5 Crafting a Business Plan and Building a Solid Strategic Plan

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Learning Objectives

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

1. Explain the benefits of an effective business plan.
2. Describe the elements of a solid business plan.
3. Explain the "five Cs of credit" and why they are important to potential lenders and investors reviewing business plans.
4. Understand the keys to making an effective business plan presentation.
5. Understand the importance of strategic management to a small business.
6. Explain why and how a small business must create a competitive advantage in the market.
7. Develop a strategic plan for a business using the nine steps in the strategic management process.

A business plan is a planning tool that builds on the foundation of the idea assessment, feasibility analysis, and business model discussed in Chapter 4. A business plan provides a more comprehensive and detailed analysis than the first three steps in the new business planning process. Together with a well-developed business model, it functions primarily as a planning tool describing in greater detail how to turn the model into a successful business. The primary goals of the business plan are to guide entrepreneurs as they launch their businesses and to help them acquire the necessary financing to launch. Research suggests that, whatever their size, companies that engage in business planning outperform those that do not. A business plan offers:

- a systematic, realistic evaluation of a venture's chances for success in the market.
- a way to determine the principal risks facing the venture.
- a "game plan" for managing the business successfully during its start-up.
- a tool for comparing actual results against targeted performance.
- an important tool for attracting capital in the challenging hunt for money.

Few activities in the life of a business are as vital—or as overlooked—as that of developing a strategy for success that guides a business beyond the start-up detailed in the business plan. Companies without clear strategies may achieve some success in the short run, but as soon as competitive conditions stiffen or an unanticipated threat arises, they usually "hit the wall" and fold. Without a basis for differentiating itself from a pack of similar competitors, the best a company can hope for is mediocrity in the marketplace.

In today's global competitive environment, any business, large or small, that is not thinking and acting strategically is extremely vulnerable. Every business is exposed to the forces of a rapidly changing competitive environment, and in the future small business executives can expect even greater change and uncertainty. From sweeping political changes around the planet and rapid technology advances to more intense competition and newly emerging global markets, the business environment has become more turbulent and challenging to business owners. Although this market turbulence creates many challenges for small businesses, it also creates opportunities for those companies that have in place strategies to capitalize on them. Entrepreneurs' willingness to adapt, to create change, to experiment with new business models, and to break traditional rules has become more important than ever. "It's not the strongest or the most intelligent [companies that] survive," says American Express CEO Ken Chenault, "but those most adaptive to change."[1]

LO1

Explain the benefits of an effective business plan.

The Benefits of Creating a Business Plan

When based on the foundation of a fully developed and tested business model, a well-conceived and factually based business plan increases the likelihood of success of a new business. For decades, research has proved that companies that engage in business planning outperform those that do not. One study by the Small Business Administration reports that entrepreneurs who write business plans early on are two-and-a-half times more likely to actually start their businesses than those who do not.[2] Unfortunately, many entrepreneurs never take the time to engage in the new business planning process, of which the business plan is an important element. The implications of the lack of planning are all too evident in the high failure rates that small companies experience.

business plan
a written summary of an entrepreneur's proposed business venture, its operational and financial details, its marketing opportunities and strategy, and its managers' skills and abilities.

A **business plan** is a written summary of an entrepreneur's proposed business venture, its operational and financial details, its marketing opportunities and strategy, and its managers' skills and abilities. There is no substitute for a well-prepared business plan, and there are no shortcuts to creating one. The plan serves as an entrepreneur's road map on the journey toward building a successful business. A business plan describes which direction the company is taking, what its goals are, where it wants to be, and how it intends to get there. The plan is written proof that an entrepreneur has performed the necessary research, has studied the business opportunity adequately, and is prepared to capitalize on it with a sound business model. Crafting a business plan is an entrepreneur's last insurance against launching a business destined to fail or mismanaging a potentially successful company.

A business plan serves two essential functions. First, it provides a battery of tools—a mission statement, goals, objectives, budgets, financial forecasts, target markets, and entry strategies—to help entrepreneurs subject their ideas to one last test of reality before launching the business. The business plan also helps the entrepreneur to lead the company successfully through its launch and early start-up phases.

The second function of the business plan is to attract lenders and investors. A business plan must prove to potential lenders and investors that a venture will be able to repay loans and produce an attractive rate of return. They want proof that an entrepreneur has evaluated the risk involved in the new venture realistically and has a strategy for addressing it. Unfortunately, many small business owners approach potential lenders and investors without having prepared to sell their business concepts. Given the increased challenges in funding small businesses since the beginning of the recession in 2008, being prepared for *any* funding meeting has become even more important. Tim Williamson, cofounder of The Idea Village, an incubator for entrepreneurs, says that of the thousands of entrepreneurs seeking funding, only about 1 percent are ready to get the money.[3] A collection of figures scribbled on a note pad to support a loan application or investment request is not enough. Applying for loans or attempting to attract investors without a solid business plan rarely lands needed capital. The best way to secure the necessary capital is to prepare a sound business plan. The quality of an entrepreneur's business plan weighs heavily in the final decision to lend or invest funds. It is also potential lenders' and investors' first impression of the company and its managers. Therefore, the finished product should be highly polished and professional in both form and content.

Preparing a sound business plan requires time and effort, but the benefits greatly exceed the costs. Building a plan forces a potential entrepreneur to look at his or her business idea in the harsh light of reality by putting the concepts developed in the business model into specific detail. To get external financing, an entrepreneur's plan must pass three tests with potential lenders and investors: (1) the reality test, (2) the competitive test, and (3) the value test. The first two tests have both an external and internal component:

REALITY TEST The external component of the reality test involves proving that a market for the product or service really does exist. It focuses on industry attractiveness, market niches, potential customers, market size, degree of competition, and similar factors. Entrepreneurs who pass this part of the reality test prove in the marketing portion of their business plans that there is strong demand for their business idea. Evidence that is gathered during the testing of the business model should be an integral part of the marketing plan to bolster the proof for the idea using real customers.

The internal component of the reality test focuses on the product or service itself. Can the company really build it for the cost estimates in the business plan? Is it truly different from what competitors are already selling? Does it offer customers something of value?

COMPETITIVE TEST The external part of the competitive test evaluates the company's relative position to its key competitors. How do the company's strengths and weaknesses match up with those of the competition? Do these reactions threaten the new company's success and survival? Recall from Chapter 4 that a compelling value proposition must clearly define the problem the target market is facing. Are current choices to address the problem for target market unworkable? Is some sort of solution for the problem facing the target market inevitable? Is the problem urgent, critical, and clear for the target market? Is the target market underserved? Successful entrepreneurs carefully and honestly evaluate the strength of their product ideas. Do we offer a solution that looks at the problem differently than competitors? Can we protect our intellectual property (if applicable) and/or create a protectable niche? Do we disrupt the market but not so much that the "cost" of changing to us is too high? A value proposition that is properly constructed answers the following questions:[4]

- Who is our target market?
- What current options exist for this target market?
- What do/will we offer the target market?
- What is the key problem it solves?
- Why is it better than other options the target market has to choose from?

A strong and compelling value proposition guides everything entrepreneurs and their employees do while starting and growing their businesses.[5]

The internal competitive test focuses on management's ability to create a company that will gain an edge over existing rivals. To pass this part of the competitive test, a plan must prove the quality, skill, and experience of the venture's management team. What other resources does the company have that can give it a competitive edge in the market?

VALUE TEST To convince lenders and investors to put their money into the venture, a business plan must prove to them that it offers a high probability of repayment or an attractive rate of return. Entrepreneurs usually see their businesses as good investments because they consider the intangibles of owning a business, such as gaining control over their own destinies and freedom to do what they enjoy. Lenders and investors, however, look at a venture in colder terms: dollar-for-dollar returns. A plan must convince lenders they will be repaid the money they lend to the business, and it must convince investors they will earn an attractive return on their money.

Even after completing a feasibility analysis and building a business model, entrepreneurs sometimes do not come to the realization that "this business just won't work" until they build a business plan. Have they wasted valuable time? Not at all! The time to find out that a business idea will not succeed is in the planning stages before committing significant money, time, and effort to the venture. It is much less expensive to make mistakes on paper than in reality. In other cases, a business plan reveals important problems to overcome before launching a company. Exposing these flaws and then addressing them enhances the chances of a venture's success. Business plans also help nascent entrepreneurs nail down important aspects of their concept and sometimes prevent costly mistakes.

The real value in preparing a plan is not as much in the plan itself as it is in the process the entrepreneur goes through to create the plan—from the idea assessment, to the feasibility analysis, through the development and testing of the business model, and finally with the crafting of the written business plan. Although the finished product is extremely useful, the process of building the plan requires entrepreneurs to explore all areas of the business and subject their ideas to an objective, critical evaluation from many different angles. What entrepreneurs learn about their industry, target customers, financial requirements, competition, and other factors is essential to making their ventures successful. Building a business plan is one controllable factor that can reduce the risk and uncertainty of launching a company.

LO2

Describe the elements of a solid business plan.

The Elements of a Business Plan

Wise entrepreneurs recognize that every business plan is unique and must be tailor-made. They avoid the off-the-shelf, "cookie-cutter" approach that produces a look-alike business plan. The elements of a business plan may be standard, but the way entrepreneurs tell their stories should be unique and reflect the specific strengths of their business model, the experience of their team, their personality and how it will shape the culture of the business, and their enthusiasm for the new venture. In fact, the best business plans usually are those that tell a compelling story in addition to the facts. For those making a first attempt at writing a business plan, seeking the advice of individuals with experience in this process often proves helpful. Accountants, business professors, attorneys, advisers working with local chapters of the Service Corps of Retired Executives (SCORE), and consultants with Small Business Development Centers (SBDCs) are excellent sources of guidance when creating and refining a plan. (For a list of SBDCs, go to the Small Business Administration Web site and see its SBDC Web page; for a list of SCORE chapters, go to the SCORE Web site). Remember, however, you should be the one to author your business plan, not someone else. A sample outline of a business plan is displayed at the end of this chapter.

Initially, the prospect of writing a business plan may appear to be overwhelming. Many entrepreneurs would rather launch their companies and "see what happens" than invest the necessary time and energy defining and researching their target markets, defining their strategies, and mapping out their finances. After all, building a plan is hard work—it requires time, effort, and thought. However, in reality the entrepreneur should do both. By getting started and seeing what happens, the entrepreneur can test and improve the basic business model. The plan is essential as the entrepreneur gets ready to build the business and scale its growth. The business plan pays many dividends, but not all of them are immediately apparent. Entrepreneurs who invest their time and energy building plans are better prepared to face the hostile environment in which their companies will compete than those who do not.

Entrepreneurs can use business planning software available from several companies to create their plans. Some of the most popular programs include Business Plan Pro (Palo Alto Software), PlanMaker (Power Solutions for Business), and Plan Write (Business Resources Software). These packages help entrepreneurs organize the material they have researched and gathered, and they provide helpful tips on plan writing with templates for creating financial statements. Business planning software may help to produce professional-looking business plans with a potential drawback: The plans they produce look as if they came from the same mold. That can be a turn-off for professional investors who review hundreds of business plans each year. Entrepreneurs benefit by making the content and appearance of their plan look professional and unique.

In the past, conventional wisdom was that business plans should be 20 to 40 pages in length, depending on the complexity of the business. More recently experts have begun to recommend that plans should be shorter, typically suggesting that they be limited to 10 to 20 pages. There is mixed opinion on how complex the financial forecasts should be. If the forecasts are based on evidence that is substantiated by testing the business model, more detail will strengthen your case. If the numbers appear to be unsubstantiated or even fabricated, more detail can actually hurt the presentation. In many ways, having to write shorter business plans can make writing them even more of a challenge. A shorter business plan does not mean that any of the elements of the plan be omitted. Instead the entrepreneur must work hard to communicate all of the key aspects of the plan as succinctly as possible. Although entrepreneurs find it difficult to communicate all the important elements of their story within the shorter page length recommendations, they run the risk of never getting used or read if their plans get too long.

This section explains the most common elements of a business plan. However, entrepreneurs must recognize that, like every business venture, every business plan is unique. An entrepreneur should use the following elements as the starting point for building a plan and should modify them as needed to better tell the story of his or her new venture.

TITLE PAGE AND TABLE OF CONTENTS A business plan should contain a title page with the company's name, logo, and address as well as the names and contact information of the company founders. Many entrepreneurs also include the copy number of the plan and the date on which it was issued on the title page. Business plan readers appreciate a table of contents that includes page numbers so that they can locate the particular sections of the plan in which they are most interested.

THE EXECUTIVE SUMMARY To summarize the presentation to each potential financial institution or investors, the entrepreneur should write an executive summary. It should be concise—a maximum of one page—and should summarize all of the relevant points of the proposed deal. After reading the executive summary, anyone should be able to understand the entire business concept, the attributes that differentiate the company from the competition, and the financing that is being requested. The executive summary is a synopsis of the entire plan, capturing its essence in a capsulized form. It should explain the basic business model and the problem the business will solve for customers, briefly describing the owners and key employees, target market(s), financial highlights (e.g., sales and earnings projections, the loan or investment requested, plans for using the funds, and projections for repaying any loans or cashing out investments), and the company's competitive advantage. The executive summary is a written version of what is known as "the elevator pitch." Imagine yourself on an elevator with a potential lender or investor. Only the two of you are on the elevator, and you have that person's undivided attention for the duration of the ride, but the building is not very tall! To convince the investor that your business idea is a great investment, you must condense your message down to its essential elements—key points that you can communicate in a matter of no more than two minutes. In the Pitch George Elevator Competition at George Washington University, students actually make their pitch to judges in an elevator, where they have the opportunity to make their elevator pitches in just three minutes. Winners receive a small cash prize and earn the opportunity to present at the GW Business Plan Competition where they compete to earn prizes totaling $101,000.

The following five-part framework helps entrepreneurs develop a meaningful elevator pitch:

1. *Context.* What does your company do in easy-to-understand words?
2. *Benefit.* What benefit or advantage does your company offer customers?
3. *Target customers.* For whom does your company provide the benefit?
4. *Point of differentiation.* How is your company different from other companies that provide similar products, services, or solutions?
5. *Clincher.* Can you leave the listener or reader with a memorable, bottom-line sound bite about your company.[6]

Like a good movie trailer, an executive summary is designed to capture readers' attention and draw them into the plan. If it misses, the chances of the remainder of the plan being read are minimal. What is different between an executive summary and a movie trailer is that the executive summary needs to give away the ending! If it does not, potential funders will never read the full plan. A coherent, well-developed summary of the full plan establishes a favorable first impression of the business and the entrepreneur behind it and can go a long way toward obtaining financing. A good executive summary should allow the reader to understand the business concept and how it will make money, and it should answer the ultimate question from investors or lenders: "What's in it for me?" Although the executive summary is the first part of the business plan, it should be the last section written to ensure that it truly captures all of the important points as they appear in the full plan.

MISSION AND VISION STATEMENT A mission statement expresses an entrepreneur's vision for what his or her company is and what it is to become. It is the broadest expression of a company's purpose and defines the direction in which it will move. It anchors a company in reality and serves as the thesis statement for the entire business plan by answering the question, "What business are we in?" Every good plan captures an entrepreneur's passion and vision for the business, and the mission statement is the ideal place to express them. Avoid the use of too much business jargon and business clichés. It should clearly state the product or service the business sells, its target market, and the basic nature of the business (e.g., manufacturing, consulting, service, outsourcing). Mission statements should be limited to no more than 25 words.

DESCRIPTION OF FIRM'S PRODUCT OR SERVICE An entrepreneur should describe the company's overall product line, giving an overview of how customers will use its goods or services. Drawings, diagrams, and illustrations may be required if the product is highly technical. It is best to write product and service descriptions so that laypeople can understand them. A statement of a product's position in the product life cycle might also be helpful. An entrepreneur should include a summary of any patents, trademarks, or copyrights that protect the product or service from infringement by competitors.

One danger entrepreneurs must avoid in this part of the plan is the tendency to dwell on the features of their products or services. This problem is the result of the "fall-in-love-with-your-product" syndrome, which often afflicts inventors. Customers, lenders, and investors care less about how much work, genius, and creativity went into a product or service than about what it will do for them. This part of the plan builds off the value proposition developed in the business model. The emphasis of this section should be on defining the benefits customers get by purchasing the company's products or services, rather than on just a "nuts and bolts" description of the features of those products or services. A **feature** is a descriptive fact about a product or service (e.g., "an ergonomically designed, more comfortable handle"). A **benefit** is what the customer gains from the product or service feature (e.g., "fewer problems with carpal tunnel syndrome and increased productivity"). Benefits are at the core of the value proposition of the business model. This part of the plan must describe how a business will transform tangible product or service features into important but often intangible customer benefits—for example, lower energy bills, faster access to the Internet, less time writing checks to pay monthly bills, greater flexibility in building floating structures, shorter time required to learn a foreign language, or others. Remember: Customers buy benefits, not product or service features.

feature
a descriptive fact about a product or service.

benefit
what a customer gains from the product or service.

ENTREPRENEURIAL PROFILE: Ami Kassar and Multifunding Ami Kassar came up with the idea for his Philadelphia-based business, Multifunding, from his experience in the small business credit industry. He had seen the difficulty small businesses had when trying to find financing, and yet he knew that there was financing available for many these businesses if they could just get connected to the right sources. Although the value of the service was apparent from the beginning, it took Kassar several pivots of his business model to finally offer small business customers what they wanted, in the way they wanted it. "There is a fundamental difference between a vision and a business model," said Kassar. "While the core model of how we make our money has not changed from day one, we are constantly testing it, and looking for ways to improve it, evolve it, and grow it. Every few months an entrepreneur should take a cold shower, and take the time to look in the rear view mirror, and come up with some new things to try and test." After getting a profile of a small business client and an assessment of its financing needs, Multifunding puts together a report that gives the small business owner various financing options. Multifunding gets paid only when the financing is completed, taking a small percentage of the approved amount of financing. Multifunding funded 7 small businesses in its first year and 48 in its second. As part of the process of testing and refining its business model, the company began looking into new sources of revenue streams during its third year.[7] ■


Ami Kassar, Founder and CEO of Kassar

BUSINESS AND INDUSTRY PROFILE If one goal of creating a plan to raise funding, the entrepreneur should include a section that acquaints lenders and investors with the industry in which a company competes. This section should provide readers with an overview of the industry or market segment in which the new venture will operate. Industry data such as key trends or emerging developments within the industry, market size and its growth or decline, and the relative economic and competitive strength of the major firms in the industry set the stage for a better understanding of the viability of a new business. Strategic issues such as ease of market entry and exit, the ability to achieve economies of scale or scope, and the existence of cyclical or seasonal economic trends further help readers to evaluate the new venture. This part of the plan also should describe significant industry trends and key success factors as well as an overall outlook for its future. Information about the evolution of the industry helps the reader comprehend its competitive dynamics. *The U.S. Industrial Outlook Handbook* is an excellent reference that profiles a variety of industries and offers projections for future trends. Another useful resource of industry and economic information is the *Summary of Commentary on Current Economic Conditions*, more commonly known as the *Beige Book*. Published eight times a year by the Federal Reserve, the *Beige Book* provides detailed statistics and trends in key business sectors and in the overall economy. It offers valuable information on topics ranging from tourism and housing starts to consumer spending and wage rates. Entrepreneurs can find this wealth of information at their fingertips on the Web site of the Minneapolis Federal Reserve. This section should cover all of the relevant information the entrepreneur uncovered during the market and industry feasibility analysis.

