in Nieman, Hough and Nieuwenhuizen, 2003:272) examines four issues that underlie signs of trouble:

- Strategic issues – relating to the effectiveness of the business within its environment. Strategic issues include misunderstood positioning, mismanaged relationships with suppliers and customers, diversification into an unrelated business area, being idea driven instead of opportunity driven, having no contingency planning, lack of specific sectoral experience and unrealistic expectations of the market potential.
- Management issues include loss of interest by the owner, underestimating the importance of financial aspects, turnover in key personnel, a wrong management focus and a lack of a proper management structure.
- Poor planning and financial systems, practices and controls – this refers to incorrect pricing, poor credit-granting policies, poor use of leverage (debt), the lack of cash budgets, poor management reporting, lack of standard costing and poorly understood cost behaviour.
- Environmental issues – include customers, suppliers, competitors and intermediaries from the market environment of the business. (Timmons and Spinelli, 2007:598)

Harvesting refers to an exit plan for the entrepreneur. Pretorius (in Nieman, Hough and Nieuwenhuizen, 2003:272) categorises four reasons for harvesting – personal reasons, financial reasons, failure and outside forces.

The alternative harvest options can be summarized as follows:

Harvest options		Advantages	Disadvantages
Outright sale Business is sold to a willing buyer	Selling to a firm looking for acquisitions	• Potential buyer has information of potential of business • Owner can negotiate a quick exit	• Owner is required to stay on for a period to train new management • There could be rumours if the deal does not go through • New owner might not have conceptual grasp of business
	Selling to a competitor	• Prospective client has information about the potential of business • Owner can make a quick exit	• There could be rumours in the market • The owner is at risk when there is a structured payment
Management buyout Selling the business to the existing management		• Management already knows the business • Owner can make a quick exit • Payment could be structured over a period of time	• Access to capital is a problem • The owner is at risk with a structured payment • Managers may not be entrepreneurial
Employee share option plan Employees take ownership through shareholding		• Ownership for employees may be positive for job motivation • Owner can be phased out • Management can stay on and participate in plan	• Entrepreneurial drive may be lost • Structuring the deal can be complex • Share option plans are only for relatively large businesses
Forming an alliance with another venture An interim step that leads to a takeover and the owner's withdrawal after a period of time		• A long-term relationship develops • Additional doors may open • If the alliance does not work, ending the relationship is easy	• Timing is crucial • There is often no legal agreement • Differing management styles may lead to conflict • If the alliance does not work, it could have a negative impact on business

Harvest options	Advantages	Disadvantages
Merging with another venture (offensive merger) Formal combination occurs through forming a new business or taking up shares in each others business	• Relationship is stronger • Merger is more formal and cannot be easily reversed	• A minority owner can be somewhat exposed • Differing management styles may lead to conflict • No harvesting occurs until one party leaves
Proceed with a professional manager A manager operates the business while the owner withdraws	• Works well when the owner has health problems	• Clashes in management styles can occur • Owner may feel loss of control • There is no 'big' harvest
Capital cow Owner proceeds with business but uses cash it generates as capital for establishment of another venture	• Serves as source of capital • Offers a different route to harvesting • It enables exploitation of other windows of opportunity	• Harvesting takes longer • There is no 'big' harvest • The owner cannot leave easily • Growth is not possible in the existing business • Cash withdrawals might lead to cash flow problems
Public offering	• Harvesting is quick and normally good • Prestige is gained	• Mostly for big business • It is expensive • There is loss of control • Requires specialist advice and experience

(Pretorius in Nieman, Hough and Nieuwenhuizen, 2003:296-299)

The life cycle stage of the business is of crucial importance to the harvest decision. During the incubation or start up stage, there is very little opportunity for harvesting because the business venture is conceptual and there is not much to harvest (except an idea or opportunity). During the start up (infancy) stage, the ability to harvest is not attractive in view of the uncertainties of the market demand. . This stage is associated with greater risk and potential for failure. The growth stage presents the best opportunity to harvest, based on future potential through sale, merger or alliance. The maturity stage is characterized by more competition. Harvesting options are driven by a defensive position (sale, merger, alliance). During the decline stage, the options to harvest decrease drastically and harvesting can occur through a defensive merger or selling of assets (Pretorius, in Nieman, Hough and Nieuwenhuizen, 2003:294).

Pretorius (in Nieman, Hough and Nieuwenhuizen, 2003:299) also indicates the principles that govern a harvest strategy as:

- Timing
- Patience
- Vision to plan ahead
- Realistic evaluation
- Contractual agreement
- Mentoring agreement
- Structured deal

Each of these elements can contribute to a better harvest.

Business failure

Start up businesses have a very high failure rate in the United Kingdom with as many as 1 in 2 failing in their first two years. The reverse side of the coin is that almost half survive and go on to prosper. Key reasons for business failure include:

Poor marketing. Successful modern businesses are ones that understand and meet the requirements of their customers. Detailed market research is therefore an essential for new businesses, to find out details such as the potential size of the market, the extent of competition, as well as consumer preferences and tastes.

Cash flow problems. Many businesses struggle through poor cash flow management. It is all very well having a good idea and a good product but it is also necessary to be able to meet short term outflows. Many businesses try to grow too quickly, and end up borrowing too much money externally, resulting in crippling interest repayment charges.

Poor business planning. A business plan should cover aspects such as marketing, finance, sales and promotional plans, as well as detailed breakdowns of costings and profit predictions. It is often said that 'failing to plan, is planning to fail'.

Lack of finance. Insufficient finance often means that businesses are unable to take opportunities that are available to them, or have to compromise - going for high cost solutions to problems, rather than lower cost ones that would yield greater competitive advantage.

Failure to embrace new technologies and new developments. In a fast changing world leading businesses are ones that make best use of advanced modern technologies in an appropriate way. Firms that operate with outdated technologies and methods frequently find themselves at a cost disadvantage over more dynamic rivals.

Poor choice of location. Location is a very important business decision. A good location is one that appeals to large numbers of customers, while at the same time minimising costs. For example in retailing it is often a mistake to choose a low cost location, that is not visible to customers. However, conversely there are considerable cost advantages to out-of-town retailers that customers are prepared to travel to visit.

