BBM 221: FEASIBILITY ANALYSIS

- For many entrepreneurs, the easiest part of launching a business is coming up with an idea for a new business concept or approach.
- Business success however, requires much more than just a great new idea.
- Once an entrepreneur develops an idea for a business, the next step is to subject it to a feasibility analysis to determine whether or not the idea can be transformed into a viable business.

  Feasibility analysis

  • This is the process of determining whether or not an entrepreneur's idea is a viable foundation for creating a successful business.

  • Its purpose is to determine whether or not a business idea is worth pursuing.

  • If the idea passes the feasibility analysis, the entrepreneur's next step is to build a solid business plan for capitalizing on the idea.

  • If the idea fails to pass the analysis, the entrepreneur drops it and moves on to the next opportunity.

Feasibility studies are particularly useful when;

• Entrepreneurs have generated multiple ideas for business concepts and must "sieve out" their options to the best choice.

• They enable entrepreneurs to explore quickly the practicality of each of several potential paths for transforming an idea into a successful business venture.

Conducting a Feasibility analysis

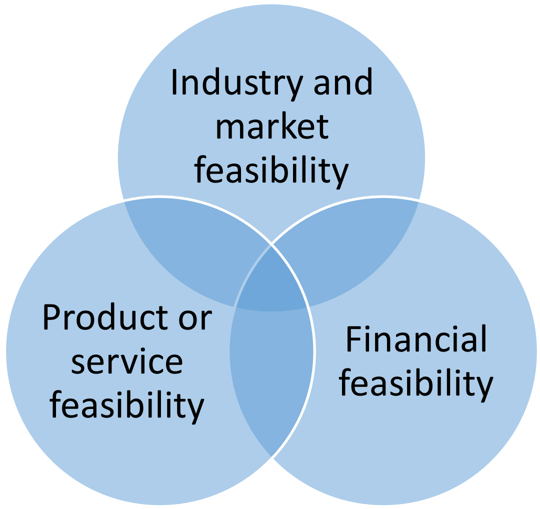
•A feasibility analysis consists of three interconnected components.

1. An industry and market feasibility analysis

2. A product or service feasibility analysis

3. A financial feasibility analysis

Elements of a feasibility Analysis



Industry and Market Feasibility Analysis

The focus in this phase is two-fold;

•1. To determine how attractive an industry is overall as a "home" for a new business
•2. to identify possible niches a small business can occupy profitably
Answering the following questions will help;
♣ How large is the industry?
♣ How fast is it growing?
♣ Is the industry as a whole profitable?
♣ How essential are its products and services to customers?
♣ What trends are shaping the industry's future?
♣ What opportunities does the industry face?
♣ How crowded is the industry?
♣ How intense is the level of competition in the industry?
♣ How old is the industry? (e.g. young, mature etc.)

The five forces model by Michael Porter

• This is a useful tool for analyzing an industry's attractiveness.
• Five forces interact with one another to determine the setting in which companies compete and hence the attractiveness of the industry.
These include;
• 1. the rivalry among the companies competing in the industry.
• 2. the bargaining power of suppliers to the industry.
• 3. the bargaining power of buyers.
• 4. the threat of new entrants to the industry.
• 5. the threat of substitute products or services.

Rivalry among the companies competing in the industry

Generally, an industry is more attractive when;

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

Bargaining power of suppliers to the industry

• The greater the leverage that suppliers of key raw materials or components have, the less attractive is the industry. E.g. the personal computers chip makers exert a great deal of power over computer manufacturers such as Dell, Hewlett-Packard.

• Generally, an industry is more attractive when;

- Many suppliers sell a commodity product to the companies in it
- Substitute products are available for the items that suppliers provide.
- Companies in the industry find it easy to switch from one supplier to another or to substitute products.
- When the items supplied to the industry account for a relatively small portion of the cost of the industry's finished products.

Bargaining power of buyers

• Generally, an industry is more attractive when;

- Industry customers' "switching costs" to competitors' products or to substitutes are relatively high
- The number of buyers in the industry is large
- Customers demand products that are differentiated rather than purchase commodity products that they can obtain from any supplier
- Customers find it difficult to gather information on suppliers' costs, prices and products features (becoming easier for customers by using the web).
- When the items the company sell to industry account for relatively small portion of the cost of their customers' finished products.

Threat of new entrants to the industry

New entrants to an industry can erode existing companies' market share and profits. Generally, an industry is more attractive to new entrants when;

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

Threat of substitute products or services

• Substitute products or services can destroy an industry. E.g. many glass makers have shut their businesses as their customers have switched to plastic containers Which are lighter, cheaper and more durable).Printed newspaper readership has declined as new generations turn to online news that is constantly updated. • Generally, an industry is more attractive when;

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

Product or Service Feasibility Analysis

• This determines the degree to which a product or service idea appeals to potential customers and identifies the resources necessary to produce the product or provide the service.

• Getting feedback from potential customers involve engaging in;

• 1. primary research

• 2. Secondary research

• 3. Building prototypes

• 4. Conducting in-home trials.

Primary research

• These techniques include;

a) Customer surveys and questionnaires

b) Focus groups Secondary research

• These include the following sources;

a) Trade associations and business directories

b) Direct mail lists

c) Demographic data

d) Census data

e) Market research

f) Articles

g) Local data

h) World Wide Web

Building prototypes

• This is an original, functional model of a new product that entrepreneurs can put into the hands of potential customers so that they can see it, test it and use it.

• Prototypes usually point out potential problems in a product's design giving investors the opportunity to fix them even before coming up with the final item.

• Leads to design improvements and new features some of which the entrepreneur may not have discovered on his/her own.

Conducting in-home trials

• Involves sending researchers into customers' homes to observe them as they use the company product or service.

• Customers are watched installing and using a product and their suggestions are recorded.

Financial Feasibility Analysis

• The major elements to be included in this analysis include the following;
• 1. Capital Requirements
• 2. Estimated earnings
• 3. Return on investment; e.g can be determined by dividing the estimated earnings the business yields by the amount of capital invested in the business.

Conclusion

• It is important for entrepreneur to take time to subject their ideas to a feasibility analysis, whatever outcome it produces.
• If the study suggests that transforming the idea into a viable business is not feasible, the entrepreneur moves to the next idea, confident that valuable resources have not been wasted by launching a business that is bound to fail.
• If the analysis shows potential then the business can be launched.