COMPETITOR ANALYSIS An entrepreneur should describe the new venture's competition and the ways in which the chosen business strategy will position it effectively against key competitors. Failing to assess competitors realistically makes entrepreneurs appear to be poorly prepared, naive, or dishonest, especially to potential lenders and investors. The plan should include an analysis of each significant competitor and how well the competing business is meeting the important criteria that target customers are currently using to make their purchase decisions among the various companies. Entrepreneurs who believe they have no competitors are only fooling themselves and are raising a huge red flag to potential lenders and investors. Gathering information on competitors' market shares, products, and strategies is usually not difficult. Trade associations, customers, industry journals, marketing representatives, and sales literature are valuable sources of data. This section of the plan should focus on demonstrating that the entrepreneur's company has an advantage over its competitors and address these questions:

- Who are the company's key competitors?
- What are their strengths and weaknesses?

- What are their strategies?
- What images do they have in the marketplace?
- How successful are they?
- What distinguishes the entrepreneur's product or service from others already on the market, and how will these differences produce a competitive edge?

Firsthand competitor research is particularly valuable.

MARKET ENTRY STRATEGY This section addresses the question of how to attract customers. By laying out a market entry strategy, an entrepreneur explains how he or she plans to enter the market and gain a competitive edge and how his or her value proposition sets the business apart from the competition. A key component of this section is defining what makes the company unique in the eyes of its customers. One of the quickest routes to business failure is trying to sell "me-too" products or services that offer customers nothing newer, better, bigger, faster, or different.

MARKETING STRATEGY One of the most important tasks a business plan must fulfill is proving that a viable market exists for a company's goods or services. The business modeling process helped to identify and describe a company's target customers and their characteristics and habits. Defining the target audience and its potential is one of the most important—and most challenging—parts of the business planning process.

Proving that a profitable market exists involves two steps: showing customer interest and documenting market claims. Both of these steps should have been part of the business modeling process and should be part of the business plan.

Showing Customer Interest An important element of any business plan is showing how a company's product or service provides a customer benefit or solves a customer problem. Entrepreneurs must be able to prove that their target customers actually need or want their goods or services and are willing to pay for them. This is why using customers to validate the business model is so important. Validation from real customers provides the proof of concept that investors look for in a business plan.

Proving that a viable market exists for a product or service is relatively straightforward for a company already in business but can be quite difficult for an entrepreneur with only an idea. In this case, the key is to find a way to get primary customer data. The feasibility analyses and the process of validating the value proposition during the development of the business model provide this type of real data from real customers. During the development of the business model, an entrepreneur might build a prototype and offer it to several potential customers to get written testimonials and evaluations to show to investors. The entrepreneur also could sell the product to several customers, perhaps at a discount on the condition that they provide evaluations. Doing so proves that there are potential customers for the product and allows customers to experience the product in operation. Getting a product into customers' hands is also an excellent way to get valuable feedback that can lead to significant design improvements and increased sales down the road. Integrating this type of primary data into the actual business plan demonstrates that the plan has a stronger chance of success.

ENTREPRENEURIAL PROFILE: Matt Cooper and Canoe and Kayak Rental Matt Cooper quit his job as an investment banker in New York to start Soggy Bottom Canoe and Kayak Rental in the backwoods of Mississippi. Cooper was tired of the corporate grind and was ready for a change of pace. When Cooper arrived in Mississippi, he went full steam ahead buying the land, building the facilities, and buying canoes, kayaks, trailers, and vans. He did no market research such as talking to any prospective customers before investing in the business. In the seven years the business operated, it never reached even half of the revenues it needed to be successful. As a result, Cooper used up all of his savings and much of his parents' savings trying to keep the business afloat. In the end, Cooper closed the business and moved to California to take a job in Silicon Valley. Cooper attributes his business failure to spending his money on buildings and equipment rather than basic market research and marketing.[8] ■

In a technology business, investors are looking for partners that have both management and technology expertise.

A résumé should summarize each individual's education, work history (emphasizing managerial responsibilities and duties), and relevant business experience. Lenders and investors look for the experience, talent, and integrity of the people who will breathe life into the plan. This portion of the plan should show that the company has the right people organized in the right fashion for success. An entrepreneur can enhance the strength of the management team with a capable, qualified board of advisers. A board of directors or advisers consisting of industry experts lends credibility and can complement the skills of the management team.

PLAN OF OPERATION To complete the description of the business, an entrepreneur should construct an organization chart identifying the business's key positions and the people who occupy them. Assembling a management team with the right stuff is difficult, but keeping it together until the company is established can be even harder. Most small companies cannot match the salaries that employees can earn at larger competitors, but offering stock options, profit-sharing, shares of ownership, and other perks helps retain and motivate key employees. A plan of operation should also describe how the business operates, including space requirements, inventory management if applicable, staffing plans, and accounting processes and policies.

Finally, a description of the form of ownership (e.g., sole proprietorship, partnership, joint venture, C corporation, S corporation, LLC) and of any leases, contracts, and other relevant agreements pertaining to the operation is helpful.

PRO FORMA (PROJECTED) FINANCIAL STATEMENTS One of the most important sections of the business plan is an outline of the proposed company's financial statements—the "dollars and cents" of the proposed venture. An entrepreneur should carefully prepare projected (pro forma) financial statements for the operation for the next year using past operating data (if available), published statistics, and research to derive forecasts of the income statement, balance sheet, cash forecast (always!), and a schedule of planned capital expenditures. (You will learn more about creating projected financial statements in Chapter 11 and cash flow forecasts in Chapter 12.) Although including only most likely forecasts in the business plan is acceptable, entrepreneurs also should develop forecasts for pessimistic and optimistic conditions that reflect the uncertainty of the future in case potential lenders and investors ask for them.

It is essential that financial forecasts be realistic. Entrepreneurs must avoid the tendency to "fudge the numbers" just to make their businesses look good. Experienced lenders and investors can detect unrealistic forecasts easily. In fact, some venture capitalists automatically discount an entrepreneur's financial projections by as much as 50 percent. One experienced angel investor says that when looking at the financial forecasts compiled by an entrepreneur, he always doubles the start-up costs and triples the time it will take to launch.

After completing these forecasts, an entrepreneur should perform a break-even analysis for the business. The break-even point is critical for an entrepreneurial venture as it signals the point where the business is able to sustain itself through cash generated by operations and should not need any additional start-up capital. It also is the point when the entrepreneur is able to get paid by the business!

It is important to include a statement of the assumptions on which these financial projections are based. Potential lenders and investors want to know how an entrepreneur derived forecasts for sales, cost of goods sold, operating expenses, accounts receivable, collections, accounts payable, inventory, taxes, and other items. Spelling out realistic assumptions gives a plan more credibility and reduces the tendency to include overly optimistic estimates of sales growth and profit margins. Greg Martin, a partner in the venture capital company Redpoint Ventures, says, "I have problems with start-ups making unrealistic assumptions—how much money they need or how quickly they can ramp up revenue. Those can really kill a deal for me."[11]

In addition to providing valuable information to potential lenders and investors, projected financial statements help entrepreneurs run their businesses more effectively and more efficiently after start-up. They establish important targets for financial performance and make it easier for an entrepreneur to maintain control over routine expenses and capital expenditures. An entrepreneur also should construct a financial dashboard that he or she can use to track the progress of the business and assess how well the actual outcomes match the key assumptions made in the business plan.

THE LOAN OR INVESTMENT PROPOSAL The loan or investment proposal section of the business plan should state the purpose of the financing, the amount requested, and the plans for repayment or, in the case of investors, an attractive exit strategy. When describing the purpose of the loan or investment, an entrepreneur must specify the planned use of the funds. Entrepreneurs should state the precise amount requested and include relevant backup data, such as vendor estimates of costs or past production levels. The proposal should include all sources of funding for the business from all intended sources including money the entrepreneur is investing into the business. Most bankers and investors will want to see evidence that the entrepreneur is willing to "put skin in the game" and put some of his or her own money at risk in the venture.

Another important element of the loan or investment proposal is the repayment schedule or exit strategy. A lender's main consideration when granting a loan is the reassurance that the applicant will repay, whereas an investor's major concern is earning a satisfactory rate of return. Financial projections must reflect a company's ability to repay loans and produce adequate returns. Without this proof, a request for funding stands little chance of being approved. It is necessary for the entrepreneur to produce tangible evidence that shows the ability to repay loans or to generate attractive returns. Developing an exit strategy, such as the option to cash out through an acquisition or a public offering, is important. Include specific examples of other firms in the same industry that have already exited to increase the confidence that there is a viable path for the investors to exit the business and realize a return on their investments.

Finally, an entrepreneur should include a realistic timetable for implementing the proposed plan. This should include a schedule showing the estimated start-up date for the project and noting all significant milestones along the way.

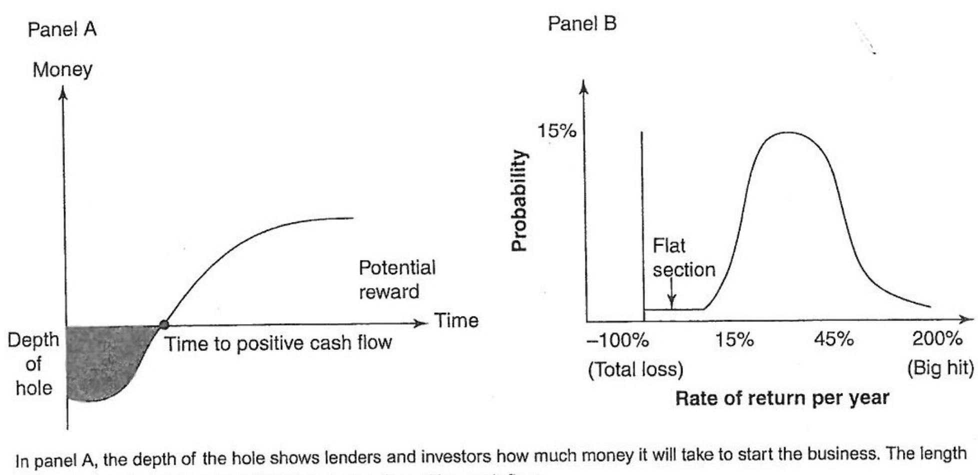
A business plan must present an honest assessment of the risks facing the new venture. Evaluating risk in a business plan requires an entrepreneur to walk a fine line, however. Dwelling too much on everything that can go wrong discourages potential lenders and investors from financing the venture. Ignoring the project's risks makes those who evaluate the plan see the entrepreneur as naïve, dishonest, or unprepared. The best strategy is to identify the most significant risks the venture faces and then to describe the plans the entrepreneur has developed to avoid them altogether or to overcome the negative outcome if the event does occur. Figure 5.1 explains how two simple diagrams communicate effectively to investors both the risks and the rewards of a business venture.

There is a difference between a working business plan (the one the entrepreneur is using to guide the business) and the presentation business plan (the one he or she is using to attract capital). Although coffee rings and penciled-in changes in a working plan don't matter (in fact, they're a good sign that the entrepreneur is actually using the plan), they have no place on a plan going to someone outside the company. A plan is usually the tool an entrepreneur uses to make

FIGURE 5.1

Visualizing a Venture's Risks and Rewards

Source: Based on William A. Sahlman, "How to Write a Great Business Plan," *Harvard Business Review*, July/August 1997, pp. 98–108.



In panel A, the depth of the hole shows lenders and investors how much money it will take to start the business. The length of the chasm shows how long it will take to reach positive cash flow.

Panel B shows investors the range of possible returns and the probability of achieving them. In this example, investors see that there is a 15 percent chance of a total loss and an equal chance that they will earn between 15 and 45 percent on their investment. There is also a small chance that their initial investment will yield a 200 percent return.

a first impression on potential lenders and investors. To make sure that impression is a favorable one, an entrepreneur should follow these tips:

- Realize that first impressions are crucial. Make sure the plan has an attractive (but not an expensive) cover.
- Make sure the plan is free of spelling and grammatical errors and typos. It is a professional document and should look like one.
- Make it visually appealing. Use color charts, figures, and diagrams to illustrate key points. Don't get carried away, however, and end up with a "comic book" plan.
- Include a table of contents with page numbers to allow readers to navigate the plan easily. Reviewers should be able to look through a plan and quickly locate the sections they want to see.
- Make it interesting. Boring plans seldom get read; a good plan tells an interesting story.
- Make the case that the business will make money. Start-ups do not necessarily have to be profitable immediately, but sooner or later (preferably sooner), they must make money.
- Use computer spreadsheets to generate a set of realistic financial forecasts. They allow entrepreneurs to perform valuable "what if" (sensitivity) analysis in just seconds.
- Always include cash flow projections. Entrepreneurs sometimes focus excessively on their proposed venture's profit forecasts and ignore cash flow projections. Although profitability is important, lenders and investors are much more interested in cash flow because they know that's where the money to pay them back or to cash them out comes from.
- Keep the plan "crisp," long enough to say what it should but not so long that it is a chore to read.
- Tell the truth. Absolute honesty is always critical when preparing a business plan.

Business plans are forecasts about the future that an entrepreneur plans to create, something that one expert compares to "taking a picture of the unknown," which is a challenging feat! As uncertain and difficult to predict as the future may be, an entrepreneur who launches a business without a plan, arguing that "trying to forecasting the future is pointless," is misguided. In the *Harvard Business Review*, William Sahlman says, "the best business plans . . . are like movies of the future. They show the people, the opportunity, and the context from multiple angles. They offer a plausible, coherent story of what lies ahead. They unfold the possibilities of action and reaction."[12] That's the kind of "movie" an entrepreneur should strive to create in a plan.

What Lenders and Investors Look for in a Business Plan

LO3

Explain the "five Cs of credit" and why they are important to potential lenders and investors receiving business plans.

To increase their chances of success when using their business plans to attract capital, entrepreneurs must be aware of the criteria lenders and investors use to evaluate the creditworthiness of businesses seeking financing. Lenders and investors refer to these criteria as the *five Cs of credit*: capital, capacity, collateral, character, and conditions.

CAPITAL A small business must have a stable capital base before any lender will grant a loan. Otherwise the lender would be making, in effect, a capital investment in the business. Most lenders refuse to make loans that are capital investments because the potential for return on the investment is limited strictly to the interest on the loan, and the potential loss would probably exceed the reward. In fact, the most common reasons banks give for rejecting small business loan applications are undercapitalization or too much debt. Investors also want to make sure entrepreneurs have invested enough of their own money into the business to survive the tenuous start-up period.

CAPACITY A synonym for capacity is cash flow. Lenders and investors must be convinced of a company's ability to meet its regular financial obligations and to repay the bank loan, and that takes cash. In Chapter 12, "Managing Cash Flow," you will see that more small businesses fail from lack of cash than from lack of profit. It is possible for a company to be earning a profit and still run out of cash. Lenders expect a business to pass the test of liquidity; they study closely a small company's cash flow position to decide whether it has the capacity required to succeed. Most lenders have become extremely cautious when evaluating cash flow since the financial crisis of 2008.

COLLATERAL Collateral includes any assets an entrepreneur pledges to a lender as security for repayment of the loan. If an entrepreneur defaults on the loan, the bank has the right to sell the collateral and use the proceeds to satisfy the loan. Typically, lenders make very few unsecured loans (those not backed by collateral) to business start-ups. Bankers view an entrepreneur's willingness to pledge collateral (personal or business assets) as an indication of dedication to making the venture a success. Bankers always look first at the personal assets of the entrepreneur because they represent the easiest way for them to get repaid on a loan if the business fails. Entrepreneurs must be ready to sign personal guarantees for all business loans, which state that they are personally liable for all bank loans to the business should the business fail. Business assets are lenders' last resort because, selling inventory, equipment, and buildings owned by the business to repay loans is not an easy or effective means of repayment for the bank.

CHARACTER Before putting money into a small business, lenders and investors must be satisfied with the owner's character. An evaluation of character frequently is based on intangible factors such as honesty, competence, polish, determination, knowledge, experience, and ability. Although the qualities judged are abstract, this evaluation plays a critical role in a lender's or investor's decision. Banks have also begun to use what potential clients post on social networking sites such as Facebook, LinkedIn, and Twitter to assess character. If the entrepreneur is closely tied to successful business people, this can help bolster the bank's assessment of character. On the other hand, posts and links that are unprofessional damage the lender's impression of the entrepreneur's character.

Lenders and investors know that most small businesses fail because of poor management, and they try to avoid extending loans to high-risk entrepreneurs. Preparing a solid business plan and a polished presentation can go far in convincing potential lenders and investors of an entrepreneur's ability to manage a company successfully.

CONDITIONS The conditions surrounding a loan request also affect the owner's chance of receiving funds. Banks consider factors relating to the business operation such as potential growth in the market, competition, location, form of ownership, and loan purpose. Again, the owner should provide this relevant information in an organized format in the business plan. Another important condition influencing the banker's decision is the shape of the overall economy, including interest rate levels, the inflation rate, and demand for money. Although these factors are beyond an entrepreneur's control, they still are an important component in a lender's decision. Conditions have not been as favorable for bank loans since the financial crisis in 2008, which has made getting business loans more difficult for all small businesses.

The higher a small business scores on these five Cs, the greater its chance will be of receiving a loan or an investment. Wise entrepreneurs keep this in mind when preparing their business plans and presentations.