Poor management. Weak and inexperienced management is one of the major causes of business failure. Managers have to work extremely hard, and to understand their customers needs, and the business that they are in if they are to be successful.

Poor human resource relations are often a cause of failure. Successful businesses motivate their employees to work hard to help the business to succeed.

Lack of clear objectives. Successful organisations have clearly focused and communicated objectives that enable everyone in the organisation to pull in the same direction.

At the turn of the millennium a host of new .com businesses were launched in this country based on the hype associated with having an 'online presence'. A large number of these businesses were based on good ideas - e.g. retailing wine, clothes and financial services on the Internet. However, what many of these businesses lacked was an established trade name, which the general public was familiar with. The major companies that we are familiar with - Coca-Cola, Cadbury Schweppes, Nestle have taken years to build their brand names. Many of the new .coms were seeking to build brand awareness very quickly. These companies were able to raise relatively large sums of capital to set up. However, advertising and promotional costs were substantial, and the pool of capital they started up with rapidly began to run out before they could make the breakthrough to profitability. What we then saw was a high level of business failure in 2000 and 2001 among the new .coms. Although many of their ideas were good they ran into cash flow problems. In the end the prime beneficiaries of the .com revolution were existing companies with well established brand names that were able to embrace the new technologies.

Source: www.times100.com

CASE STUDY

A Seller’s Tale

Joseph Grassadonia loves the ocean so much that he planned his life around it, including starting businesses that would allow him to have both the time and money to enjoy the sun and surf of California’s beaches. Over the years, Grassadonia launched six magazines, including his most recent, D*ive Travel*. He compares the thrill and challenge of starting and managing a magazine to surfing and catching the ultimate wave. “When you’re surfing and you’re totally in control of the wave and the equipment is right and everything is working, it’s exhilarating,” he says. After five years of running *Dive Travel*, however, Grassadonia says that he got to the point where it wasn’t fun anymore. “That’s when I knew I had to sell,” he recalls.

Actually, Grassadonia knew he would eventually sell *Dive Travel* from the day he started it. Managing and growing a magazine is “not my forte” he says. He began shopping for a business broker. The first order of business was to put a price tag on *Dive Travel*, something that proved to be a more emotional experience for Grassadonia than he had imagined. Although he knew that a company’s value depends on the cash it can generate, he couldn’t help but recall all of the energy, time and talent he had invested in building the magazine from nothing to its current level. ”This business is a chunk of my life. How do you put a value on that?” he asks philosophically.

Grassadonia had built *Dive Travel* into a successful publication. “We do business with just about every major advertiser in the marketplace,” he says. “It would be very expensive to try and recreate that.” Using *Dive Travel’s* sales of $324 000 and earnings of $50 000, the broker suggested an asking price of $500 000. For the next year, the business attracted very few leads; ads in industry trade journals produced only a few nibbles but no serious buyers. Grassadonia was anxious to sell, so the price was reduced to $ 450 000. Several more months slipped by with no interest from buyers, and Grassadonia was beginning to wonder if *anyone* wanted to buy *Dive Travel.*

Finally Susan Wilmink and Thomas Schneck contacted Grassadonia’s broker about *Dive Travel*. The couple was living in Germany, where Wilmink worked for a large international magazine publisher and Schneck owned a software company. The only problem was that Wilmink and Schneck couldn’t afford to buy *Dive Travel* outright. They proposed that Grassadonia sell them a controlling interest in the company and stay on as a consultant for three years. Grassadonia hesitated at first but then agreed to stay on as long as Wilmink and Schneck took over the day-to-day operations of running the business.

A major factor in his decision was Wilmink's presentation on how she and Schneck planned to run the company – from adding a website to repositioning the magazine. "Susan came in with a vision," says Grassadonia.

Negotiating the final deal took another six months. The final price the parties agreed on was $215 000 for the 51% controlling interest Wilmink and Schneck got. Wilmink became the new president and publisher, and Grassadonia agreed to stay on as a paid consultant for three years. At the end of that time, he would sell his share, with Wilmink and Schneck getting the right of first refusal. In addition, Grassadonia got a percentage of the company's revenues over the three years.

The deal has worked to everyone's satisfaction. Grassadonia has the freedom to surf whenever he pleases, and Wilmink and Schneck have the company they wanted. *Dive Travel's* circulation has more than doubled, and profits are up.

1. Why is the process of valuing a business so difficult for the entrepreneur who founded it?
2. Which method(s) of valuing a business do you think would be most appropriate in placing a realistic value on *Dive Travel*? Explain
3. Evaluate the final deal the parties struck from both the buyers' and the seller's perspectives.

Source: Zimmerer and Scarborough (2005:167)

CHAPTER NINE

FAMILY BUSINESS

Chapter Nine

FAMILY BUSINESS

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Discuss the factors that make a family business unique
- Outline the roles and relationships in a family business
- Discuss the nature of family businesses
- Explain the importance of preparing for management succession

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 16

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 10

Burns, Paul (2007). Entrepreneurship and Small Business. Second edition
New York. Palgrave Macmillan – Chapter 15

Maas (in Nieman, Hough and Nieuwenhuizen, 2003:181) makes the point that a family business is not a normal business because of the involvement of family issues that are, by nature, more emotional.

Maas defines a family business as one that is influenced by family ties in order to achieve the vision of the family over, potentially, several generations. Emerging from this definition are four general remarks:

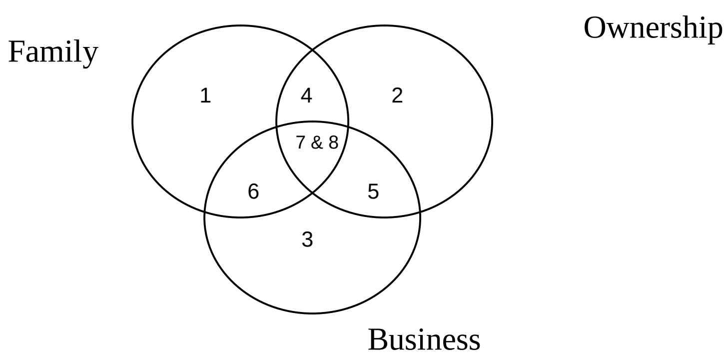
- The family (or a part thereof) is actively involved in the business
- Family members have a definite input into the strategic direction of the business
- There is more than one family member involved in the business
- The intention is to continue the family business over time.