LO4

Understand the keys to making an effective business plan presentation.

The Pitch: Making the Business Plan Presentation

Entrepreneurs who are informed and prepared when requesting a loan or investment impress lenders and investors. When entrepreneurs try to secure funding from lenders or investors, the written business plan most often precedes the opportunity to meet face-to-face. In recent years, some investors have moved away from requiring the submission of a formal business plan and instead based their interest on the entrepreneur's presentation of the business model. The written plan must first pass muster before an entrepreneur gets the opportunity to present the plan in person. Usually, the time for presenting a business opportunity is short, often no more than just a few minutes. (When presenting a plan to a venture capital forum, the allotted time is usually less than 20 minutes and rarely more than 30.) When the opportunity arises, an entrepreneur must be well prepared. It is important to rehearse, rehearse, and then rehearse some more. It is a mistake to begin by leading the audience into a long-winded explanation about the technology on which the product or service is based. Within minutes most of the audience will be lost, and so is any chance the entrepreneur has of obtaining the necessary financing for the new venture. A business plan presentation should cover five basic areas:

- Your company and its products and services. The presentation should answer in simple terms the first question that every potential lender and investor has: What does your company do?
- The problem to be solved, preferably told in a personal way through a compelling story. Is it eliminating the time, expense, and anxiety of waiting for the results of medical tests with a device that instantly reads blood samples? Or making hearing aids more effective at filtering out background noise while enhancing the dominant sound for the user?
- A description (again in simple terms) of your company's solution to the problem. Ideally, the solution your company has developed is unique and serves as the foundation of your company's competitive edge in the marketplace.
- Your company's business model. This part of the presentation explains how your company makes money and includes figures such as revenue per sale, expected gross profit and net profit margins, and other relevant statistics. This is your opportunity to show lenders and investors how your company will produce an attractive payback or payoff.
- Your company's competitive edge. Your presentation should identify clearly the factors that set your company apart from the competition.

No matter how good a written business plan is, entrepreneurs who stumble through the presentation will lose the deal. Entrepreneurs who are successful raising the capital their companies need to grow have solid business plans and make convincing presentations of them. Some helpful tips for making a business plan presentation to potential lenders and investors include:

- Prepare. Good presenters invest in preparing their presentations and knowing the points they want to get across to their audiences.
- Practice your delivery and then practice some more.
- Demonstrate enthusiasm about the business but don't be overemotional. Be genuine and be yourself.
- Focus on communicating the dynamic opportunity your idea offers and how you plan to capitalize on it. Fight the temptation to launch immediately into a lengthy discourse about the details of your product or service or how much work it took to develop it. Otherwise, you'll never have the chance to describe the details to lenders and investors.
- Hook investors quickly with an up-front explanation of the new venture, its opportunities, and the anticipated benefits to them. For some businesses a story of its impact can be a good hook to start a presentation.
- Use visual aids. They make it easier for people to follow your presentation. Don't make the mistake of making the visuals the "star" of the presentation, however. Visual aids should punctuate your spoken message and focus the audience's attention on the key points.
- Follow Guy Kawasaki's 10/20/30 rule for PowerPoint presentations. Use 10 slides that you can cover in 20 minutes. Use 30-point font to ensure you do not try to put too many words on each slide.[13]
- Explain how your company's products or services solve some problem and emphasize the factors that make your company unique.
- Offer proof. Integrate relevant facts into your presentation to prove your plan's claims, customers' satisfaction with your company's products or services, and its profit potential.

- Hit the highlights. Specific questions will bring out the details later. Don't get caught up in too much detail in early meetings with lenders and investors.
- Keep the presentation "crisp," just like your business plan. Otherwise, says one experienced investor, "Information that might have caused an investor to bite gets lost in the endless drone."[14]
- Avoid the use of technical terms that will likely be above most of the audience. Do at least one rehearsal before someone who has no special technical training. Tell him or her to stop you anytime he or she does not understand what you are talking about. When this occurs (and it likely will), rewrite that portion of your presentation.
- Remember that every potential lender and investor you talk to is thinking "What's in it for me?" Be sure to answer that question in your presentation.
- Close by reinforcing the potential of the opportunity. Be sure you have sold the benefits the investors will realize when the business succeeds.
- Be prepared for questions. In many cases, there is seldom time for a long "Q&A" session, but interested investors may want to get you aside to discuss the details of the plan.
- Anticipate the questions the audience is most likely to ask and prepare for them in advance.
- Be sensitive to the issues that are most important to lenders and investors by reading the pattern of their questions. Focus your answers accordingly. For instance, some investors may be interested in the quality of the management team whereas others are more interested in marketing strategies. Be prepared to offer details on either.
- Follow up with every investor to whom you make a presentation. Don't sit back and wait; be proactive. They have what you need—investment capital. Demonstrate that you have confidence in your plan and have the initiative necessary to run a business successfully.

You Be the Consultant

The Battle of the Plans

The Richards Barrentine Values and Ventures® Business Plan Competition, run by the Neeley Entrepreneurship Center at Texas Christian University, focuses on for-profit enterprises owned by current undergraduate students that specifically impact society in meaningful ways. Plans must demonstrate a societal or environmental need to be filled, such as contributions to sustainability, innovations in the health and life sciences, innovations in energy, or opportunities for underrepresented groups in business. Business plans submitted for the Values and Ventures competition must be for-profit values-centered enterprises. The competition defines a values-centered enterprise as one that assures sustainable prosperity while also supporting the needs of company owners and shareholders, employees and their families, suppliers, customers, communities, and the environment. This is not a competition for nonprofit social enterprises.

Values and Ventures is a two-day event. During the first day, teams present in concurrent sessions. The teams are grouped into flights. The first place team in each flight automatically advances to the finals. The second place teams in each flight compete in a "lightning round." The top two teams from the lightening round also make the finals. In the second day of competition, each finalist presents again to the judges. Each team gets 12 minutes to present and 10 minutes to respond to questions from the judges.

Mathew Wallis

You Be the Consultant *(continued)*

Teams that do not make the finals compete in an elevator pitch competition. One member from each non-finalist team is invited to participate in a 90-second elevator pitch on the second day of the competition.

One recent competition fielded teams from 28 universities. The third place team, winner of $5,000, was Sneeze4 from Texas Christian University. The venture sells tissues that support issues directed by the consumer. The second place team, winner of $10,000, was SoundSense from Christopher Newport University. SoundSense offers a home communication system for the hearing impaired. The first place team, winner of $15,000, was Crowdvance from George Washington University, founded by Dylan Fox, a self-taught Web site designer. Fox came up with the idea for Crowdvance while working on his design software and was able to attract a couple of fraternity brothers to help him launch the company.

Crowdvance supports small community groups, such as a Little League team struggling to pay for its uniforms or a high school debate team that needs money to enter a national competition. Donors to Crowdvance get a menu of exclusive deals, such as discounts on tickets or various products from national companies such as Hulu and Fathead. Crowdvance gets its revenues from its donors buying products through its Web site. Crowdvance charges no fee against the actual donation, which differentiates the company from its competitors, which charge a 3 to 10 percent fee. The small community groups get 100 percent of the donated funds.

After graduation, Fox began working full-time on Crowdvance. The company raised a seed round of financing.

Crowdvance reports that it increases the percentage of first-time donors for the charities it serves by 78 percent and has a 92 percent approval rating from its donors.

1. What benefits do entrepreneurs who compete in business plan competitions such as the one at Texas Christian University gain?
2. Work with a team of your classmates to brainstorm ideas for establishing a business plan competition on your campus. How would you locate judges? What criteria would you use to judge the plans? What prizes would you offer the winners, and how would you raise the money to give those prizes? Who would you allow to compete in your competition?
3. Using the ideas you generated in question 2, create a two-page proposal for establishing a business plan competition at your school.

Sources: "Neeley Entrepreneurship Center, Values and Ventures® Business Plan Competition," Neeley School of Business, Texas Christian University, n.d., www.neeley.tcu.edu/vandv/; "Case Studies," Crowdvance, n.d., www.crowdvance.com/case-studies/; Vanessa Small, "GWU students help small groups raise money," *Washington Post*, May 5, 2013, www.washingtonpost.com/business/capitalbusiness/gwu-students-help-small-groups-raise-money/2013/05/05/fffbc452-b422-11e2-9a98-4be1688d7d84_story.html; Annabelle Massey Malloy, "Profit and Virtue," *Fort Worth Weekly*, June 5, 2013, www.fwweekly.com/2013/06/05/profit-and-virtue/; "Crowdvance.com Now the Only Fundraising Platform on the Planet to not Charge a Service Fee and to Reward Donors," *Boston Globe*, June 18, 2013, http://finance.boston.com/boston/news/read/24447209/Crowdvance.com_Now_the_Only_Fundraising_Platform_on_the_Planet_to_not_Charge_a_Service_Fee_and_to_Reward_Donors.

Building a Strategic Plan

LO5

Understand the importance of strategic management to a small business.

The rules of the competitive game are constantly changing. To be successful, entrepreneurs must adapt to changes in the marketplace. Fortunately, entrepreneurs have at their disposal a powerful weapon to cope with an often hostile, ever-changing environment: the process of strategic planning. Strategic planning involves developing a game plan to guide a company as it strives to accomplish its vision, mission, goals, and objectives and to keep it from straying off course.

A solid strategic plan provides managers and employees a sense of direction when everyone is involved in creating and updating it. As more team members become committed to making the plan work, it takes on special meaning. It gives everyone targets to shoot for, and it provides a yardstick for measuring actual performance against those targets, especially in the crucial and chaotic start-up phase of the business.

Clate Mask, cofounder and CEO of Infusionsoft, credits strategic planning for the successful growth of his company from a small start-up to a 450-employee company funded with venture capital. Infusionsoft's strategic planning is built from a bold three- to five-year vision of what the business can become and what it can achieve. From there, the company develops three to five annual priorities that ensure progress toward the vision. Finally, managers develop the quarterly priorities and operational tactics necessary to reach their annual goals. "Strategic planning isn't a one-time event," says Mask. "Once you've laid out your strategy, it's crucial to stay focused over the long-term. I've found that it's vital to schedule a steady rhythm of productive meetings—annually, quarterly, monthly, weekly, and daily."[15]

ENTREPRENEURIAL PROFILE: Abt Electronics Abt Electronics is a family-owned business founded by David and Jewel Abt in Chicago, Illinois, in 1936. To compete with large national chains, such as Best Buy, Abt pursues several successful strategies. Abt installed several activity and play stations throughout its 350,000-square-foot store, including a flight simulator, a giant granite ball that floats on water, and aquariums teaming with sharks and other fish. Abt employees treat their customers well, offering them coffee and fresh-baked cookies. Abt offers extensive training for its employees and empowers them to offer customers discounts without the need for a supervisor's approval. Abt ties part of employee bonuses to customer service, rather than only to sales targets. Abt offers more than just electronics. Customers can buy watches, gourmet food, exercise equipment, furniture, and many other specialty products. Abt was an early entrant into online retailing, beginning Internet sales in 1998. Jon Abt, co-president of the company, says Best Buy's advertising helps build awareness of the products Abt sells in its store. Abt offers more than just its products—it offers an enjoyable experience for the entire family.[16] ■

Perhaps the biggest change that entrepreneurs face is unfolding now: the shift in the world's economy from a base of *financial to intellectual* capital. "Knowledge is no longer just a factor of production," says futurist Alvin Toffler. "It is the *critical* factor of production."[17] Today, a company's intellectual capital is likely to be the source of its competitive advantage in the marketplace. **Intellectual capital** is comprised of three components:[18]

intellectual capital
one source of a company's competitive advantage that consists of human, structural, or customer capital.

1. *Human capital* consists of the talents, creativity, skills, and abilities of a company's workforce and shows up in the innovative strategies, plans, and processes the people in an organization develop and then passionately pursue.
2. *Structural capital* is the accumulated knowledge and experience that a company possesses. It can take many forms, including processes, software, patents, copyrights, and, perhaps most important, the knowledge and experience of the people in a company.
3. *Customer capital* is the established customer base, positive reputation, ongoing relationships, and goodwill that a company builds up over time with its customers.

Increasingly, entrepreneurs are recognizing that the capital stored in these three areas forms the foundation of their ability to compete effectively and that they must manage this intangible capital base carefully. Every business uses all three components in its strategy, but the emphasis on each one varies from company to company.

ENTREPRENEURIAL PROFILE: Gabe Newell and Mike Harrington and Valve Corporation Valve Corporation, based in Bellevue, Washington, is a video game development and digital distribution company. Gabe Newell and Mike Harrington founded Valve in 1996, after leaving their positions at Microsoft. Valve's first video game success was Half-Life, which it released in 1998. Valve's 300 employees work in an organization that has no bosses and no formal managers. Any employee has the power to approve a new project and hire new employees. All desks are on wheels, allowing employees to move around freely and join any project that interests them. Valve CEO Gabe Newell, to whom nobody in the company officially reports, says the structure makes sense for what they produce. He says managers are good at creating procedures and processes. Because Valve must continuously create new games that have never existed, Newell believes managers would get in the way of employees' creativity.[19] ■

This knowledge shift is creating as much change in the world's business systems as the Industrial Revolution did in the agriculture-based economies of the 1800s. The Knowledge Revolution threatens the existence of those companies that are not prepared for it, but it is spawning tremendous opportunities for those entrepreneurs who are equipped with the strategies to exploit these opportunities. Management legend Jack Welch, who masterfully guided General Electric for many years, says, "Intellectual capital is what it's all about. Releasing the ideas of people is what we've got to do if we are going to win."[20] However, in practice, releasing people's ideas is much more difficult than it appears. The key is to encourage employees to generate a large volume of ideas, recognizing that only a few (the best) will survive. According to Gary Hamel, author of *Inside the Revolution*, "If you want to find a few ideas with the power to enthrall customers, foil competitors, and thrill investors, you must first generate hundreds and potentially thousands of unconventional strategic ideas. Put simply, you have to crush a lot of rock to find a diamond."[21] In other words, small companies must use the creativity-stimulating techniques discussed in Chapter 3 as one source of competitive advantage over their rivals.

Building a Competitive Advantage

LO6

Explain why and how a small business must create a competitive advantage in the market.

competitive advantage
the value proposition that sets a small business apart from its competitors and gives it a unique position in the market that is superior to its competition.

The goal of developing a strategic plan is to create for the small company a **competitive advantage**—the value proposition that sets a small business apart from its competitors and gives it a unique position in the market that is superior to its rivals. It is the differentiating factor that makes customers want to buy from your business rather than from your competitors. From a strategic perspective, the key to business success is to develop a sustainable competitive advantage, one that is durable, creates value for customers, and is difficult for competitors to duplicate. For example, Whole Foods competes successfully with giant chains such as Wal-Mart and Kroger not on price but by emphasizing superior customer service, higher-quality products, a more extensive inventory of local and organic products, and a commitment to fair-trade suppliers. Its stores are well organized, attractive, and entertaining. Asked to describe his recently opened Whole Foods store, team leader Matthew Mell says, "It's a Disney World for foodies."[22] Companies that fail to define their competitive advantage fall into "me-too" strategies that never set them apart from their competitors and do not allow them to become market leaders or to achieve above-average profits.

Entrepreneurs should examine five aspects of their businesses to define their companies' competitive advantages:

1. *Products they sell.* What is unique about the products the company sells? Do they save customers time or money? Are they more reliable and more dependable than those that competitors sell? Do they save energy, protect the environment, or provide more convenience for customers? By identifying the unique customer benefits of their companies' products, entrepreneurs can differentiate their businesses. Jason Lucash and Mike Szymczak developed their first audio speakers to solve their own problem. They wanted to develop speakers that would be easy to take along on trips. Their solution was speakers made of recycled cardboard that come flat and open up like an origami paper model. OrigAudio cardboard speakers caught on quickly with customers looking for inexpensive speakers with an edgy design. OrigAudio added eight more products to its line of audio speakers, including custom printed headphones that let customers choose their own unique designs. OrigAudio headphones sell for one-fifth the price of most major brands. "It's hard to be in a huge sector," says Lucash. "But if we stick to what we are good at, we will be successful."[23]

2. *Service they provide.* Many entrepreneurs find that the service they provide their customers is an excellent way to differentiate their companies. Because they are small, friendly, and close to their customers, small businesses can provide customer service that is superior to that which their larger competitors can provide. What services does the company provide (or which ones can it provide) to deliver added value and a superior shopping experience for customers?

3. *Pricing they offer.* As we will see later in this chapter, some small businesses differentiate themselves using price. Price can be a powerful point of differentiation; offering the lowest price gives some customers a great incentive to buy. However, offering the lowest price is not always the best way to create a unique image. Small companies that do not offer the lowest prices must emphasize the value their products offer.

4. *Way they sell.* Customers today expect to be able to conduct business when they want to, meaning that companies that offer extended hours—even 24-hour service seven days a week (perhaps via the Internet)—have the basis for an important competitive advantage. Zoots, a small chain of dry-cleaning stores in the Northeast, offers customers extended hours seven days a week and allows a secure 24-hour pickup and drop-off service. The company also offers a home pickup and delivery service that customers can book online and an environmentally friendly cleaning process, all of which maximize customers' convenience and set the company apart from its competition.[24]

5. *Values to which they are committed.* The most successful companies exist for reasons that involve far more than merely making money. The entrepreneurs behind these companies understand that one way to connect with customers and establish a competitive

edge is to manage their companies from a values-based perspective and operate them in an ethical and socially responsible fashion. In other words, they recognize that there is no inherent conflict between earning a profit and creating good for society and the environment.

Building a competitive advantage alone is not enough; the key to success over time is building a *sustainable* competitive advantage. In the long run, a company gains a sustainable competitive advantage through its ability to develop a set of core competencies that enable it to serve its selected target customers better than its rivals. **Core competencies** are a unique set of capabilities that a company develops in key areas, such as superior quality, customer service, innovation, team building, flexibility, and responsiveness, that allow it to vault past competitors. As the phrase suggests, they are central to a company's ability to compete successfully and are usually the result of important skills and lessons that a business has learned over time.

core competencies
a unique set of capabilities that a company develops in key areas that allow it to vault past competitors.