Burns (2007:415) offers three definitions of what constitutes a family business:

1. An owner-managed enterprise with family members predominantly involved in its administration, operations and the determination of its destiny (Poutziouris, 1994)
2. A company in which majority ownership or control lies in a single family and in which two or more family members are directly involved in the business (Rosenblatt *et al*., 1985)
3. A company is which 25% of the voting shares are controlled by the family (Nelton, 1986)

Timmons and Spinelli (2007:579) define the term family enterprising as the proactive and continuous search for opportunistic growth and contend that the outcome of family enterprising is transgenerational entrepreneurship and wealth creation.

Maas outlines a three-circle model (Murray) that reveals/reflects the complexity of a family business.



In the model:

1. Family members
2. Non-family investors
3. Non-family employees
4. Family shareholders
5. Non-family working owners
6. Working family members
7. Working family owners
8. Family owners and business leaders

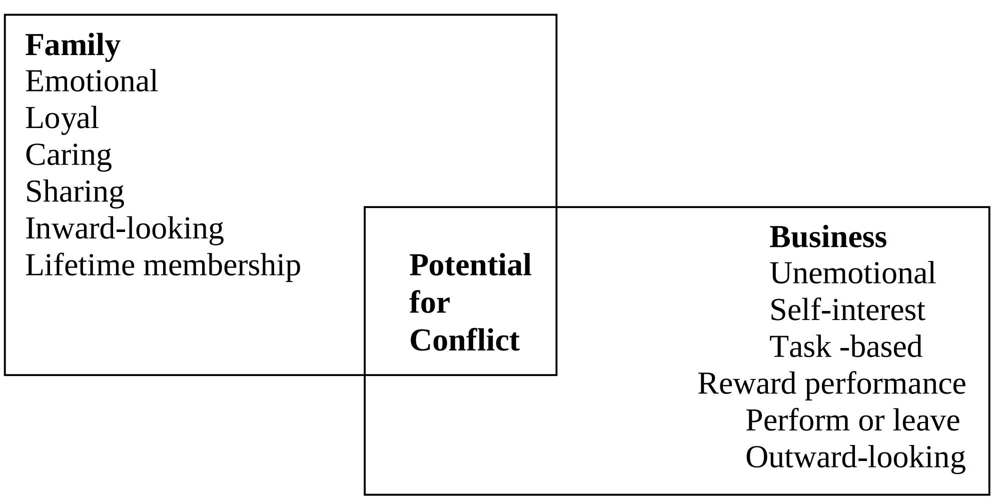
If the systems of family businesses are not in harmony, then conflict might have a detrimental effect on the long term survival and growth of the business. Maas refers to the following in this regard:

- Only 30% of family businesses are successful into the second generation
- Only 10% of family businesses are successful into the third generation

- The average lifespan of a family business is 24 years (the time the founder-manager stays in business)
- Family businesses become less entrepreneurial when the family system dominates.

This is confirmed by Burns (2007:418) who cites Poutziouris and Chittenden(1996):
"Four out of five family businesses are managed by the first generation, which benefits from the entrepreneurial drive of the founder. However, less than one third of founders successfully pass ownership and management control of the family business to the second generation. Only 10 per cent of second generation family firms are transferred to third generation and less than 5 per cent ever reach beyond the third generation of family management"

At the heart of the family business are its distinctive values and beliefs – its culture.
Whilst family culture can be a tremendous asset for the business, it can also create the potential for conflict. The problem arises when there are differences between the family and business cultures. Families exist primarily to take care of and nurture family members, whereas businesses exist to profitably generate goods and services. The family culture is based on emotion emphasizing loyalty, caring and sharing. It is inward looking and lasts a lifetime. In contrast, business culture is unemotional, task-orientated and is based on self-interest. It is outward-looking, rewarding performance and penalizing lack of performance. Conflict between the two cultures is unlikely at start-up but, as the organization grows and time passes, the potential for conflict increases (Burns, 2007:416).



Beyond the inherent complexity of family businesses, Lank (in Burley and Muzyka ,2000:194) examines the factors that explain the 'fragility' of family businesses. Lank provides two sets of factors.

Firstly, family businesses disappear for the same reasons as any corporation:

- The opportunity to sell out at an attractive price
- Inability to anticipate or adjust to changes in the market
- Insufficient investment in research and development (R & D)
- Inadequate control of costs
- Lack of access to affordable capital
- Poor management practices

Secondly, there are specific challenges faced by family enterprises:

- Failure to find capital for growth without diluting the family's equity
- Inability to balance the family's need for liquidity and the business's need for cash
- Poor estate planning
- Lack of willingness of older generation to 'let go' of ownership and management power at appropriate time
- Inability to attract and retain competent and motivated family successors
- Unchecked sibling rivalries with n o consensus on chosen successor
- Inability to attract and retain competent senior non-family professional managers
- Unmanaged conflict between the cultures of the family and the business.

(Lank in Burley and Muzyka, 2000:195)

According to Timmons and Spinelli (2007:562) family businesses do not always look and act entrepreneurially. "They can focus on serving local markets, sustaining the family's lifestyle or providing jobs to family members. They are often conflicted due to family dynamics, constrained by nepotism or limited by their conservative risk profile."

Family businesses can suffer from nepotism and a lack of professionalism. Managers who are not family members can feel alienated and isolated, believing that important decisions being made without their involvement, 'over the kitchen table' rather than in the office. Family conflict and politics can result in the business being neglected or business decisions being made for other than commercial reasons. It can also mean that the business is used as 'milk cow' for the family and loses its commercial edge (Burns, 2007:430).

Burns (2007:417) argues that research shows that family culture even influences the management style within a family business. Because of the relationships between family members, family businesses tend to use fewer formal management techniques. Family influence acts to dilute managerial power and discretion. This can constrain operating efficiency.

However, the business influences the culture within the family. The business can exact a toll on family life, and the separation between the two can become blurred. Building a successful business can become an obsessive occupation that affects family life (Burns, 2007:417).

However, Timmons and Spinelli argue that these realities must be contrasted with the fact that families comprise the dominant form of business organization worldwide, and provide more resources for the entrepreneurial economy than any other source (2007:562).
This is supported by Lank (in Burley and Muzyka, 2000:193) who says that “family enterprises are a – if not *the* – major contributor to the economic and social well-being of all capitalist economies”

Timmons and Spinelli (2007:567) present five different roles families play in the entrepreneurial process and distinguish between formal and informal application of these roles:

	Family-Influenced Startups	Family Corporate Venturing	Family Corporate Renewal	Family Private Cash	Family Investment Funds
Formal	An entrepreneur with no legacy assets/ existing business, but who formally launches a new business with family and/or intending to involve family	Family holding companies or businesses that have formal new venture creation and/or acquisition strategies, plans, departments, or capabilities	Family-controlled companies with a formal strategic growth plan for creating new streams of value through change in business strategy, model or structure	Startup money from family member or business with a formal written agreement for market-base ROI and/or repayment	Stand-alone professional or private equity or venture capital fund controlled by family and/or using family generated capital
Informal	An entrepreneur with no legacy assets/ existing business who happens to start a new business out of necessity and it begins to involve family members	Family holding companies or businesses that grow through more informal, intuitive, and opportunistic business startup and acquisitions	Intuitive growth initiatives that result in a change in business strategy, model or structure and new streams of value for the family company	Startup money or gift from family member or business with no agreement or conversation about ROI or repayment	Internal capital and/or funds used by family owners to invest in real estate, passive partnerships, or seed new businesses

Rwigema and Venter(2004:495) define succession planning in the family business as the “explicit process of identifying and transferring management authority and control from one generation to the next”.

Burns (2007:426) contends that of succession is not planned and managed, it can be a traumatic and stressful event which can threaten the existence of the business. He points out that there are several options available to the founder:

- Passing on the business within the family
- Sale – competitors may be interested in buying the business as a going concern
- Management buy out – the management team in the business might be interested in bidding for the business

- Management buy-in – an external management team might be interested in bidding for the business as a going concern
- Appoint a professional manager – the family remain as shareholders and/or non-execuive directors
- Appoint a caretaker manager – until the next generation is ready to take over
- Liquidate – the least attractive option. (Burns, 2007:427)

Burns (2007:427) suggests a systematic approach to succession, directed at the founder of the family business, using the approach of Leach (1996):

- Start planning early
- Encourage intergenerational teamwork
- Develop a written succession plan
- Involve the family and colleagues
- Take advantage of outside help
- Establish a training process
- Plan for retirement

CASE STUDY:

Keeping it in the Family

From his glass-fronted office at the exit of Kit Kat Cash & Carry store, Ahmed Gani, MD of Kit Kat group, waves to customers and suppliers as they leave. “I want to see that nobody looks unhappy as they walk out. I want them to see me so that at least our eyes can meet and we can greet each other,“ he explains. It’s a hands-on approach that has come to epitomize what this business is about.

Started as a corner café by Gani’s grandfather and great uncle in 1953, Kit Kat Group has grown to incorporate the Cash & Carry outlet, three retail outlets and, this year, the first of many franchise outlets. Gain describes the opening of the 20 000 m² - plus Cash & Carry outlet as a “humungous” step for the family. “Being a privately owned business, money comes in limited amounts, but we’ve always run a tight ship with low overheads, good stock turns and quick turnovers. And that enabled us to build up a reasonable amount of capital in our family so that the business has always carried itself,” he says of how the growth has been funded.

In spite of the growth and success, Kit Kat has managed to retain all the benefits of being family owned. “The pros far outweigh the cons of a family business,” says Gani, explaining that independence and the lack of corporate ‘red-tape’ gives the company the flexibility to react quickly to market demands in order to stay a step ahead of its competitors.

However, the pitfalls of family-owned businesses are well documented. All too often they are too democratically run and lack a ‘buck-stops-here’ boss. As they grow, family members, long used to signing off on everything, battle to relinquish control of operations, stifling future success potential. Or a wayward son or grandson with a big ego and a small business brain ruins what it took his forefathers years to build.

The Gani family has managed to avoid such pitfalls by implementing strict systems that ensure that the way the business is run won’t fluctuate too dramatically depending on who sits in the boss’s chair. “The boss is the system,” says Gani, explaining that the family has devised proven set of systems over time to which family members, management and staff alike are expected to adhere. On the question of delegating tasks and decisions to empowered managers, he says simply, “If you can’t share, you can’t grow.”

All family members, from Gani as MD to his brother and cousin who occupy positions as financial and merchandise directors, have done their time on the shop floor. “The advice I would give to any family-run business is that you can’t take a family member and put them at the helm of the business if they don’t understand what it is about and haven’t been through every category of the business.”

Apart from internal operational challenges, Kit Kat is up against it when it comes to the size and sheer clout of its competitors. But, as Gani explains, their hands-on approach has stood them in good stead here as well: “Customers see the value of dealing with hands-on type operators. If you are not satisfied, you can meet the MD of the company in a minute and we can immediately try to rectify things so that you leave here as a happy client,” he explains.

The same applies to suppliers, and Gani lists integrity and supplier relationships as key factors in the company’s success: “A lot of suppliers feel cornered by the large chain groups so they look for outlets of our type to leverage themselves and get into the market without being dictated to too much. We build up good relations with suppliers over time.” That’s not to say that healthy negotiations with suppliers don’t form a solid base to the business and, as Gani points out: “In order to sell competitively you’ve got to buy competitively so when we sit across a table and do a deal, we fight to get the best possible price, structures and payment terms but once we shake on it we honour it. If I tell a supplier he will be paid on the 15th of the month, on the 14th he’s got his money.”