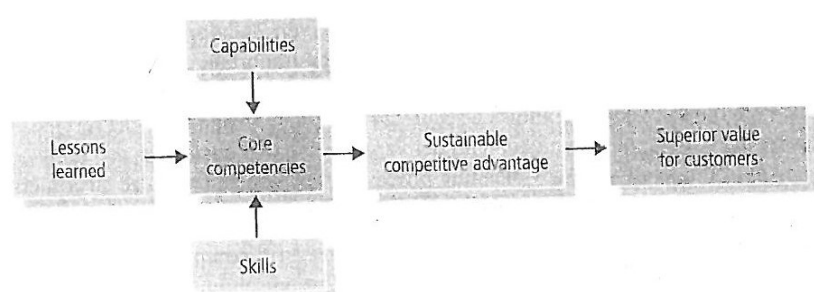
Typically, a company develops core competencies in no more than five or six (often fewer) areas. These core competencies become the nucleus of a company's competitive advantage and are usually quite enduring over time. Markets, customers, and competitors may change, but a company's core competencies are more durable, forming the building blocks for everything a company does. To be effective strategically, these competencies should be difficult for competitors to duplicate, and they must provide customers with an important perceived benefit. Small companies' core competencies often have to do with the advantages of their size, such as agility, speed, closeness to their customers, superior service, or the ability to innovate. Smart entrepreneurs use their companies' size to their advantage, recognizing that it allows them to do things that their larger rivals cannot. The key to success is building the company's strategy on its core competencies and concentrating them on providing value for target customers (see Figure 5.2).

Successful small companies are able to build strategies that exploit all the competitive advantages that their size gives them by doing the following:

- Responding quickly to customers' needs
- Providing the precise desired level of customer service
- Remaining flexible and willing to change
- Constantly searching for new, emerging market segments
- Building and defending small market niches
- Erecting "switching costs," the costs a customer incurs by switching to a competitor's product or service, through personal service and loyalty
- Remaining entrepreneurial and willing to take risks and act with lightning speed
- Constantly innovating

ENTREPRENEURIAL PROFILE: Kevin Reddy and Noodles & Company Noodles & Company is a restaurant chain that has grown to more than 350 U.S. locations since it opened

FIGURE 5.2
Building a Sustainable Competitive Advantage



its first store in 1996. The company has achieved this growth even after moving away from a franchising model, which is the most common strategic approach for growing restaurant chains. Kevin Reddy, Chairman and CEO of Noodles & Company, says the company may start selling franchises again at some point in the future, but its strategy is to build a solid base by staying close to customers and offering a simple menu built on noodles and pasta. Although the company has faced some pressure to grow more quickly since its IPO in 2013, managers are holding firm to their long-term strategic focus. The company continues to use feedback from its customers to adapt its business model and strategies. The company views its core competency as operational excellence used to build a strong brand. By owning most of the stores, Reddy says, the company focuses on growing its customers rather than adding a certain number of franchises. He says it also offers more opportunity for employees to grow and develop within the company, which creates a stronger team.[25] ■

No business can (or should) be everything to everyone. In fact, one of the biggest pitfalls many entrepreneurs stumble into is failing to differentiate their companies from the crowd of competitors. Entrepreneurs often face the challenge of setting their companies apart from their larger, more powerful competitors (who can easily outspend them) by using their creativity and the special abilities their businesses offer customers. Developing core competencies does *not* necessarily require a company to spend a great deal of money. It does, however, require an entrepreneur to use creativity, imagination, and vision to identify those things that it does best and that are most important to its target customers. Businesses have an infinite number of ways to create a competitive edge, but building a strategy around a company's core competencies allows it to gain a sustainable competitive advantage based on what it does best.

Strategic management enhances a small company's effectiveness, but entrepreneurs first must have a process designed to meet their needs and their business's special characteristics. It is a mistake to attempt to apply a big business's strategic development techniques to a small business because a small business is not merely "a little big business." Because of their size and their particular characteristics—small resource base, flexible managerial style, informal organizational structure, and adaptability to change—small businesses need a different approach to the strategic management process. The strategic management procedure for a small business should include the following features:

- Use a relatively short planning horizon—two years or less for most small companies.
- Be informal and not overly structured; a shirtsleeve approach is ideal.
- Encourage the participation of employees and outside parties to improve the reliability and creativity of the resulting plan.
- Do not begin with setting objectives because extensive objective setting early on may interfere with the creative process of strategic management.
- Maintain flexibility; competitive conditions change too rapidly for any plan to be considered permanent.
- Focus on strategic *thinking*, not just planning, by linking long-range goals to day-to-day operations.
- Be an ongoing process because businesses and the competitive environment in which they operate constantly change.

The Strategic Management Process

LO7

Develop a strategic plan for a business using the nine steps in the strategic management process.

Strategic management is a continuous process that consists of nine steps:

Step 1. Develop a clear vision and translate it into a meaningful mission statement.

Step 2. Assess the company's strengths and weaknesses.

Step 3. Scan the environment for significant opportunities and threats facing the business.

Step 4. Identify the key factors for success in the business.

Step 5. Analyze the competition.

Step 6. Create company goals and objectives.

Step 7. Formulate strategic options and select the appropriate strategies.

Step 8. Translate strategic plans into action plans.

Step 9. Establish accurate controls.

Step 1. Develop a Clear Vision and Translate It into a Meaningful Mission Statement

VISION Throughout history, the greatest political and business leaders have been visionaries. Whether the vision is as grand as Martin Luther King Jr.'s "I have a dream" speech or as simple as Ray Kroc's devotion to quality, service, cleanliness, and value at McDonald's, the purpose is the same: to focus everyone's attention on the same target and to inspire them to reach it. The vision is future oriented and touches everyone associated with the company—its employees, investors, lenders, customers, and the community. It is an expression of what an entrepreneur stands for and believes in. Highly successful entrepreneurs communicate their vision and their enthusiasm about that vision to those around them.

A vision is the result of an entrepreneur's dream of something successful that does not exist yet and the ability to paint a compelling picture of that dream for everyone to see. It answers the question, "Where are we going?" Former NFL player Nick Buoniconti started the Miami Project to Cure Paralysis with a vision to "cure spinal cord injury" after his son, Mark, was paralyzed by a football injury. This was considered an audacious goal at that time because spinal cord injuries were considered permanent and incurable. Buoniconti created a bold vision to help bring together supporters and researchers to move toward real progress in spinal cord treatment. Since its founding, the Miami Project has raised hundreds of millions of dollars for research that has led to critical breakthroughs in treating spinal cord injuries.[26] A strong vision helps a company in four ways:

1. ***Vision provides direction.*** Entrepreneurs who spell out the vision for their company focus everyone's attention on the future and determine the path the business will take to get there.
2. ***Vision determines decisions.*** The vision influences the decisions, no matter how big or how small, that owners, managers, and employees make every day in a business. This influence can be positive or negative, depending on how well defined the vision is.
3. ***Vision inspires people.*** A clear vision excites and ignites people to action. People want to work for a company that sets its sights high.
4. ***Vision allows for perseverance in the face of adversity.*** Young companies, their founders, and their employees often face many hardships from a multitude of sources. Having a vision that serves as a company's "guiding star" enables people to overcome imposing obstacles.

Vision is based on an entrepreneur's values. Explaining how an entrepreneur's values are the nucleus around which a company grows, author and consultant Ken Blanchard says, "Winning companies first emphasize values—the beliefs that you, as the business owner, have about your employees, customers, quality, ethics, integrity, social responsibility, growth, stability, innovation, and flexibility. Managing by values—not by profits—is a powerful process."[27] Successful entrepreneurs build their businesses around a set of three to seven core values that might range from respect for the individual and innovation to creating satisfied customers and making the world a better place. Indeed, truly visionary entrepreneurs see their companies' primary purpose as more than just "making money."

Business writer Thomas Stewart explains that works in small businesses don't just fill out forms and do menial work; they are also making important decisions. The entrepreneur must ensure that the workers' decisions are aligned with the company's strategic compass. The extent of that alignment depends on the entrepreneur's values and how well he or she transmits them throughout the company.* Table 5.1 offers useful tips for creating a vision for your company.

The best way to put values into action is to create a written mission statement that communicates those values to everyone the company touches.

MISSION The **mission statement** addresses another basic question of any business venture: "What business are we in?" Establishing the purpose of the business in writing must come first in order to give the company a sense of direction. "As an entrepreneur, your company's mission statement should be concise and specific so your customers understand your purpose and how you provide value to them," says serial entrepreneur Patrick Hull.[28] As an enduring declaration of a company's purpose, a mission statement is the mechanism for making it clear to everyone the company touches "why we are here" and "where we are going."

mission statement an enduring declaration of a company's purpose that addresses the first question of any business venture: What business are we in?

TABLE 5.1 Creating a Vision for Your Company

Ari Wienzweig, founder of Zingerman's Community of Businesses, emphasizes the importance of creating a vision to achieve entrepreneurial success. A vision is a picture of what success will look like in a business at a particular time in the future. "The power that comes out of visioning is huge," he says. "Effective visioning allows us to move toward the future we want, not just react to a present-day reality we don't like."

How does an entrepreneur start the visioning process? First, select the time frame, ideally 3 to 10 years out. The next step is to write the first draft of your vision, remembering to shoot for something *great*, even those things that other people have told you repeatedly were unachievable. As you proceed, write as if your vision already has happened. The following questions will help you get started:

1. How big is your business?
2. What has your business achieved that you are most proud of?
   a. Relative rank in your industry
   b. Financial success
   c. Product or service quality
   d. Contribution to the community
   e. Awards and recognitions
3. What are your most important product lines or services?
4. What products or services do you refuse to offer?
5. What is a customer's shopping experience like at your business? What makes that experience different from your competition?
6. Who are your customers? How did you find them?
7. If you asked your customers to list the three most noteworthy characteristics of your business, what would they be?
8. How do you describe your management style?
9. What kind of people do you hire as employees and managers?
10. What kind of relationship do you have with your employees? What do they say about their jobs?
11. What do you do every day when you go to work? How many hours a week do you work?
12. How does the community view your business?
13. What do suppliers say about your business?
14. What do industry experts say about your business?

You will probably write several drafts of your vision before sharing it with others, especially with the people who will be involved in making it a reality. Ask for their feedback and input, but remember: It's *your* vision. When people ask (and they inevitably will) "How will we achieve that?" remember that vision is about the "*what*"; strategy—the "*how*"—comes later.

Source: Based on Ari Weinzweig, "Creating a Company Vision," *Inc.*, February 1, 2011, www.inc.com/magazine/20110201/creating-a-company-vision.html/2.

Source: Thomas A. Stewart, "Why Values Statements Don't Work," *Fortune*, June 10, 1996, p. 137.

Without a concise, meaningful mission statement, a small business risks wandering aimlessly in the marketplace, with no idea of where to go or how to get there. A great mission statement sets the tone for the entire company and focuses its attention in the right direction.

Elements of a Mission Statement A sound mission statement need not be lengthy to be effective. In fact, shorter usually is better. The four key questions entrepreneurs and their employees should address as they develop a mission statement for their businesses are the following:

- What are we in business to accomplish?
- Who are we in business to serve?
- How are we going to accomplish that purpose?
- What principles and beliefs form the foundation of the way we do business?

A company's mission statement may be the most essential and basic communication that it puts forward. It should inspire and motivate employees by communicating the company's overarching values. If the people on the plant, shop, retail, or warehouse floor don't know what a company's mission is, then, for all practical purposes, it does not have one! The mission statement expresses a company's character, identity, and scope of operations, but writing it is only half the battle, at best. The most difficult and important part is *living* that mission every day. *That's* how employees decide what really matters. To be effective, a mission statement must become a natural part of the organization, embodied in the minds, habits, attitudes, and decisions of everyone in the company every day. In other words, a good mission statement is translated into positive performance within an organization. Five years after founding Field Trip Factory Inc., a business that organizes life skill educational field trips for students, Susan Singer saw the need to update the company's mission statement. At a company retreat, she and her employees decided that their existing mission statement no longer reflected what the company actually stood for and did. A brainstorming session yielded a new mission statement that Singer says is helping her company improve its bottom line. "It became so clear what we do vs. what we want to be," she says.[29]

A well-used mission statement serves as a strategic compass for a small company, guiding both managers and employees as they make decisions in the face of uncertainty. Some companies use short, one- or two-sentence mission statements that are easy to remember and understand, and others create longer mission statements with multiple components. Consider the following examples:

- Bongo World is the parent company of five coffee shops in Nashville, Tennessee all committed to serving organic, fair-trade coffee. Bongo World's mission: "Bongo World supports communities by expanding the definition of quality to include how stuff is produced, purchased and served."[30]
- Badger Mining Corporation, Berlin, Wisconsin: "We will be the leader in the industrial sand industry with a team of associates committed to excellence and a passion for satisfying our stakeholders."[31]
- Putney, Inc., located in Portland, Maine, manufactures generic prescription drugs for pets. Its mission is to "partner with veterinary practices to provide high-quality medicines that meet pet medical needs and offer cost-effective medicines for pet owners."[32]
- Nisolo Shoes is a social enterprise that supports artisans in developing countries by creating distribution and branding for their products. Co-founder Patrick Woodyard says its mission is as follows: "Nisolo is a socially conscious brand dedicated to offering a unique product that fuses quality and fashion with a vision to spur sustainable development throughout impoverished regions of the world."[33]
- The Clymb is a retailer of outdoor gear and apparel located in Portland, Oregon. "Our mission is to increase the well-being of the planet and its inhabitants by inspiring human-powered adventure."[34]

A company may have a powerful competitive advantage, but it is wasted unless (1) the owner has communicated that advantage to workers, who, in turn, work hard to communicate it to customers and potential customers and (2) customers recommend the company to their friends because they understand the benefits they are getting from it that they cannot get elsewhere. *That's* the real power of a mission statement. Table 5.2 offers some useful tips on writing a mission statement.

TABLE 5.2 Tips for Writing a Powerful Mission Statement

A mission statement is a useful tool for getting everyone fired up and heading in the same direction, but writing one is not as easy as it may first appear. Here are some tips for writing a powerful mission statement:

- *Keep it short.* The best mission statements are just a few sentences long. If they are short, people tend to remember them better.
- *Keep it simple.* Avoid using fancy jargon just to impress outsiders such as customers or suppliers. The first and most important use of a mission statement is inside a company.
- *Know what makes your company different.* Your competitors are trying to reach the same customers that you are. A mission statement should address what is unique about your company and what sets it apart from the competition.
- *Take a broad view, but not too broad.* If it is too specific, a mission statement can limit a company's potential. Similarly, a mission statement is too broad if it applies to any company in the industry. When asked what business his company was in, Rob Carter, a top manager at FedEx, did not mention shipping packages quickly; instead, his response was, "We're in the business of engineering time."
- *Get everyone involved.* If the boss writes the company mission statement, who is going to criticize it? Although the entrepreneur has to be the driving force behind the mission statement, everyone in the company needs the opportunity to have a voice in creating it. Expect to write several drafts before you arrive at a finished product.
- *Keep it current.* Mission statements can get stale over time. As business and competitive conditions change, so should your mission statement. Make a habit of evaluating your mission periodically so that it stays fresh.
- *Make sure your mission statement reflects the values and beliefs you hold dear.* They are the foundation on which your company is built.
- *Make sure your mission includes values that are worthy of your employees' best efforts.* One entrepreneur says a mission statement should "send a message to employees, suppliers, and customers as to what the purpose of the company is aside from just making profits."
- *Make sure your statement reflects a concern for the future.* Business owners can get so focused on the present that they forget about the future. A mission statement should be the first link to the company's future.
- *Keep the tone of the statement positive and upbeat.* No one wants to work for a business with a pessimistic outlook of the world.
- *Use your mission statement to lay an ethical foundation for your company.* This is the ideal time to let employees know what your company stands for—and what it won't stand for.
- *Look at other companies' mission statements to generate ideas for your own.* Two books, *Say It and Live It: The 50 Corporate Mission Statements That Hit the Mark* (Currency/Doubleday) and *Mission Statements: A Guide to the Corporate and Nonprofit Sectors* (Garland Publishing), are useful resources. Internet searches also produce useful examples of mission statements.
- *Make sure your mission statement is appropriate for your company's culture.* Although you should look at other companies' missions, do not make the mistake of trying to copy them. Your company's mission is unique to you and your company.
- *Revise it when necessary.* No business is static, which means that your company's mission statement should change as your company changes. Work with a team of employees on a regular basis to review and revise your company's mission statement.
- *Use it.* Don't go to all of the trouble of writing a mission statement just to let it collect dust. Post it on bulletin boards, print it on buttons and business cards, stuff it into employees' pay envelopes. Talk about your mission often, and use it to develop your company's strategic plan. That's what it's for!

urce: Based on "Ten Tips for Writing a Mission Statement," AllBusiness, http://www.allbusiness.com/marketing/vertising-copywriting/12185-1.html; Ken Blanchard, "The New Bottom Line," *Entrepreneur*, February 1998, . 127–131; Alan Farnham, Brushing Up Your Vision Thing," *Fortune*, May 1, 1995, p. 129; Sharon Nelton, "Put ur Purpose in Writing," *Nation's Business*, February 1994, pp. 61–64; Jacquelyn Lynn, "Single-Minded," *trepreneur*, January 1996, p. 97.

Step 2. Assess the Company's Strengths and Weaknesses

strengths
positive internal factors that a company can use to accomplish its mission, goals, and objectives.

weaknesses
negative internal factors that inhibit the accomplishment of a company's mission, goals, and objectives.

Having defined the vision they have for their company and translated that vision into a meaningful mission statement, entrepreneurs can turn their attention to assessing company strengths and weaknesses. Building a successful competitive strategy requires a business to magnify its strengths and overcome or compensate for its weaknesses. **Strengths** are positive internal factors that a company can draw on to accomplish its mission, goals, and objectives. They might include special skills or knowledge, a superior proprietary product or process, a positive public image, an experienced sales force, an established base of loyal customers, and many other factors. For instance, 1366 Technologies, a company in Lexington, Massachusetts, has developed a revolutionary process called the Direct Wafer method for producing the silicon wafers inside most solar panels. The process represents a major strength for the small company because it reduces wafer manufacturing costs 60 percent and reduces the time required to make a wafer from more than two days to just seconds.[35] **Weaknesses** are negative internal factors that inhibit a company's ability to accomplish its mission, goals, and objectives. Lack of capital, a shortage of skilled workers, the inability to master technology, and an inferior location are examples of weaknesses.