It’s obvious that in spite of being small by comparison, Kit Kat is making an impact on the market. In the past year, two different chain groups have attempted to buy the business out, but Gani is having none of it. With big plans for the future, he wants to keep the business independent. The opening of at least four new Cash & Carry outlets, and 25 franchises over the next two to three years, are just some of the plans in the pipeline. His answer to buy-out offers were, “No thank you. We are not for sale. But look out for us within the next five years – I might be coming to buy you out.” They may prove to be prophetic words.

Adapted from Keeping it in the family by Juliet Koeman in Entrepreneur, April 2007 issue

1. **“**The pros far outweigh the cons of a family business,” Discuss this statement in the context of this case.
2. Discuss why management succession is an important issue in a family business.
3. Evaluate the growth strategy of Kit Kat

CHAPTER TEN

E-ENTREPRENEURSHIP

Chapter Ten

E - ENTREPRENEURSHIP

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Define e-commerce
- Discuss the benefits of e-commerce for the entrepreneur
- Explain the most common business models on the internet
- Explain the myths of e-commerce

Reading:

Rwigema, Henry and Venter, Robert. (2004). Advanced Entrepreneurship
Cape Town. Oxford University Press – Chapter 18

Dollinger, Marc J. (2003). Entrepreneurship Strategies and Resources.Third edition
Singapore. Pearson Education

Nieman, Gideon., Hough, Johan and Nieuwenhuizen, Cecile (Editors). (2003).
Entrepreneurship: A South African Perspective
Pretoria. Van Schaik – Chapter 18

E-commerce is creating new ways of doing business, connecting producers, sellers and customers via technology in ways that have not been possible before.

Rwigema and Venter (2004:540) offer two definitions of e-commerce:

- 'Technology mediated exchanges between parties as well as electronically based intra-organisational activities that facilitate such exchanges" (Rayport and Jaworski, 2001:3)
- The marketing, promoting, buying and seling of goods and services electronically, particularly via the internet (Kuratko and Hodgetts, 2001:14)

E-commerce thus refers to conducting business via electronic media, and most commonly, the Internet. The Internet or WWW (World Wide Web) is a network of millions of computers linked around the world through telephone lines, allowing for almost instantaneous transfer of data.

Rwigema and Venter (2004:541) argue that the Internet has transformed the way in which business is done in a number of ways:

- The Internet transcends the boundaries of time and space allowing business to be conducted at any and all the time in any and all locations across the world.
- The Internet allows penetration of global markets without incurring logistical costs of access
- The Internet allows organizations to differ their products and services in different locations without having to set up separate sales infrastructure in each location
- The Internet allows small businesses to compete more effectively with big businesses
- The Internet allows buyers and sellers to communicate and connect and reduces transaction and information costs.

Zimmerer and Scarborough (2005: 214) describe the benefits of selling on the World Wide Web as:

- The opportunity to increase revenues
- The ability to expand reach into global markets
- The ability to remain open 24 hours a day, seven days a week
- The capacity to use the interactive nature of the Internet to enhance customer service
- The power to educate and inform
- The ability to lower the cost of doing business
- The ability to spot new business opportunities and to capitalize on them
- The ability to grow faster
- The power to track sales results

Nel (in Nieman, Hough and Nieuwenhuizen, 2003:332) describes the benefits of e-commerce for businesses as:

- The electronic marketplace expands the local marketplace to national and international markets.
- Electronic commerce decreases the cost of creating, distributing, and retrieving paper-based information
- Supply chain inefficiencies, such as excessive inventories and delivery delays, can be minimized by e-commerce

- The pull-type processing allows for inexpensive customization of products and services and provides a competitive advantage for companies that implement these strategies.
- E-commerce reduces the time between the outlay of capital and the receipt of products and services
- E-commerce supports business process reengineering
- E-commerce lowers the cost of telecommunications

Other benefits of e-commerce may include an improved corporate image, improved customer service, new business partners, simplified processes, compressed time to the market, increased productivity, reduced paper and paperwork, increased access to information, reduced transportation costs and increased flexibility.

(Nel in Nieman, Hough and Nieuwenhuizen, 2003:332)

Zimmerer and Scarborough (2005: 218) also outline some of the myths of e-commerce:

MYTH 1: Setting up a business on the Web is easy and inexpensive
MYTH 2: If I launch a site, customers will flock to it
MYTH 3: Making money on the Web is easy
MYTH 4: Privacy is not an important issue on the Web
MYTH 5: The most important part of any e-commerce effort is technology
MYTH 6: On the Web, customer service is not as important as it is in a traditional retail store
MYTH 7: No strategy is needed to sell on the Web; with a website, the rest will take care of itself
MYTH 8: Flash makes a website better
MYTH 9 It's what's up front that counts
MYTH 10: E-commerce will cause brick-and-mortar retail stores to disappear
MYTH 11: The greatest opportunities for e-commerce lie in the retail sector
MYTH 12: It's too late to get on to the Web

Dollinger (2003:213) outlines seven business models for e-entrepreneurs:

- B2C business model – selling directly to the final customer and the end user. It is sometimes called 'e-tailing' – a derivation of retailing on the internet. This is the most ubiquitous form of online selling. Attention must be paid to the website which must be designed for easy use and be personalized. Awareness must be built up – customers must find the supplier. In addition, fulfilling orders is a big issue – deliver the product on time or lose the customer forever.

- B2B business model – this refers to business-to-business, where the final user is another company. B2B is a much larger market than B2C and is dominated by traditional suppliers who have shifted to the Internet to make purchasing more efficient.
- B2B2C – business-business-consumer refers to business models where the e-entrepreneur produces a product for another business that then markets it to the consumer.
- Niches – a niche business on the web either targets a very specific market segment and provides that segment with a complete vertical supply chain or specializes in a very specific type of product or service and offers it to a number of horizontal segments. The niche strategy possesses resources and capabilities to either serve a specific customer or offer a specific product, but usually not both.
- Clicks and Bricks – this business model represents a combination of a physical presence business and an Internet business. Having a physical presence and an Internet capability are complements that provide value to customers.
- Roll-Ups – the role-up business model is a result of great competition within a fragmented market. The roll-up entrepreneur overcomes this fragmentation by buying up many of the smaller competitors. This enables the entrepreneur to reap the benefits of economies of scale and, when done on the Internet, economies of information.
- Advertising models – it was initially thought that to make money on the Web, one should set up a site and sell advertising. Advertising revenue can be a source of income for the e-entrepreneurial Web venture, but should not be the only source if the business is to be successful.
- Pay-for-Content models – this business model means that users must pay to access a Web site. An example could be a newspaper charging a subscription fee for its online edition.