Identifying strengths and weaknesses helps owners understand their businesses as they exist (or that, for start-ups, will exist). An organization's strengths should originate in the core competencies that are essential to gaining an edge in each of the market segments in which the firm competes. The key to building a successful strategy is using the company's underlying strengths as its foundation and matching those strengths against competitors' weaknesses.

One technique for taking this strategic inventory is to prepare a "balance sheet" of the company's strengths and weaknesses (see Table 5.3). The left side should reflect important skills, knowledge, or resources that contribute to the firm's success. The right side should record honestly any limitations that detract from the company's ability to compete. This balance sheet should analyze all key performance areas of the business—human resources, finance, production, marketing, product development, organization, and others. This analysis should give owners a realistic perspective of their businesses, pointing out foundations on which they can build future strengths and obstacles that they must remove for the business to progress. This exercise can help entrepreneurs determine the best way to move from their current position to a desired one.

Step 3. Scan the Environment for Significant Opportunities and Threats Facing the Business

opportunities
positive external options that a company can exploit to accomplish is mission, goals, and objectives.

OPPORTUNITIES Once entrepreneurs have taken an internal inventory of company strengths and weaknesses, they must turn to the external environment to identify any opportunities and threats that might have a significant impact on the business. **Opportunities** are positive external options that a firm can exploit to accomplish its mission, goals, and objectives. The number of potential opportunities is limitless; therefore, entrepreneurs should analyze only those that are most significant to the business (probably two or three at most). The key is to focus on the most promising opportunities that fit most closely with the company's strengths and core competencies. That requires entrepreneurs to say "no" to opportunities, even promising ones, that do not fit their companies' strategic vision.

TABLE 5.3 **Identifying Company Strengths and Weaknesses**

Strengths (Positive Internal Factors)	Weaknesses (Negative Internal Factors)

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positive external options that a company can exploit to accomplish is mission, goals, and objectives.

TABLE 5.3 **Identifying Company Strengths and Weaknesses**

Strengths (Positive Internal Factors)	Weaknesses (Negative Internal Factors)

When identifying opportunities, an entrepreneur must pay close attention to new potential markets and product offerings. Are competitors overlooking a niche in the market we could easily exploit? Is there a better way to reach our customers, such as a greater focus on online sales? Are there new markets we can expand into with our existing business? Can we develop new products that offer customers better value? What opportunities are trends in the industry creating?

ENTREPRENEURIAL PROFILE: World Wrestling Entertainment The rapid growth in online streaming of video content led World Wrestling Entertainment (WWE) to shift away from relying on cable television distribution of its shows to launching its own 24/7 online streaming network. WWE Network airs all of the WWE live pay-per-view events, original programming, reality shows, documentaries, classic matches from its archives, and more than 1,500 hours of video on demand. Customers pay a flat monthly subscription fee to gain access to all WWE network content through its Web site and through apps that are compatible with most tablets and smart phones. Viewership of pay-per-view over cable and satellite television has been declining, while online streaming has continued to grow as a new medium for video content. WWE believes that the new business model provides an opportunity to generate more predictable and growing revenues.[36] ■

As WWE Network's experience illustrates, opportunities arise as a result of factors that are beyond entrepreneurs' control. Constantly scanning for those opportunities that best match their companies' strengths and core competences and pouncing on them ahead of competitors is the key to success.

threats
negative external forces that inhibit a company's ability to achieve its mission, goals, and objectives.

Threats are negative external forces that inhibit a company's ability to achieve its mission, goals, and objectives. Threats to the business can take a variety of forms, such as new competitors entering the local market, a government mandate regulating a business activity, an economic recession, rising interest rates, mounting energy prices, or technology advances making a company's product obsolete. For instance, the growing reach of cellular phone networks and advances in smart phone technology pose a threat to companies that provide traditional landline

Hands On . . . How To

Beat the Big Guys

It's the news that sends shivers down the spines of small business owners everywhere: Wal-Mart (or any other "big-box" retailer) is coming to town. "How can my small business compete against the largest retailer in the world?" they wonder. "Can my business survive?"

Although no business owner welcomes a threat of this magnitude from a giant competitor with greater buying power, more name recognition, and a reputation for driving small companies out of business, it is no reason to fold up the tent and go home. Smart entrepreneurs know that, by formulating and executing the proper strategy, they can not only survive in the face of larger competitors but also *thrive* in their presence.

Rule 1. Don't Play Their Game

A fundamental concept in strategy is to avoid matching your company's weaknesses against a competitor's strengths. For instance, because Wal-Mart buys in such huge volume from its suppliers, it can extract the lowest prices from them. Small companies purchasing from those same suppliers cannot; therefore, it makes little sense for small companies to try to compete with Wal-Mart and other giant retailers on price. Unless your small company has another more significant cost advantage, competing on the basis of price is a recipe for disaster. Entrepreneurs who compete successfully emphasize features that giant discounters cannot provide—extensive product knowledge, better selection, superior customer service, a hassle-free buying experience, higher quality, and others. "Not everyone wants the lowest quality at the lowest price," says one expert.

Rule 2. Emphasize the Unique Aspects of Your Company and How They Benefit Your Customers

Joe Runyan, founder of Hangers Cleaners of Kansas City, Missouri, was faced with the challenge of competing with Proctor & Gamble's entry into the dry cleaning market with its national rollout of Tide Dry Cleaners. Hangers Cleaners had been able to differentiate its service by offering an environmentally safe dry cleaning process. Hangers Cleaners uses liquid carbon dioxide instead of the harsh chemicals traditionally used by dry cleaners. However, Tide Dry Cleaning also offered eco-friendly dry cleaning services. To compete with a large national brand, Runyan pursued several strategies. Hangers focused on its offbeat image. The company sent out entertaining promotional e-mails, gave away T-shirts bearing the invitation to "Sniff Me," put funny messages on its hangers, and held a St. Patrick's Day tailgate party in the parking lot. The company also pays close attention to customer service. Hangers has several programs to help with fundraising for local nonprofits and schools. The company offers van service for pick-up and delivery to affluent neighborhoods willing to pay a premium

(continued)

Hands On . . . How To *(continued)*

for the extra service. Although many of the other local dry cleaners suffered after the entry of Tide Dry Cleaners, Runyan's business has continued to experience growth in revenues and profits.

Rule 3. Hit 'em Where They Ain't

Big companies usually aim at big markets and often ignore small but profitable niche markets, which are ideal targets for small companies. Ashley Rosebrook and Stefan Peters entered a crowded personalized photo printing industry with their Web site Pinhole Press. When researching the industry, they found that most of the competition offered too many choices for the most common customer—new grandparents and parents. By creating a simple site that is easy to use, Pinhole found a niche in the market. The founders recently sold Pinhole for $33 million to a large software company.

Rule 4. Hire the Best—and Train Them

Small companies usually cannot afford to pay the highest wages in an area; however, because their companies are small, entrepreneurs have the opportunity to create a work environment in which employees can thrive. For instance, one small company attracts and retains quality workers by allowing them to use flexible work schedules that make it easier for them to manage their busy lives. The owner also invests heavily in training workers so that they can move up the organization—and the pay scale—faster. The training pays off, however, in the form of greater productivity, lower turnover, increased customer satisfaction, and higher sales per employee. Paying attention to seemingly small details, such as more communication, frequent recognition for jobs well done, less bureaucracy, and flexible benefits, enables small companies to build a loyal, motivated workforce that can outperform those at larger companies.

Rule 5. Bring Back What the Big Boys Have Eliminated

Ron Samuels founded Avenue Bank in Nashville, Tennessee, in 2007, not long before the financial crisis rocked the banking industry. However, Avenue Bank not only survived one of the most difficult times in banking since the Great Depression, but the company's old-fashioned approach to banking also resulted in strong and steady growth. Avenue focuses on highly personalized service, which is no longer available in many national bank chains. Avenue Bank offers the same personalized service to small businesses and entrepreneurs. The bank works with start-ups by offering concierge services, working to meet their unique needs from start-up through growth.

Rule 6. Use the Cost Advantages of the Internet to Gain an Edge

Ernesto Perez-Carrillo Jr. and his family launched EPC Cigar as a premium cigar company. The promotional channels for cigars include taxi-top advertising in large cities, commercials on cable channels, radio ads in large markets, and print ads in national business magazines and specialty publications that cater to the wealthy. This type of advertising is quite costly and not always highly effective. One ad might cost up to half EPC Cigar's total marketing budget. Because the company could not afford a traditional advertising campaign, the company put its marketing budget into the Internet, social media initiatives, trade shows, and special events. EPC Cigar's sales grew to more than $1.5 million in revenue within the first year.

Rule 7. Be *Great* at Something Customers Value, Such as Service and Personal Attention

Do not make the mistake of choosing a "middle-of-the-road" strategy where, one writer says, there "are yellow lines, dead armadillos, and once-great companies that are slowly going out of business." Successful small companies differentiate themselves from their larger, more powerful rivals by emphasizing superior, friendly, personal service, something their size makes them uniquely capable of doing. Successful small companies also treat their customers like VIPs. Many small business owners know their customers by name, something that large companies cannot achieve. One of the best ways to determine exactly how to provide superior service and personal attention is to identify your top five customers and periodically ask them, "How can we serve you better?"

Rule 8. Get Involved in the Community

Entrepreneurs can make their small companies stand out from the crowd by supporting events in their local communities. A big budget is not a prerequisite. For instance, Pizza Ranch franchises host "community impact" nights. Family members and friends of employees bus tables to help fundraising for local causes. Pizza Ranch donates all of the evening's tips plus a matching share of the profits. The events generally draw additional donations from the community. The events help the franchises build relationships in the community and make genuine and enduring relationships with customers.

1. Why do many small businesses fail when a big discount retailer such as Wal-Mart enters their market?
2. Work with a team of your classmates to identify a local small business that competes with a bigger competitor. Which of these strategies has the small company employed to become a stronger competitor? What other strategies would you recommend to the owner of this business?
3. Based on your work in question 2, develop a one-page report summarizing your strategic suggestions.

Sources: Based on Chad Brooks, "10 Ways You Can Beat Wal-Mart," Business News Daily, April 20, 2011, http://www.businessnewsdaily.com/walmart-small-stores-1201; Norm Brodsky, "How Independents Can Hold Their Ground," *Inc.*, August 2007, pp. 65–66; Thomas M. Box, Kent Byus, Chris Fogliasso, and Warren D. Miller, "Hardball and OODA Loops: Strategy for Small Firms," *Proceedings of the Academy of Strategic Management* 6, no. 1 (2007): 5–10; Matthew Maier, "How to Beat Wal-Mart," *Business 2.0*, May 2005, pp. 108–114; Rhonda Abrams, "Small Businesses Can Compete with the Big Guys," *Business*, September 26, 2004, p. 8; Barry Cotton and Jean-Charles Cachon, "Resisting the Giants: Small Retail Entrepreneurs against Mega-Retailers—An Empirical Study," paper presented at the International Council for Small Business 2005 World Conference, June 2005; Amy Merrick, Gary McWilliams, Ellen Byron, and Kortney Stringer, "Targeting Wal-Mart," *Wall Street Journal*, December 1, 2004, pp. B1, B2; William C. Taylor, "The Fallacy of the 'Middle of the Road' Strategy," *BNET*, February 23, 2011, http://www.bnet.com/blog/innovator/the-fallacy-of-the-8220middle-of-the-road-8221-strategy/195; Jessica Shambora, "David vs. Goliath," *Fortune*, November 15, 2010, p. 55; Pamela Ryckman, "A Local Dry Cleaner Tries to Compete Against P.&G.," *New York Times*, April 14, 2010, www.nytimes.com/2010/04/15/business/smallbusiness/15sbiz.html?_r=1&; Judith Ohikuare, "How Pinhole Press Cut the Complexity and Got Noticed," *Inc.*, April 11, 2013, www.inc.com/best-industries-2013/judith-ohikuare/pinhole-press-cuts-the-complexity.html; "Avenue Bank Adds Four to the Team," *Nashville.com*, September 3, 2013, www.nashville.com/news/nashville-business-news/avenue-bank-adds-four-to-the-team; Jane Levere, "Choosing a Marketing Plan: Traditional or Social Media," *New York Times*, February 24, 2010, www.nytimes.com/2010/02/25/business/smallbusiness/25sbiz.html?ref=casestudies.

phone service and equipment. Landline phones reached their peak in 2001 when there were 57 fixed landlines (business and residential) for every 100 people. Just a decade later, more than half of all American households did not have or use a landline phone. A survey of Chief Information Officers found that 65 percent believed landline phones will likely disappear from everyday use by 2017. AT&T plans to end all landline service by the year 2020. Businesses that based their business models on the traditional landline phone system, such as companies manufacturing copper wire and telephone switching systems, face the ultimate threat to their future survival.[37]

Many small businesses face a threat from larger rivals who offer lower prices because of their high-volume purchasing power, huge advertising budgets, and megastores that attract customers for miles around. However, small businesses with the proper strategies in place do *not* have to fold in the face of intense competition. The accompanying "Hands On . . . How To" feature explains that, with the proper strategy, small companies cannot only survive but also thrive in the shadow of larger, more powerful rivals.

Opportunities and threats are products of the interactions of forces, trends, and events outside the direct control of the business. These external forces have direct impact on the behavior of the markets in which the business operates, the behavior of competitors, and the behavior of customers. The number of potential threats facing a business is huge, but entrepreneurs should focus on the three or four most significant threats confronting their companies. Table 5.4 provides a simple analytical tool to help entrepreneurs identify the threats that pose the greatest danger to their companies.

The interactions of strengths, weaknesses, opportunities, and threats can be the most revealing aspects of using a SWOT analysis as part of a strategic plan. This analysis also requires entrepreneurs to take an objective look at their businesses and the environment in which they operate, as they address many issues fundamental to their companies' success in the future.

TABLE 5.4 Identifying and Managing Threats

Every business faces threats, but entrepreneurs cannot afford to be paranoid or paralyzed by fear when it comes to dealing with them. At the same time, they cannot afford to ignore threats that have the potential to destroy their businesses. The most productive approach to dealing with threats is to identify those that would have the most severe impact on a small company and those that have the highest probability of occurrence.

Research by Greg Hackett, president of management think tank MergerShop, has identified 12 major sources of risk that can wreak havoc on a company's future. The following table helps entrepreneurs to determine the threats on which they should focus their attention.

Source	Specific Threat	Severity (1 = Low, 10 = High)	Probability of Occurrence (0 to 1)	Threat Rating (Severity × Probability, Max = 10)
1. Channels of distribution				
2. Competition				
3. Demographic changes				
4. Globalization				
5. Innovation				
6. Waning customer or supplier loyalty				
7. Offshoring or outsourcing				
8. Stage in product life cycle				
9. Government regulation				
10. Influence of special interest groups				
11. Influence of stakeholders				
12. Changes in technology				

Once entrepreneurs have identified specific threats facing their companies in the 12 areas (not necessarily all 12), they rate the severity of the impact of each one on their company on a 1 to 10 scale. Then they assign probabilities (between 0 and 1) to each threat. To calculate the Threat Score, entrepreneurs simply multiply the severity of each threat by its probability. (Maximum Threat Score is 10.) The higher a threat's score, the more attention it demands. Typically, one or two threats stand out above all of the others, and entrepreneurs should focus on those.

Source: Based on Edward Teach, "Apocalypse Soon," *CFO*, September 2005, pp. 31–32.

phone service and equipment. Landline phones reached their peak in 2001 when there were 57 fixed landlines (business and residential) for every 100 people. Just a decade later, more than half of all American households did not have or use a landline phone. A survey of Chief Information Officers found that 65 percent believed landline phones will likely disappear from everyday use by 2017. AT&T plans to end all landline service by the year 2020. Businesses that based their business models on the traditional landline phone system, such as companies manufacturing copper wire and telephone switching systems, face the ultimate threat to their future survival.[37]

Many small businesses face a threat from larger rivals who offer lower prices because of their high-volume purchasing power, huge advertising budgets, and megastores that attract customers for miles around. However, small businesses with the proper strategies in place do *not* have to fold in the face of intense competition. The accompanying "Hands On . . . How To" feature explains that, with the proper strategy, small companies cannot only survive but also thrive in the shadow of larger, more powerful rivals.

Opportunities and threats are products of the interactions of forces, trends, and events outside the direct control of the business. These external forces have direct impact on the behavior of the markets in which the business operates, the behavior of competitors, and the behavior of customers. The number of potential threats facing a business is huge, but entrepreneurs should focus on the three or four most significant threats confronting their companies. Table 5.4 provides a simple analytical tool to help entrepreneurs identify the threats that pose the greatest danger to their companies.

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Step 4. Identify the Key Factors for Success in the Business

KEY SUCCESS FACTORS Every business is characterized by controllable variables that determine the relative success of market participants. By focusing efforts to maximize their companies' performance on these key success factors, entrepreneurs can achieve dramatic market advantages over their competitors. Companies that understand these key success factors tend to be leaders of the pack, whereas those that fail to recognize them become also-rans.

key success factors the factors that determine a company's ability to compete successfully in an industry.

Key success factors (KSFs, also called key performance indicators) come in a variety of patterns, depending on the industry. Simply stated, these factors determine a company's ability to compete successfully in an industry. Every company in an industry must understand the KSFs that drive the industry; otherwise, they are likely to become industry also-rans like the horses trailing the pack in the Kentucky Derby. Many of these sources of competitive advantages are based on cost factors, such as manufacturing cost per unit, distribution cost per unit, or development cost per unit. Some are less tangible and less obvious but are just as important, such as superior product quality, solid relationships with dependable suppliers, superior customer service, a highly trained and knowledgeable sales force, prime store locations, readily available customer credit, and many others. For example, one restaurant owner identified the following KSFs:

- Experience in the industry
- Sufficient start-up capital
- Tight cost control (labor costs, 15 to 18 percent of sales, and food costs, 35 to 40 percent of sales)
- Accurate sales forecasting, which minimizes wasted food
- Proper inventory control
- Meticulous cash management
- Choosing locations that maximize customer convenience
- Cleanliness
- High food quality
- Friendly and attentive service from a well-trained wait staff
- Consistency in quality and service over time
- Speed, particularly at lunch, when the restaurant attracts businesspeople who must dine quickly and get back to work
- A clear definition of the restaurant's distinctive concept—its food, decor, service, and ambiance

These controllable variables determine the ability of any restaurant in this market segment to compete. Restaurants lacking these KSFs are not likely to survive, but those that build their strategies with these factors in mind will prosper. However, before entrepreneurs can build a strategy around the industry's KSFs, they must identify them. Table 5.5 presents a form to help owners identify the most important success factors in the industry and their implications for their companies.