Dollinger (2003:213), referring to an article by Useem (2000) in *Fortune,* summarises the learning's relating to e-entrepreneurs and dot-com businesses:

- *The Internet doesn't change anything* – it is not a disruptive technology, but rather helps complement existing businesses
- *If it doesn't make sense, it doesn't make cents* – businesses still need to make profits
- *Time favours existing businesses* – important lessons were gleaned from the early dot-com pioneers on what not to do.
- *Making money is harder than it looks*
- *There is no such thing as "Internet time"* – "internet time" meant acting before thinking or spending before analyzing.

- *"Branding" is not a strategy* – a brand is developed by producing high-quality products over time. Instant branding does not work.
- *Entrepreneurship cannot be systematized* – entrepreneurial ventures cannot be institutionalized. Rules must not be followed – they must be broken
- *Investors are not customers* – the ability to attract investors is different from the ability to serve customers and make a profit
- *The Internet changed everything* – it may not have changed the old industrial order, but is has changed the way that order does business.
- *The Internet changes your job* – information is everywhere and we can do our jobs better because of the Internet
- *The distinction between Internet companies and non-Internet companies is fading* - the clicks-and bricks model works and purchasing can improve with B2B networks.
- *The real wealth creation is yet to come* – the Internet revolution has started.

(Dollinger, 2003:214)

Like other businesses, companies doing business on the Web must rely upon the traditional precepts of marketing – price, place, product and promotion – to attract and lock in their customers. However, doing business on the Web is unlike operating any other business. The Internet instantly transforms all Web-based business into global entities and potentially opens the door to any customers who has a computer, a cellular telephone or a digital personal assistant. The Internet's main impact has been to lower the cost of communication. Although the Web spotlight initially celebrated e-tailers, it is the information-intensive industries, such as financial services, entertainment, education, health care and government which appear to have the best chance to succeed on the Internet.
(Dollinger, 2003:214)

Zimmerer and Scarborough (2005: 227) offer some guidelines for entrepreneurs in order to achieve success in their e-commerce efforts:

- Consider focusing on a niche in the market – niches exist in every industry and can be highly profitable, given the right strategy for serving them
- Develop a community – creating a community through e-mail lists, chat rooms, customer polls, web logs (blogs), guest books and message boards turn customers into loyal fans who not only come back but invite others to join them.
- Attract visitors by giving away "freebies" – the 'freebie' must be something customers value, but it does not have to be expensive nor does it have to be a product. Information is a common give

away on the web. Giving something away and then selling something is called the ‘rhythm of the web’.

- Make creative use of e-mail, but avoid becoming a spammer – e-mail can be an effective, low cost way to build traffic on a web site
- Make sure your web site says “credibility” – unless a company can build trust in its web site, selling is virtually impossible. Using known and trusted brand names is one of the simplest ways to establish credibility.
- Consider forming strategic alliances
- Make the most of the Web’s global reach
- Promote your web site online and off-line

CHAPTER ELEVEN

ENTREPRENEURIAL AND SMALL BUSINESS STRATEGY

Chapter Eleven

Entrepreneurial and Small Business Strategy

Learning Outcomes:

Having worked through this chapter, the student should be able to:

- Identify differences in strategic outlook between small businesses and large organizations
- Discuss the strategies available to entrepreneurial ventures

Reading:

Ehlers, T. and Lazenby, K. (editors). 2005. Strategic Management Southern African Concepts and Cases. Pretoria. Van Schaik

Burns, Paul (2007). Entrepreneurship and Small Business. Second edition New York. Palgrave Macmillan – Chapter 9

'Entrepreneurial' refers to starting up a venture based on a business opportunity. The entrepreneurial phases of the life cycle of a business venture cover the pre-start-up, start-up and early growth phases of the cycle. Entrepreneurial strategies thus relate more to the circumstances and environment of the small venture in its early life cycle than to those found in the managerial phases of late growth, maturity and decline.

Strategy is defined as an integrated and co-ordinated set of commitments and actions designed to exploit core competencies and gain competitive advantage. Strategy refers to the way in which all resources are applied in the business to gain advantage over competitors. The resources include finance, human resources and innovation assets, and their application.

The principles of strategy are as relevant for the small business venture as for larger organisations. The key differences between small ventures and large organisations relate to:

- Resources
- Growth stage
- Competitive environment
- Structure.

The issues that confront the small venture flow from its differences from large organisations and include:

- Opportunity or threat? – a perceived opportunity can become a threat if it lures the business into taking risks greater than it can afford to take. This is referred to as ‘overtrading’.
- Less information available – the small business has less exposure to and contact with important sources of information.
- To start-up or acquire? – the issue is whether to start up a new business or acquire an existing business.
- Flexibility – small businesses are more flexible than large organisations and can react faster to environmental changes and trends.

A business has a competitive advantage whenever it has an edge over rivals in attracting customers and defending itself against competitive forces. The positioning of a business relates to how the business is perceived (by existing and potential customers) in relation to the competition. The most basic competitive advantage is to provide customers with what they perceive as superior value, such as:

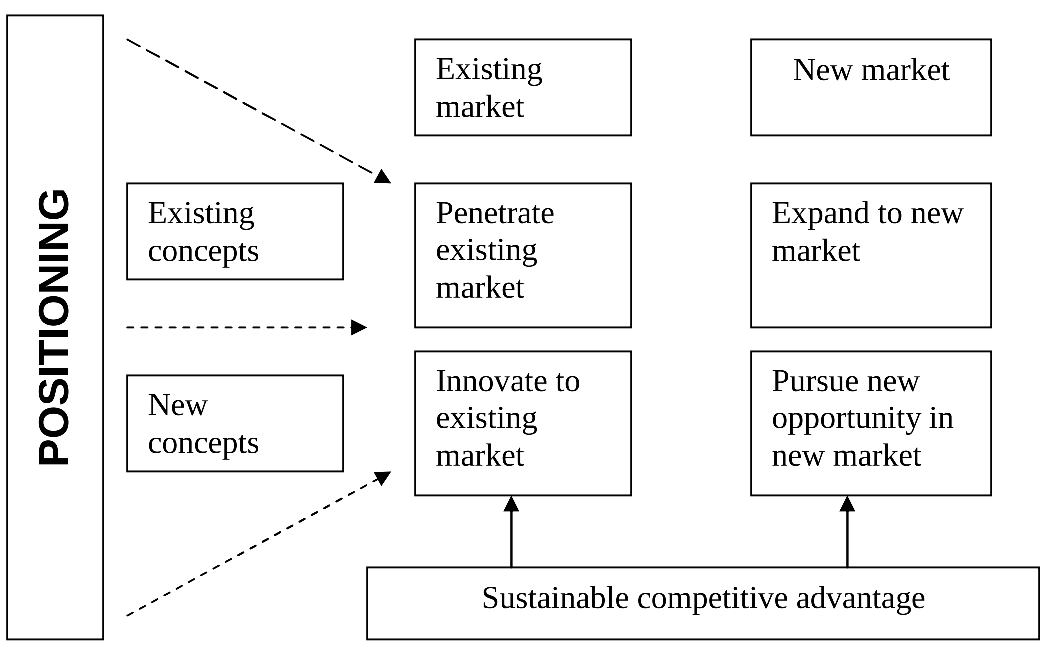
- A good product at a low price
- A superior product that is worth paying extra for
- A best-value offering that offers a combination of price, features, quality, service or other attributes that customers may find attractive.

A sustainable competitive advantage can be found within the list of strengths, competencies and capabilities of a business. Some attributes used as competitive advantage include:

- Control over a resource
- Patents
- Access to a distribution channel
- Contractual agreements
- Innovative responsiveness
- Contacts and networks
- Franchising
- Location
- Brand

The five generic competitive strategies available to large organisations in order to position themselves relative to the competition (Overall low-cost producer strategy, focused low-cost strategy, broad differentiation strategy, focused differentiation strategy and best cost provider strategy) are available to small business ventures, but may have limited application value as a result of the limited access of small businesses to certain resources. The broad positioning and growth strategies available to the entrepreneurial venture include:

- Product leadership - a small venture may develop a new leading positioning if it has patent protection and can grow in a short space of time. Product leadership, however, is generally not available to the small business because of its general lack of research and development capacity and the resources required to sustain the new product development process.
- Customer intimacy – refers to the development of close relationships with one's customers by marketing activities or becoming involved in customers' operations. The strategy is successful if the customers become dependent on the service(s) supplied to them.
- Operational excellence – refers to the efficiency with which inputs are converted to outputs. Applying this strategy entails directing resources towards infrastructure, equipment and systems.
- Follower ("also ran") strategy – this is the distinction between the entrepreneur (who comes up with new opportunities and growth) and the small business owner (who follows the market).



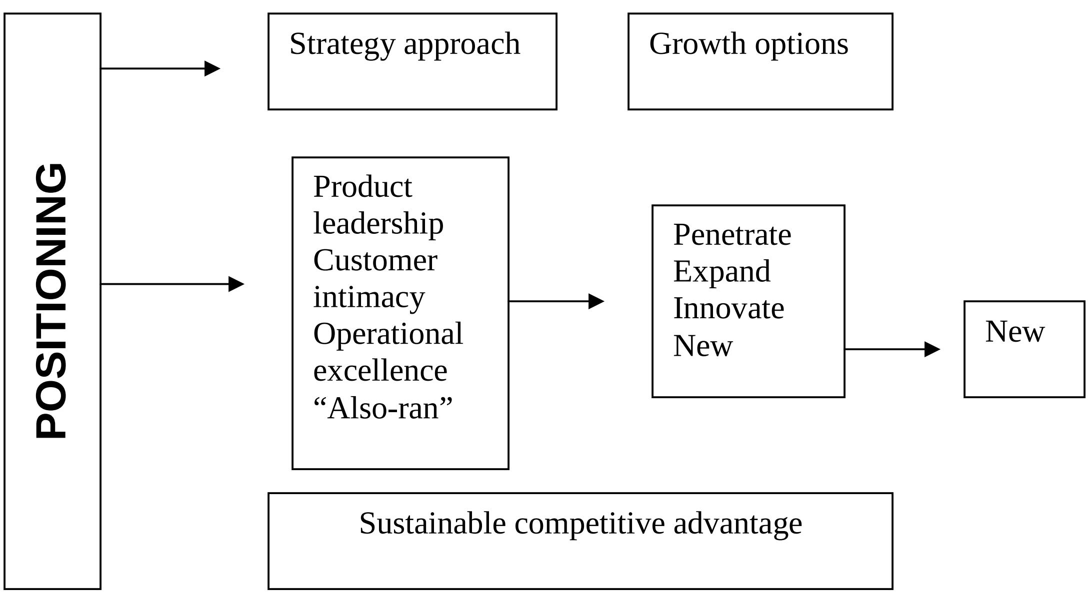
There are two basic strategic options for growth:

- Growing the business internally in size (organic growth) – requires expansion through increased market share. The options available are
  - penetrating the existing market
  - finding new customers
  - adding new products and services to service existing customers better
  - adding new products and starting to serve new markets
- Growing the business through the acquisition of additional businesses (external growth) – refers to buying related or unrelated ventures in order to enlarge the business operations.

A retrenchment strategy is the opposite of a growth strategy – requiring certain operations to be scaled down or eliminated.