Identifying the KSFs in an industry allows entrepreneurs to determine where they should focus their companies' resources strategically. It is unlikely that a company, even a large one, can excel on every KSF it identifies. Therefore, as they begin to develop their strategies, successful entrepreneurs focus on surpassing their rivals on one or two KSFs to build a sustainable competitive edge. As a result, KSFs become the cornerstones of a company's strategy. The last recession took a heavy toll on the casual dining sector of the restaurant industry, forcing many restaurants to refocus their attention on the KSFs in their respective market segments. At Chili's and Cracker Barrel, managers targeted lunch customers by making changes designed to reduce food preparation and service times. Recognizing that shaving even a few minutes from a lunch visit makes a huge difference for the lunch crowd, managers simplified lunch menus, streamlined their service procedures, retrained wait staff, and redesigned their kitchen layouts for maximum efficiency.[38]

TABLE 5.5 **Identifying Key Success Factors**

List the specific skills, characteristics, and core competences your business must possess if it is to be successful in its market segment.

Key Success Factor	How Your Company Rates . . .
1	Low 1 2 3 4 5 6 7 8 9 10 High
2	Low 1 2 3 4 5 6 7 8 9 10 High
3	Low 1 2 3 4 5 6 7 8 9 10 High
4	Low 1 2 3 4 5 6 7 8 9 10 High
5	Low 1 2 3 4 5 6 7 8 9 10 High

Conclusions:

In the hotly competitive gourmet burger segment of the industry, entrepreneurs behind chains such as Five Guys Burgers and Fries, Blazing Onion Burger Company, and In-N-Out are emphasizing KSFs to fuel their growth: high-quality burgers made from fresh ingredients, clean restaurants, superior service, and prices that offer good value. Because customers wait 10 minutes and pay anywhere from $5 to more than $10 for a burger at fast-growing chains such as these, managers make sure that customers understand that "this is not a typical fast-food burger joint." At Five Guys, which was founded in 1986 by CEO Jerry Murrell, his wife, and three sons, customers enjoy French fries that are hand cut daily and burgers made from fresh beef. Five Guys, now with more than 1,000 locations, is the fastest-growing restaurant chain in the United States. The Blazing Onion Burger Company, a small chain based in Mill Creek, Washington, offers customers 25 gourmet burgers made from fresh beef as well as a turkey burger, a veggie burger, a meatloaf burger, and an assortment of homemade desserts. Service at Blazing Onion, founded by David Jones in 2007, is paramount. Each table has a "Service Alert" card that resembles a stop sign; when customers post it, "we'll be there in 30 seconds," says Jones, who plans to open a new location every 10 months and recently began franchising.[39]

Step 5. Analyze the Competition

Ask most small business owners to identify the greatest challenge their companies face, and the most common response is *competition*. The Internet and e-commerce have increased the ferocity and the scope of the competition entrepreneurs face and have forced many business owners to change completely the ways in which they do business.

ENTREPRENEURIAL PROFILE: PJ's Coffee PJ's Coffee of New Orleans was founded seven years after Starbucks. While Starbucks grew to become the dominant global brand, PJ's Coffee has focused on establishing a strong local brand in New Orleans and growing locations in the Gulf Coast region. PJ's Coffee's strong regional brand has made it difficult for Starbucks to penetrate this region. PJ's Coffee follows a strategy that has been successful for many other regional brands competing against strong national brands. PJ's measures its success based on quality rather than quantity. Although Starbucks measures its success by the growth in number of retail outlets and market share, PJ's developed strong relationships with its farmers and local roasters. PJ's knows its customers and has developed niche products in response. Its growth strategy is based on organic growth and expanding distribution into regional grocery outlets.[40] ■

Keeping tabs on rivals' movements through competitive intelligence programs is a vital strategic activity. "Business is like any battlefield. If you want to win the war, you have to know who you're up against," says one small business consultant.[41] Unfortunately, most businesses are not very good at competitive intelligence: 97 percent of U.S. businesses do not systematically track the progress of their key competitors.[42] A study of business executives around the world by McKinsey and Company reports that just 23 percent of companies discovered a major competitive innovation by a competitor in time to be able to plan a response before the innovation hit the market.[43] The primary goals of a competitive intelligence program include the following:

- Conducting continuous rather than periodic analysis of competition
- Avoiding surprises from existing competitors' new strategies and tactics
- Identifying potential new competitors
- Improving reaction time to competitors' actions
- Anticipating rivals' next strategic moves

COMPETITOR ANALYSIS Sizing up the competition gives a business owner a realistic view of the market and his or her company's position in it. Yet not every competitor warrants the same level of attention in the strategic plan. *Direct competitors* offer the same products and services,

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Digital Franchise Seeks to Expand Nationwide

When Chris Jeffery was in college at Penn State in 2003, he noticed that very few restaurants had their menus posted on a Web site. Those that did have an Internet presence did not have online ordering for delivery or takeout. Jeffery started OrderUp to help restaurants and customers connect through its online platform.

After college, Jeffery proved the concept by licensing it to a small number of people. Once he had proof of concept, Jeffery was ready to scale and expand into other markets. He looked into raising venture capital but came away convinced that he would rather find a way to grow the business in a way that he could maintain control of the company.

After operating as LionsMenu while Jeffery was in college and LocalUp when he was first testing the concept, he eventually chose the name OrderUp for his venture. Jeffery was able to raise seed money from an angel investor but relied mostly on bootstrapping to establish a franchising model to grow the concept. However, Jeffery faced the challenge that no one had ever franchised an online business before.

OrderUp offers its franchises for an up-front cost of $42,000, which covers the software system, training, and territorial rights to a specific area defined by phone number area codes. OrderUp handles all of the order processing and customer support via online chat or telephone. OrderUp pays the restaurant for each order, after keeping 5 percent for the company and 5 to 9 percent for its franchisee. Customers have the convenience of viewing a wide variety of menu items from several restaurants on one online location.

The franchisees are responsible for selling the service to local restaurants and for connecting OrderUp with the local community. Social media also is an important tool for expanding the sales for each territory. Quick service restaurants are the most receptive to the OrderUp model. In many markets, franchisees are forging partnerships with restaurants to create special promotions, featured menu items, and even new products. Franchisees who are able to meet sales targets can earn more than $100,000 a year.

Bill Proferes, a veteran restaurateur, is an example of a successful OrderUp franchisee. After one year as owner of the Norfolk, Virginia, franchise, Proferes bought additional franchise rights in Norfolk. Proferes has signed up dozens of local restaurants to be partners with his OrderUp franchise.

By its 10th year in business, OrderUp had grown to 32 markets in 18 states, had more than 1,000 restaurants signed up to participate in its program, and had more than 400,000 registered users.

The company plans to continue this growth into mid-sized markets across the country, but faces competition from other companies developing online restaurant ordering Web sites and mobile applications.

1. Visit OrderUp Web site at https://orderup.com to learn more about the company. Work with a team of your classmates to identify the company's strengths and weaknesses.
2. What opportunities and threats does OrderUp face?
3. Identify OrderUp's major competitors. What are their strengths and weaknesses?
4. Write a short memo (two pages maximum) to Chris Jeffery and his management team describing your strategic recommendations for helping OrderUp gain and maintain a competitive advantage in their industry and realize their goals grow the company to become a national industry leader.

Sources: "OrderUp Internet Startups That Thriveb of Success Servicing the Norfolk Area," *Franchising.com*, October 30, 2013, www.franchising.com/news/20131030_orderup_celebrates_one_year_of_success_servicing_t.html; Minda Zetlin, "Digital Franchises: New Spin on an Old Business Model," *Inc.*, March 7, 2013, www.inc.com/minda-zetlin/orderup-founder-tells-vcs-to-get-lost-and-creates-first-digital-franchise-instea.html; "Online Ordering Platform Keeps It All in the Community," *QRS*, May 31, 2013, www.qsrmagazine.com/news/online-ordering-platform-keeps-it-all-community; Andrew Zaleski, "OrderUp: Canton Startup Invests in 'Digital Franchising' to Bring Online Food-ordering Nationwide," *Technically Baltimore*, January 28, 2013, http://technical.ly/baltimore/2013/01/28/orderup-localup-digital-franchise/; "We're in 32 Markets across the Country and Growing," OrderUp.com, n.d., https://orderup.com.

and customers often compare prices, features, and deals from these competitors as they shop. *Significant competitors* offer some of the same products and services. Although their product or service lines may be somewhat different, there is competition with them in several key areas. *Indirect competitors* offer the same or similar products or services only in a small number of areas, and their target customers seldom overlap yours. Entrepreneurs should monitor closely the actions of their direct competitors, maintain a solid grasp of where their significant competitors are heading, and spend only minimal resources tracking their indirect competitors.

Collecting competitive intelligence enables entrepreneurs to update their knowledge of top competitors by answering the following questions:

- What are the primary criteria customers used to choose among competitive businesses in your industry?
- Who are your primary competitors? Where are they located?
- What distinctive competencies have they developed?
- How do their cost structures compare to yours? Their financial resources?
- How do they promote their products and services?
- What do customers say about them? How do customers describe their products or services, their way of doing business, and the additional services they might supply?
- What are their key strategies?
- What are their strengths? How can your company counteract them?
- What are their major weaknesses? How can your company capitalize on them?
- Are new competitors entering the business?

According to the Society of Competitive Intelligence, 95 percent of the competitive intelligence information is available from public sources that anyone can access—if they know how.[44] Gathering competitive intelligence does not require entrepreneurs to engage in activities that are unethical, illegal, or unsavory (such as dumpster diving). One expert says competitive intelligence involves "taking information from the public domain, adding it to what you know about your company and your industry, and looking for patterns."[45] By collecting many nuggets of information about their competitors, entrepreneurs can assemble the pieces to make reliable inferences about their rivals' overall strategies. Entrepreneurs can use the following low-cost competitive intelligence methods to collect information about their rivals:

- Read industry trade publications for announcements and news stories about competitors.
- Ask questions of customers and suppliers about what they hear competitors may be doing. In many cases, this information is easy to gather because some people love to gossip.
- Regularly debrief employees, especially sales representatives and purchasing agents. Experts estimate that 70 to 90 percent of the competitive information a company needs already resides with employees who collect it in their routine dealings with suppliers, customers, and other industry contacts.[46]
- Attend industry "meet-ups" in your local community.
- Attend trade shows and collect competitors' sales literature.
- Monitor social media for insights into your direct competitors.
- Watch for employment ads and job postings from competitors; knowing what types of workers they are hiring can tell you a great deal about their future plans.
- Conduct patent searches for patents competitors have filed. This gives important clues about new products they are developing.
- Learn about the kinds and amounts of equipment and raw materials that competitors are importing by studying the *Journal of Commerce Port Import Export Reporting Service (PIERS)* database. These clues can alert an entrepreneur to new products that a competitor is about to launch.

- If appropriate, buy competitors' products and assess their quality and features. Benchmark their products against yours.
- Obtain credit reports on each of your major competitors to evaluate their financial condition. For less than $200, Dun & Bradstreet and other research firms provide detailed credit reports of competitors that can be helpful in a strategic analysis.
- Publicly held companies must file periodic reports with the Securities and Exchange Commission, including quarterly 10-Q and annual 10-K reports. Information on publicly held companies is available at the Securities and Exchange Commission Web site.
- Investigate Uniform Commercial Code reports. Banks file these with the state whenever they make loans to businesses. These reports often include the amount of the loan and what it is for.
- Check out the resources of your local library, including articles, computerized databases, and online searches. Press releases, which often announce important company news, can be an important source of competitive intelligence. Many companies supply press releases through the PR Newswire. For local competitors, review back issues of the area newspaper for articles on and advertisements by competitors.
- Visit competitors' Web sites periodically to see what news is contained there. The Web enables small companies to uncover valuable competitive information at little or no cost.
- Sign up for competitors' social media feeds for current news about their businesses.
- Visit competing businesses periodically to observe their operations. Tom Stemberg, CEO of Staples, a chain of office supply superstores, says, "I've never visited a store where I didn't learn something."[47]
- Don't resort to unethical or illegal practices.

competitive profile matrix
a tool that allows business owners to evaluate their companies against major competitors using the key success factors for that market segment.

Entrepreneurs can use the results of their competitive intelligence efforts to construct a competitive profile matrix for its most important competitors. A **competitive profile matrix** allows owners to evaluate their firms against the major competitor using the KSFs for that market segment. The first step is to list the KSFs identified in step 4 of the strategic planning process (refer to Table 5.5) and to attach weights to them reflecting their relative importance. (For simplicity, the weights in this matrix sum add up to 1.00.) In this example, notice that product quality is weighted twice as heavily (twice as important) as price competitiveness.

The next step is to identify the company's major competitors and to rate each one (and your company) on each of the KSFs:

If Factor Is a . . .	Rating Is . . .
Major weakness	1
Minor weakness	2
Minor strength	3
Major strength	4

Once the rating is completed, the owner simply multiplies the weight by the rating for each factor to get a weighted score and then adds up each competitor's weighted scores to get a total weighted score. Table 5.6 shows a sample competitive profile matrix for a small company. The results show which company is strongest, which is weakest, and which of the KSFs each one is best and worst at meeting. By carefully studying and interpreting the results, an entrepreneur can begin to envision the ideal strategy for building a competitive edge in his or her corner of the market. Notice that the small company profiled in Table 5.6 should emphasize the competitive advantages it holds over its rivals in quality and perception of value in its business strategy.

TABLE 5.6 Sample Competitive Profile Matrix

Key Success Factors (from Step 4)	Weight	Your Business Rating	Your Business Weighted Score	Competitor 1 Rating	Competitor 1 Weighted Score	Competitor 2 Rating	Competitor 2 Weighted Score
Quality	0.25	4	1.00	2	0.50	2	0.50
Customer retention	0.20	3	0.60	3	0.60	3	0.60
Location	0.15	4	0.60	3	0.45	4	0.60
Perception of value	0.20	4	0.80	2	0.40	3	0.60
Cost control	0.20	3	0.60	1	0.20	4	0.80
Total	1.00		**3.60**		**2.15**		**3.10**

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Finding a Niche with a Subscription Business Model

In his book *Break from the Pack*, Oren Harari explains how business owners can escape the problems of the "Copycat Economy, where everyone has access to the same resources and talent, where the Web is the great equalizer, and where the market's twin foundations are imitation and commoditization." He argues that too many businesses are stuck in the pack with "me-too" products and services that customers see as commodities. The danger of being stuck in the pack (or relying on a "middle-of-the-road strategy") is becoming what entrepreneur Terry Brock calls "disgustingly generic." What can small companies, which often lack the resources that large companies have, do to break from the pack strategically? Consider the lessons we can learn from the following small businesses that all rely on subscription services.

Dollar Shave Club

Michael Dubin, CEO of Dollar Shave Club, effectively uses social media to successfully compete with well-established national brands Schick and Gillette. Dollar Shave Club sends out razors to its subscribers that cost $1, $3, or $9 per month. The products are simple in design but are made of high quality materials. Dollar Shave Club partners with an overseas manufacturer. The 38 employees who work for Dollar Shave Club focus on marketing, order fulfillment, and product development. The company's YouTube video features Dubin, who uses humor and passion to try to convince people to buy shaving goods by mail rather than from the grocery store. The YouTube Dollar Shave Club commercial was viewed more than 13 million times in just two years and attracted hundreds of thousands of subscribers.

Citrus Lane

Mauria Finley used her own experience as a new mother to develop the business model for her company, Citrus Lane. Like many first-time mothers planning for the arrival of their first babies, Finley spent months planning her business model. She sent out e-mails to all her friends who already had babies, seeking advice on their favorite products and brands. Her e-mail in box was soon full of recommendations for a wide variety of products for her new baby. She realized other new mothers could benefit from the same wisdom from experienced mothers that she had received Citrus Lane is a subscription service that sends new parents "care packages" of products recommended by a panel of advisers and by Citrus Lane customers. Subscribers pay $25 per month to get a package with age-appropriate products for their children. Venture capital firms have endorsed the Citrus Lane concept with two rounds of financing of more than $6 million.

For the Makers

For the Makers is a subscription business built on the popularity of at-home craft projects. For the Makers sends its subscribers a monthly box that contains instructions and materials for four to six small craft projects. Most of the projects are jewelry or similar trinkets and take less than an hour to complete. Cofounders Janet Crowther and Katie Covington, who have past experience designing for national fashion brands, dream up the projects and develop the detailed instructions on how to make each project. The company also provides online tutorials for all of the projects it sells. For the Makers charges subscribers $29 per month for the materials and online support.

1. Which of the strategies discussed in this chapter are these companies using? Explain.
2. What competitive advantages does the successful execution of their subscription-based strategies produce for these businesses?
3. What are the risks associated with these companies' strategies?

Sources: Erica Swallow, "Ten Internet Startups That Thrive by Mail," *Forbes*, April 26, 2012, www.forbes.com/sites/ericaswallow/2012/04/26/internet-startups-by-mail/; Kathleen Davis, "Moss of the Month Club? 15 Unique Subscription Services," *Entrepreneur*, November 15, 2013, www.entrepreneur.com/slideshow/229916#0; Daniel Gross, "After 100 Years, the Shaving Industry Is Finally Being Disrupted," *Daily Beast*, January 24, 2014, www.thedailybeast.com/articles/2014/01/24/after-100-years-the-shaving-industry-is-finally-being-disrupted.html; Jennifer Van Grove, "Oh baby, Citrus Lane bags $5.1M to send care packages to new moms," *Venture Beat*, April 24, 2012, http://venturebeat.com/2012/04/24/citrus-lane-funding/; "Our Story," Citrus Lane, n.d., wwws.citruslane.com/about-us/; Fiorella Valdesolo, "What Do You Subscribe To?," *New York*, May 13, 2012, http://nymag.com/shopping/features/subscriptions-2012-5/; Ryan Kim, "For the Makers creates monthly boxes for DIY crafters," *Gigaom*, December 18, 2012; http://gigaom.com/2012/12/18/for-the-makers-creates-monthly-boxes-for-diy-crafters/.