Other strategic options are:

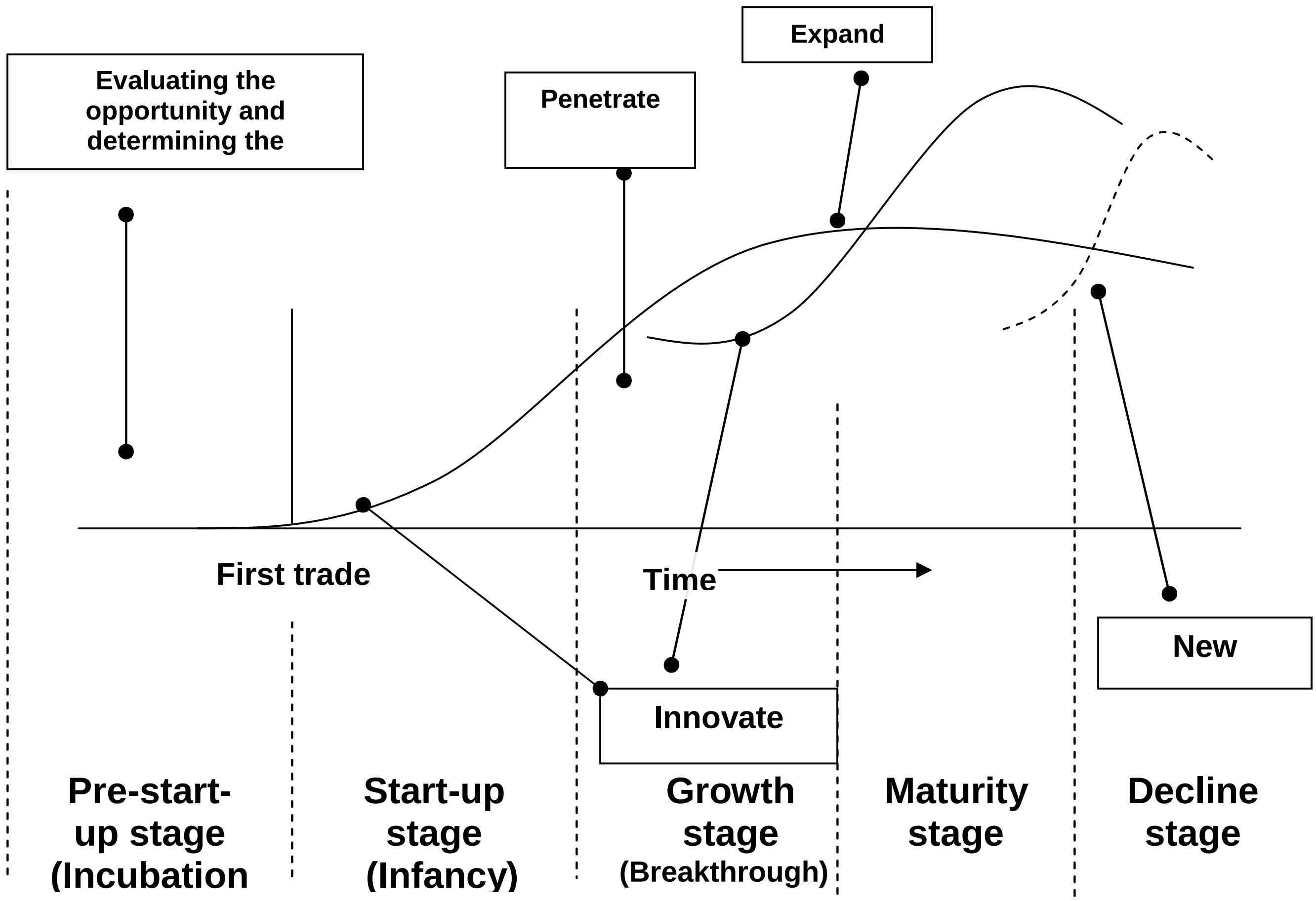
- Stability – a stability strategy is followed when the owner of a venture does not want to grow the total operation. Growth requires capital investment.
- Combination – a combination strategy could be any combination of the growth, retrenchment and stability strategies.



There are several issues that will influence the choice of an initial strategy for a business venture aimed at growth and competitiveness:

- Economies of scale – although the small venture does not normally have the resources to establish economies of scale early in the life cycle, if any economies of scale can be achieved, the business venture will benefit significantly from them.
- Learning-curve effects – experience-based cost savings occur as a result of staff learning to perform their tasks more efficiently and from the debugging of new technology.
- Linkages – interactions with other businesses to co-operate and share costs can benefit small ventures.
- Alliances – alliances with some of its suppliers, distributors or customers can allow a small venture to integrate its operations either forward or backward. In addition, other service providers can be used as ‘partners’ in bigger contracts.
- Environmental changes – environmental issues include customers, suppliers, competitors and intermediaries from the market environment of the business venture. In addition are the political, economic, social, technological, global and physical factors from the macro environment that govern the market environment.

The life-cycle stage of the venture is important to the choice of strategy:



- Incubation stage (pre-start-up) – during this stage there are few options. The venture is conceptual and the positioning that is envisaged is chosen.
- Start-up stage – focuses on acquiring resources (determined by the positioning and strategy chosen), gaining customer awareness and getting the product or service distributed.
- Growth stage – the focus changes towards market expansion, retaining existing customers and gaining new customers.
- Maturity stage – characterised by more and tougher competition, with pressure on the price and distribution elements.
- Decline stage – sales, profitability and future potential decrease rapidly.

During both the maturity and decline stages, it will be necessary for the business venture to make some strategic decisions. An opportunity analysis should be done (preferably at the late growth phase) to determine what options potentially exist for the business.

Understanding the impact of positioning on the choice of strategy brings insight to the entrepreneur, helping to anticipate, plan and execute a successful strategy and implement it. The chosen strategy must be monitored and adapted accordingly to the changing environment. Entrepreneurs can adapt many strategies used by large organisations. However, a key difference between the small business venture and larger organisations is the impact of limited resources and access to resources, which both restrict the choices available to small business ventures. Ideally the venture should first determine its strategy, and then apply its resources to support this strategy. Unfortunately, the limitations on resources often force the selection of a strategy based on available resources.

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