Step 6. Create Company Goals and Objectives

Before entrepreneurs can build a comprehensive set of strategies, they must first establish business goals and objectives, which give them targets to aim for and provide a basis for evaluating their companies' performance. Without them, it is impossible to know where a business is going or how well it is performing. The following conversation between Alice and the Cheshire Cat, taken from Lewis Carroll's *Alice in Wonderland*, illustrates the importance of creating meaningful goals and objectives as part of the strategic management process:[48]

> "Would you tell me please, which way I ought to go from here?" asked Alice.
>
> "That depends a good deal on where you want to get to," said the Cat.
>
> "I don't much care where . . .," said Alice.
>
> "Then it doesn't matter which way you go," said the Cat.

A small business that "doesn't much care where" it wants to go (i.e., one that has no goals and objectives) will find that "it really doesn't matter which way" it chooses to go (i.e., its strategy is irrelevant).

goals
broad, long-range attributes that a business seeks to accomplish; they tend to be general and sometimes abstract.

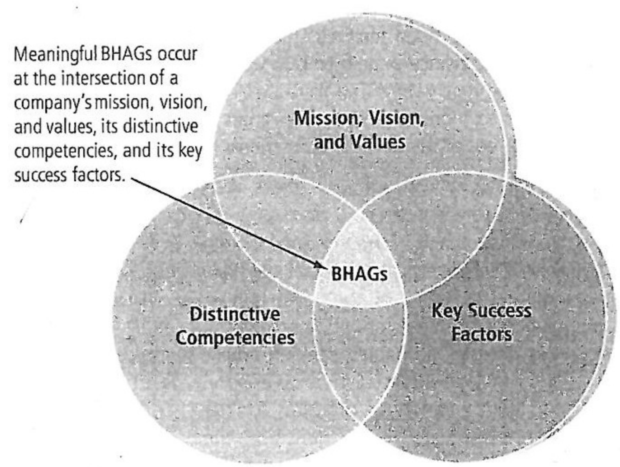
GOALS The broad, long-range attributes that a business seeks to accomplish are its **goals**; they tend to be general and sometimes even abstract. Goals are not intended to be specific enough for a manager to act on but simply state the general level of accomplishment sought. Do you want to boost your market share? Does your cash balance need strengthening? Would you like to enter a new market or increase sales in a current one? Do you want to develop new products or services? Researchers Jim Collins and Jerry Porras studied a large group of businesses for their book *Good to Great* and determined that one of the factors that set apart successful companies from unsuccessful ones was the formulation of ambitious, clear, and inspiring long-term goals. Collins and Porras called them BHAGs ("Big Hairy Audacious Goals," pronounced "bee-hags") and suggest that their main benefit is to inspire and focus a company on important actions that are consistent with its overall mission.[49] Figure 5.3 shows that effective BHAGs originate at the intersection of a company's mission, vision, and values; its distinctive competencies; and its KSFs. Addressing these broad issues will help entrepreneurs focus on the next phase—developing specific, realistic objectives.

objectives
more specific targets of performance, commonly addressing areas such as profitability, productivity, growth, and other key aspects of a business.

OBJECTIVES **Objectives** are more specific targets of performance. Common objectives concern profitability, productivity, growth, efficiency, sales, financial resources, physical facilities, organizational structure, employee welfare, and social responsibility. Because some of these objectives might conflict with one another, it is important to establish priorities. Which objectives are most important? Which are least important? Arranging objectives in a hierarchy according to their priority can help an entrepreneur resolve conflicts when they arise. Well-written objectives have the following characteristics:

They are specific. Objectives should be quantifiable and precise. For example, "to achieve a healthy growth in sales" is not a meaningful objective; however, "to increase retail sales

FIGURE 5.3
What Makes an Effective BHAG?



by 12 percent and wholesale by 10 percent in the next fiscal year" is precise and spells out exactly what management wants to accomplish.

They are measurable. Managers should be able to plot the organization's progress toward its objectives; this requires a well-defined reference point from which to start and a scale for measuring progress.

They are action commitments. Objectives are linked to specific actions. Ideally, managers and employees should be able to see how their jobs lead to the company achieving its objectives. ProviderTrust is a healthcare software company that is backed by venture capital, which means that the management team has specific revenue growth objectives investors expect the company to reach. The company holds 10- to 15-minute meetings with all 11 employees at the start of every day during which team members can talk about what they are working on to help the company achieve its revenue objectives.[50]

They are assignable. Unless an entrepreneur assigns responsibility for an objective to an individual, it is unlikely that the company will ever achieve it. Creating objectives without giving someone responsibility for accomplishing them is futile. Accountability is the key.

They are realistic yet challenging. Objectives must be within the reach of the organization, or motivation will disappear. In any case, managerial expectations must remain high. In other words, the more challenging an objective is (within realistic limits), the higher the performance will be. Set objectives that will challenge your business and its employees.

They are timely. Objectives must specify not only what is to be accomplished but also when it is to be accomplished. A time frame for achievement is important.

They are written down. Setting objectives does not have to be complex; in fact, an entrepreneur should keep the number of objectives relatively small (from 5 to 10). Writing down objectives makes them more concrete and makes it easy to communicate them to everyone in the company.

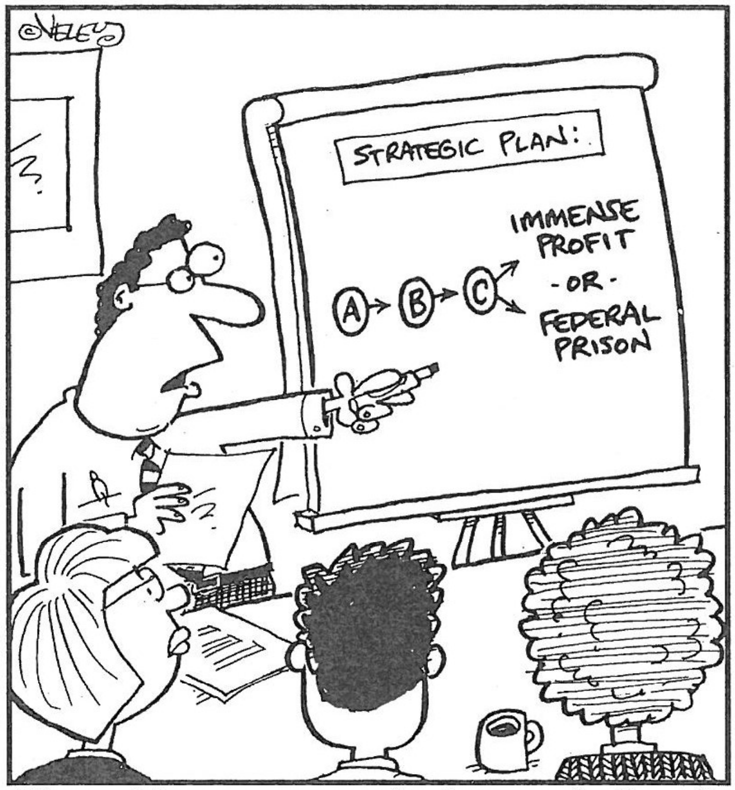
The strategic planning process works best when managers and employees work together to set goals and objectives. Developing a plan is top management's responsibility, but executing it falls to managers and employees; therefore, encouraging them to participate broadens the plan's perspective and increases the motivation to make the plan work. Unfortunately, although 65 percent of companies have a clear strategy, only 14 percent of employees understand their role in implementing the company's strategies.[51] A recent study by SuccessFactors reports that companies that set goals, align them with their companies' overall strategy, and measure employees' performance against those goals using multiple benchmarks financially outperform companies that do not. SuccessFactors cites three primary benefits of an effective goal-setting process: (1) increased profitability, (2) faster execution of company strategy, and (3) reduced employee turnover.[52]

Step 7. Formulate Strategic Options and Select the Appropriate Strategies

By this point in the strategic management process, entrepreneurs should have a clear picture of what their businesses do best and what their competitive advantages are. They also should understand their firms' weaknesses and limitations as well as those of their competitors. The next step is to evaluate strategic options and then prepare a game plan designed to achieve the stated mission, goals, and objectives.

strategy
a road map of the actions an entrepreneur draws up to fulfill the company's mission, goals, and objectives.

STRATEGY A **strategy** is a road map of the actions an entrepreneur draws up to accomplish a company's mission, goals, and objectives. In other words, the mission, goals, and objectives spell out the ends, and the strategy defines the means for reaching them. A strategy is the master plan that covers all the major parts of the organization and ties them together into a unified whole. The plan must be action oriented; it should breathe life into the entire planning process. An entrepreneur must build a sound strategy based on the preceding steps that uses the



"Stay with me now, people, because in Step C, things get a bit delicate."

Bradford Veley, www.cartoonstock.com

company's core competencies and strengths as the springboard to success. Joseph Picken and Gregory Dess, authors of *Mission Critical: The 7 Strategic Traps That Derail Even the Smartest Companies*, write, "A flawed strategy—no matter how brilliant the leadership, no matter how effective the implementation—is doomed to fail. A sound strategy, implemented without error, wins every time."[53]

ENTREPRENEURIAL PROFILE: Zina and Jason Santos and August Kitchen August Kitchen offers a meal starter for hamburgers, called J-BURGER, which was born in the kitchen of Zina and Jason Santos. Their friends kept wanting to take home some of the meal starter the couple used to zest up their burgers. In 2009, they invested about $100,000 of their own funds to try commercializing their product. Their first product was J-BURGER (the "J" is for Jason). To ensure that its product is fresh, which is a big selling point, August Kitchen partnered with a packager that could produce small batches tied to grocery store orders. Getting shelf space and building consumer awareness of J-BURGER has been a challenge. The Santoses spent many hours cooking mini-burgers to entice shoppers to take J-BURGER home with them. By working with stores that support local products and by listening to what consumers want, the company is gaining market acceptance. More than 60 retailers in 11 states now carry August Kitchen products. August Kitchen has added J-CHILI and J-MEATLOAF meal starters to its product line.[54] ■

A successful strategy is comprehensive and well integrated, focusing on establishing the KSFs that the entrepreneur identified in step 4. For instance, if maximum shelf space is a KSF for a small manufacturer's product, the strategy must identify techniques for gaining more in-store shelf space (e.g., offering higher margins to distributors and brokers than competitors do, assisting retailers with in-store displays, or redesigning a wider, more attractive package).

		Competitive Advantage	
		Uniqueness perceived by the customer	Low cost position
Target Market	Industry	Differentiation	Low cost
	Niche	Differentiation focus	Cost focus

FIGURE 5.4
Three Strategic Options

Source: Michael E. Porter, *Competitive Strategy* (New York: Free Press, 1980), chap. 2.

THREE STRATEGIC OPTIONS Obviously, the number of strategies from which the small business owner can choose is infinite. When all the glitter is stripped away, however, three basic strategies remain. In his classic book *Competitive Strategy*, Michael Porter defines these strategies: (1) cost leadership, (2) differentiation, and (3) focus (see Figure 5.4).[55]

COST LEADERSHIP A company pursuing a **cost leadership strategy** strives to be the lowest-cost producer relative to its competitors in the industry. Many companies attempt to compete by offering low prices, but low costs are a prerequisite for success. Low-cost leaders have a competitive advantage in reaching buyers whose primary purchase criterion is price, and they have the power to set the industry's price floor. This strategy works well when buyers are sensitive to price changes, when competing firms sell the same commodity products and compete on the basis of price, and when companies can benefit from economies of scale. Not only is a low-cost leader in the best position to defend itself in a price war, but it also can use its power to attack competitors with the lowest price in the industry.

cost leadership strategy
a strategy in which a company strives to be the low-cost producer relative to its competitors in the industry.

There are many ways to build a low-cost strategy, but the most successful cost leaders know where they have cost advantages over their competitors, and they use these as the foundation for their strategies. Successful cost leaders often find low-cost suppliers (or use a vertical integration strategy to produce their own products), eliminate the inefficiencies in their channels of distribution, use the Internet to cut costs, and operate more efficiently than their competitors. They are committed to squeezing every unnecessary cost out of their operations.

ENTREPRENEURIAL PROFILE: Eric Casaburi and Retro Fitness Eric Casaburi, founder and CEO of Retro Fitness, pursues a low-cost strategy in a highly competitive industry. Retro Fitness offers gym memberships at a rock bottom price of $19.99 per month in its more than 100 fitness centers in 13 states. Featuring a 1980s theme, Retro Fitness offers quality equipment and service with no additional frills. Casaburi keeps costs down by negotiating deals with suppliers and by carefully selecting low-cost sites. Instead of building 30,000-square-foot gyms, Retro Fitness is able to fit everything its customers need within a space one-third that size, which saves a significant amount of rent expense each month. Retro Fitness also offers additional products its customers want, such as smoothies, training sessions, and clothing, which adds to the monthly revenue per customer. The company offers an app as part of membership that allows customers to track their workouts, measure progress toward goals, make an appointment with a trainer, and order a smoothie from the smoothie bar. Casaburi plans to have 300 locations by 2018.[56] ■

Of course, there are dangers in following a cost leadership strategy. Sometimes a company focuses exclusively on lower manufacturing costs, without considering the impact of purchasing, distribution, or overhead costs. Another danger is incorrectly identifying the company's true cost drivers. Although their approach to managing is characterized by frugality, companies that understand cost leadership are willing to invest in those activities that drive costs out of doing business, whether it is technology, preventive maintenance, or some other factor. In addition, over time, competitors may erode a company's cost advantage by finding ways to lower their own costs. Finally, a firm may pursue a low-cost leadership strategy so zealously that, in its drive to push costs downward, it eliminates product or service features that customers consider to be essential.

Under the right conditions, a cost leadership strategy executed properly can be an incredibly powerful strategic weapon. Small discount retailers that live in the shadows of Wal-Mart and thrive even when the economy slows succeed by relentlessly pursuing low-cost strategies. Small chains, such as Fred's, Dollar General, Family Dollar, 99 Cents Only, and Dollar Tree, cater to low- and middle-income customers who live in inner cities or rural areas. They offer inexpensive products such as food, health and beauty products, cleaning supplies, clothing, and seasonal merchandise, and many of the items they stock are closeout buys (purchases made as low as 10 cents on the dollar) on brand-name merchandise. These companies also strive to keep their overhead costs as low as possible. For instance, 99 Cents Only, whose name describes its merchandising strategy, is housed in a no-frills warehouse in an older section of City of Commerce, California.[57] By keeping their costs low, these retailers offer customers prices that are within 1 to 2 percent of those at Wal-Mart, even though they do not benefit from the quantity discounts that the low-cost giant does. The success of these stores proves that companies pursuing a cost leadership strategy must emphasize cost containment in *every* decision, from where to locate the company headquarters to which items to stock.

differentiation strategy
a strategy in which a company seeks to build customer loyalty by positioning its goods or services in a unique or different fashion.

DIFFERENTIATION A company following a **differentiation strategy** seeks to build customer loyalty by selling goods or services that provide unique attributes and that customers perceive to be superior to competing products. That, in turn, enables the business to command higher prices for its products or services than competitors. There are many ways to create a differentiation strategy, but the key is to be unique at something that is important to the customer. In other words, a business strives to be better than its competitors at something customers value.

Phillip Tompkins, Tompkins Venture LLC, DBA Rent the Chicken

ENTREPRENEURIAL PROFILE: Jenn and Phillip Tompkins and RentTheChicken.com Jenn and Phillip Tompkins started RentTheChicken.com in Freeport, Pennsylvania, to take advantage of the growing interest in backyard, suburban farms. RentTheChicken.com takes the risk out of backyard farming for the first-time urban farmers. Every spring, the company brings two egg-laying chickens and all of the necessary supplies to its customers who are all located within about an hour of the company's headquarters. The Tompkins offer lessons to clients to help ensure their success at raising chickens. The chicken rental and supplies costs $350 a season. Then in the fall, RentTheChicken.com picks up the chickens to keep them safe and warm over the winter. If predators eat any of the rented chickens, the chickens are replaced at no cost. However, if a chicken dies from neglect, RentTheChicken.com picks up the equipment and charges the customer a fee. Environmentalists praise the business model because it reduces the number of chickens that end up in animal shelters after would-be urban farmers find raising chickens to be more work than they had assumed.[58] ■

If a small company can improve a product's (or service's) performance, reduce the customer's cost and risk of purchasing it, or provide intangible benefits that customers value (such as status, prestige, exclusivity, or a sense of safety), it has the potential to be a successful differentiator. Companies that execute a differentiation strategy successfully can charge premium prices for their products and services, increase their market share, and reap the benefits of customer loyalty and retention. To be successful, a business must make its product or service truly different, at least in the eyes of its customers.

Although few businesses are innately as unique as RentTheChicken.com, the goal for a company pursuing a differentiation strategy is to create that kind of uniqueness in the minds of its customers. The key to a successful differentiation strategy is to build it on a core competency something a small company is uniquely good at doing in comparison to its competitors. Common bases for differentiation include superior customer service, special product features, complete product lines, instantaneous parts availability, absolute product reliability, supreme product quality, and extensive product knowledge. To be successful, a differentiation strategy must create the perception of value in the customer's eyes. No customer purchases a good or service that fails to produce its perceived value, no matter how real that value may be. One business consultant advises, "Make sure you tell your customers and prospects what it is about your business that makes you different. Make sure that difference is on the form of a true benefit to the customer."[59]

Small companies encounter risks when pursuing a differentiation strategy. One danger is trying to differentiate a product or service on the basis of something that does not boost its performance or lower its cost to customers. Another pitfall is trying to differentiate on the basis of something customers do not see as important. Business owners also must consider how long they can sustain a product's or service's differentiation; changing customer tastes may make the basis for differentiation temporary. Imitations and "knockoffs" from competitors also pose a threat to a successful differentiation strategy. For instance, designers of high-priced original clothing see much cheaper knockoff products on the market shortly after their designs hit the market. Another pitfall is over-differentiating and charging so much that the company prices its products out of the market. The final risk is focusing only on the physical characteristics of a product or service and ignoring important psychological factors, such as status, prestige, and image, which can be powerful sources of differentiation.

FOCUS A **focus strategy** recognizes that not all markets are homogeneous. In fact, in any given market, there are many different customer segments, each having different needs, wants, and characteristics. Businesses with a focus strategy sell to these specific segments rather than try to sell to the mass market. Chris Anderson, editor-in-chief of *Wired Magazine,* in his book *The Long Tail*, explains that the digital age has opened up smaller niche market segments to smaller businesses, creating a long tail of niche markets (see Figure 5.5). Three drivers create the long tail of the market:[60]

focus strategy
a strategy in which a company selects one or more market segments; identifies customers' special needs, wants, and interests; and approaches them with a good or service designed to excel in meeting those needs, wants, and interests.

1. *The tools of production are more affordable.* Software and hardware are now much cheaper to buy and easier to use. For instance, in the past, musical artists recorded their work in a studio at a cost of thousands of dollars per song. Today, musicians no longer have to rely on large record companies to produce their music. With affordable software such as Pro Tools, artists can record and edit music with a personal computer or laptop anywhere. The quality of these recordings is so high that it is almost impossible to tell the difference between a recording made in a professional recording studio and one made in an artist's living room.
2. *The Internet has created better access to niche markets.* Internet aggregators can pull together all of the products consumers may possibly want. Amazon, iTunes, eBay, and many other Internet retailers have opened up distribution to many small businesses that would never have been able to achieve such broad market exposure. In addition, the company Web site is now a tool to reach consumers directly through digital advertising and social media.
3. *Search tools make it easier to reach specific consumers.* Search engines and recommendations available through Web sites and social media drive consumers to specific products and services on the Internet that meet their particular needs. For example, a consumer who traveled to the Czech Republic and wanted to buy some Czech crystal after getting home can easily search for Czech crystal manufacturers that ship abroad.

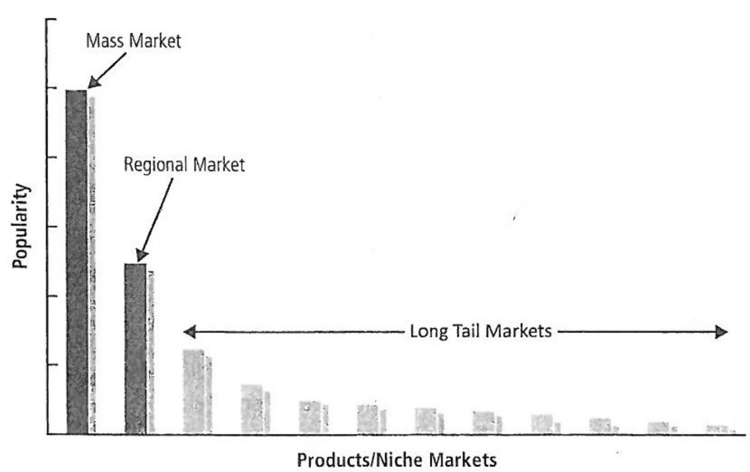


FIGURE 5.5
Long Tail Markets

Source: Anderson, Chris. *The long tail: Why the future of business is selling less of more.* (New York: Hyperion Books, 2008).

shareholder value. On balanced scorecards, companies often break their financial goals into three categories: survival, success, and growth.

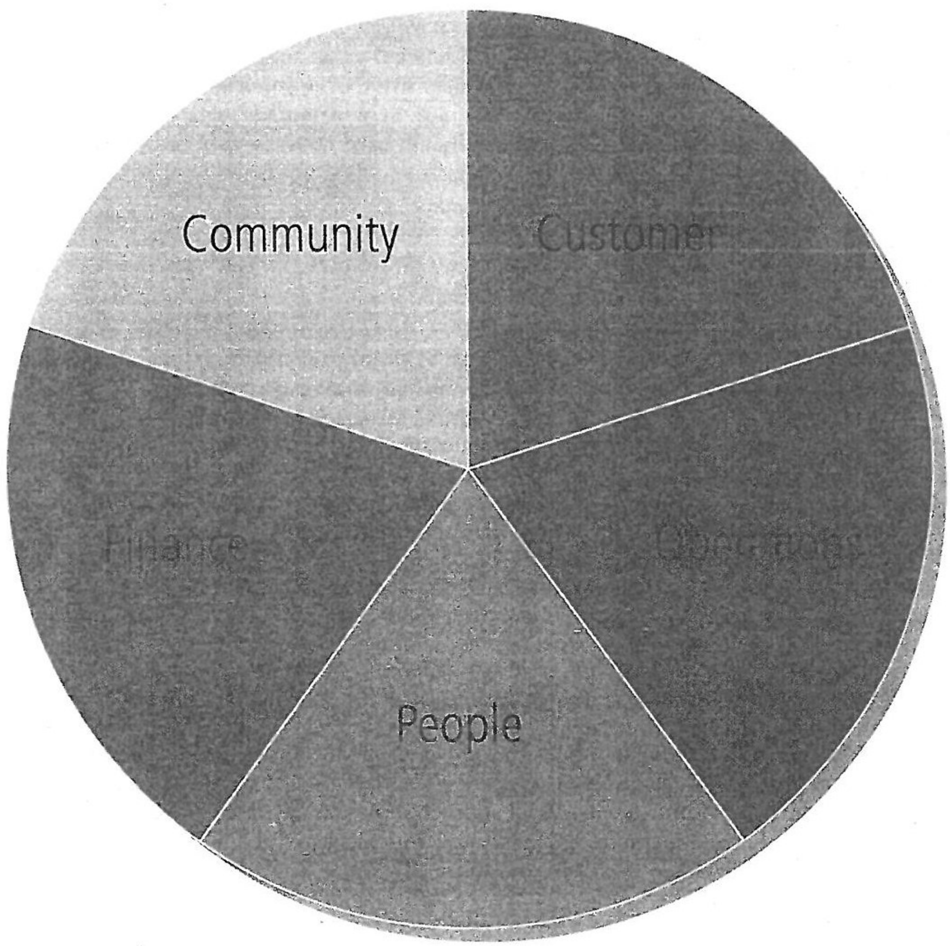
CORPORATE CITIZENSHIP How well are we meeting our responsibility to society as a whole, the environment, the community, and other external stakeholders? Even small companies must recognize that they must be good business citizens.

ENTREPRENEURIAL PROFILE: Tesco's Corporate Steering Wheel Tesco is a chain of nearly 5,400 food and general merchandise stores based in Cheshunt, Hertfordshire, United Kingdom, that operates in 14 markets in Europe, Asia, and North America. It is recognized as one of the most successful grocery chains in the world. The company recently developed a balanced scorecard called the Tesco Corporate Steering Wheel to implement and control its seven-part strategy. At the heart of the wheel is Tesco's philosophy, "Every little bit helps." Surrounding this are two customer-focused values statements ("No one tries harder for customers" and "Treat people how we like to be treated") that drive the way the company does business. The next ring shows 20 areas in which Tesco has developed specific objectives (e.g., "earn lifetime loyalty," "be responsible, fair and honest," "grow sales," "an interesting job," and others) that are separated into the five perspectives described earlier: customer, community, operations, people, and finance (see Figure 5.7). The Wheel works; Tesco's sales increased 31 percent, and its profit increased 36 percent in just a three-year period.[69] ■

FIGURE 5.7

Corporate Steering Wheel, an Application of the Balanced Scorecard

Source: Based on *Delivering Success: How Tesco Is Managing, Measuring, and Maximizing Its Performance*, Advanced Performance Institute, June 23, 2009, p. 4.



Although the balanced scorecard is a vital tool that helps managers keep their companies on track, it is also an important tool for changing behavior in an organization and for keeping everyone focused on what really matters. Used properly, balanced scorecards allow managers to see how actions in each of the five dimensions of performance influence actions in the others. As competitive conditions and results change, managers can use the balanced scorecard to make corrections in plans, policies, strategies, and objectives to get performance back on track. A practical control system is also economical to operate. Most small businesses have no need for a sophisticated, expensive control system. The system should be so practical that it becomes a natural part of the management process.

Conclusion

A solid business plan is essential to raising the capital needed to start a business; lenders and investors demand it. "There may be no easier way for an entrepreneur to sabotage his or her request for capital than by failing to produce a comprehensive, well-researched, and, above all, credible business plan," says one small business expert.[70] Creating a successful business requires entrepreneurs to put the plan into action and then manage the company's growth with a sound strategic plan.

The strategic planning process does *not* end with the nine steps outlined here; it is an ongoing procedure entrepreneurs must repeat. With each round, managers and employees gain experience, and the steps become easier. The planning process described here is designed to be simple. No small business should be burdened with an elaborate, detailed formal planning process it cannot easily use. Some planning processes require excessive amounts of time to operate and generate a sea of paperwork. Entrepreneurs need neither.

What does this strategic planning process lead to? It teaches business owners a degree of discipline that is important to business survival. It helps them learn about their businesses, their core competencies, their competitors, and, most important, their customers. Although strategic planning cannot guarantee success, it does dramatically increase a small company's chances of survival in a hostile business environment.

Sample Business Plan Outline

Although every company's business plan will be unique, reflecting its individual circumstances, certain elements are universal. The following outline summarizes these components.

I. Executive Summary (not to exceed one page)
   A. Company name, address, and phone number
   B. Name(s), addresses, and phone number(s) of all key people
   C. Brief description of the business, its products and services, the customer problems they solve, and the company's competitive advantage
   D. Brief overview of the market for your products and services
   E. Brief overview of the strategies that will make your company successful
   F. Brief description of the managerial and technical experience of key people
   G. Brief statement of the financial request and how the money will be used
   H. Charts or tables showing highlights of financial forecasts

II. Vision and Mission Statement
   A. Entrepreneur's vision for the company
   B. "What business are we in?"
   C. Values and principles on which the business stands
   D. What makes the business unique? What is the source of its competitive advantage?

III. Company History (for existing businesses only)
   A. Company founding
   B. Financial and operational highlights
   C. Significant achievements

IV. Company Products and Services
   A. Description
      1. Product or service features
      2. Customer benefits
      3. Warranties and guarantees
      4. Unique Selling Proposition (USP)
   B. Patent or trademark protection
   C. Description of production process (if applicable)
      1. Raw materials
      2. Costs
      3. Key suppliers
      4. Lead times
   D. Future product or service offerings

V. Industry Profile and Overview
   A. Industry analysis
      1. Industry background and overview
      2. Significant trends
      3. Growth rate
      4. Barriers to entry and exit
      5. Key success factors in the industry
   B. Outlook for the future
   C. Stage of growth (start-up, growth, maturity)

VI. Competitor Analysis
   A. Existing competitors
      1. Who are they? Create a competitive profile matrix.
      2. Strengths
      3. Weaknesses
   B. Potential competitors: Companies that might enter the market
      1. Who are they?
      2. Impact on your business if they enter

VII. Business Strategy
   A. Desired image and position in market
   B. Company goals and objectives
      1. Operational
      2. Financial
      3. Other
   C. SWOT analysis
      1. Strengths
      2. Weaknesses
      3. Opportunities
      4. Threats
   D. Competitive strategy
      1. Cost leadership
      2. Differentiation
      3. Focus

VIII. Marketing Strategy
   A. Target market
      1. Problem to be solved or benefit to be offered
      2. Demographic profile
      3. Other significant customer characteristics
   B. Customers' motivation to buy
   C. Market size and trends
      1. How large is the market?
      2. Is it growing or shrinking? How fast?

D. Personal selling efforts
   1. Sales force size, recruitment, and training
   2. Sales force compensation
   3. Number of calls per sale
   4. Amount of average sale
E. Advertising and promotion
   1. Media used (reader, viewer, listener profiles)
   2. Media costs
   3. Frequency of usage
   4. Plans for generating publicity
F. Pricing
   1. Cost structure
      a. Fixed
      b. Variable
   2. Desired image in market
   3. Comparison against competitors' prices
   4. Discounts
   5. Gross profit margin
G. Distribution strategy (if applicable)
   1. Channels of distribution used
   2. Sales techniques and incentives for intermediaries
H. Test market results
   1. Surveys
   2. Customer feedback on prototypes
   3. Focus groups

IX. Location and Layout
   A. Location
      1. Demographic analysis of location vs. target customer profile
      2. Traffic count
      3. Lease/rental rates
      4. Labor needs and supply
      5. Wage rates
   B. Layout
      1. Size requirements
      2. Americans with Disabilities Act compliance
      3. Ergonomic issues
      4. Layout plan (suitable for an appendix)

X. Description of management team
   A. Key managers and employees
      1. Their backgrounds
      2. Experience, skills, and know-how they bring to the company
   B. Résumés of key managers and employees (suitable for an appendix)
   C. Future additions to management team
   D. Board of directors or advisers

XI. Plan of Operation
   A. Form of ownership chosen and reasoning
   B. Company structure (organization chart)
   C. Decision-making authority
   D. Compensation and benefits packages
   E. Staffing plans

XII. Financial Forecasts (suitable for an appendix)
   A. Key assumptions
   B. Financial statements (year 1 by month, years 2 and 3 by quarter)

1. Income statement
2. Balance sheet
3. Cash flow statement

C. Break-even analysis

D. Ratio analysis with comparison to industry standards (most applicable to existing businesses)

XIII. Loan or Investment Proposal

A. Amount requested

B. Purpose and uses of funds

C. Repayment or "cash out" schedule (exit strategy)

D. Timetable for implementing plan and launching the business

XIV. Appendices (Supporting documentation, including market research, financial statements, organization charts, résumés, and other items)

Chapter Summary by Learning Objective

1. Explain the benefits of an effective business plan.

- A business plan, which builds off of information from the feasibility analysis and business model, serves two essential functions. First and more important, it guides the company's operations by charting its future course and devising a strategy for following it. The second function of the business plan is to attract lenders and investors. Applying for loans or attempting to attract investors without a solid business plan rarely attracts needed capital. Rather, the best way to secure the necessary capital is to prepare a sound business plan.
- An effective business plan should pass these three tests:
  - Reality test. The external component of the reality test revolves around proving that a market for the product or service really does exist. The internal component of the reality test focuses on the product or service itself.
  - Competitive test. The external part of the competitive test evaluates the company's relative position to its key competitors. The internal competitive test focuses on the management team's ability to create a company that will gain an edge over existing rivals.
  - Value test. To convince lenders and investors to put their money into the venture, a business plan must prove to them that it offers a high probability of repayment or an attractive rate of return.

2. Describe the elements of a solid business plan.

- Although a business plan should be unique and tailor-made to suit the particular needs of a small company, it should cover these basic elements: executive summary, mission statement, company history, business and industry profile, description of the company's business strategy, profile of its products or services, statement explaining its marketing strategy, competitor analysis, owners' and officers' résumés, plan of operation, financial data, and loan or investment proposal.

3. Explain the "five Cs of credit" and why they are important to potential lenders and investors reviewing business plans.

- Small business owners need to be aware of the criteria bankers use in evaluating the creditworthiness of loan applicants, known as the *five Cs of credit*: capital, capacity, collateral, character, and conditions.
- Capital—Lenders expect small businesses to have an equity base of investment by the owner(s) that will help support the venture during times of financial strain.
- Capacity—A synonym for capacity is cash flow. The bank must be convinced of the firm's ability to meet its regular financial obligations and to repay the bank loan, and that takes cash.
- Collateral—Collateral includes any assets the owner pledges to the bank as security for repayment of the loan.
- Character—Before approving a loan to a small business, the banker must be satisfied with the owner's character.
- Conditions—The conditions–interest rates, the health of the nation's economy, industry growth rates, etc.—surrounding a loan request also affect the owner's chance of receiving funds.

4. Understand the keys to making an effective business plan presentation.

- Entrepreneurs who are informed and prepared when requesting a loan or investment favorably impress lenders and investors.
- Tips include: Demonstrate enthusiasm about the venture, but don't be overemotional; "hook" investors quickly with an up-front explanation of the new venture, its opportunities, and the anticipated benefits to them; use visual aids; hit the highlights of your venture; don't get caught up in too much detail in early meetings with lenders and investors; avoid the use of technological terms that will likely be above most of the audience; rehearse your presentation before giving it; close by reinforcing the nature of the opportunity; and be prepared for questions.

5. Understand the importance of strategic management to a small business.

- Companies without clear strategies may achieve some success in the short run, but as soon as a competitive threat arises, they often fail.

6. Explain why and how a small business must create a competitive advantage in the market.

- The goal of developing a strategic plan is to create for the small company a competitive advantage—the combination of factors that sets the small business apart from its competitors and gives it a unique position in the market.
- Every small firm must establish a plan for creating a unique image in the minds of its potential customers.
- A company builds a competitive edge on its core competencies, which are a unique set of capabilities that a company develops in key operational areas, such as quality, service, innovation, team building, flexibility, responsiveness, and others, that allow it to vault past competitors. They are what the company does best and are the focal point of the strategy. This step must identify target market segments and determine how to position the firm in those markets.
- Entrepreneurs must identify some way to differentiate their companies from competitors.

7. Develop a strategic plan for a business using the nine steps in the strategic management process.

- Small businesses need a strategic planning process designed to suit their particular needs. It should be relatively short, be informal and not structured, encourage the participation of employees, and not begin with extensive objective setting.
- Linking the purposeful action of strategic planning to an entrepreneur's little ideas can produce results that shape the future.

  Step 1. Develop a clear vision and translate it into a meaningful mission statement. Highly successful entrepreneurs communicate their vision to those around them. The firm's mission statement answers the first question of any venture: What business am I in? The mission statement sets the tone for the entire company.

  Step 2. Assess the company's strengths and weaknesses. Strengths are positive internal factors; weaknesses are negative internal factors.

  Step 3. Scan the environment for significant opportunities and threats facing the business. Opportunities are positive external options; threats are negative external forces.

  Step 4. Identify the key factors for success in the business. In every business, key factors determine the success of the firms in it, so they must be an integral part of a company's strategy. KSFs are relationships between a controllable variable and a critical factor influencing the firm's ability to compete in the market.

  Step 5. Analyze the competition. Business owners should know their competitors almost as well as they know their own. A competitive profile matrix is a helpful tool for analyzing competitors' strengths and weaknesses.

  Step 6. Create company goals and objectives. Goals are the broad, long-range attributes that the firm seeks to accomplish. Objectives are quantifiable and more precise; they should be specific, measurable, assignable, realistic, timely, and written down. The process works best when managers and employees are actively involved.

  Step 7. Formulate strategic options and select the appropriate strategies. A strategy is the game plan the firm plans to use to achieve its objectives and mission. It must center on establishing for the firm the KSFs identified earlier.

  Step 8. Translate strategic plans into action plans. No strategic plan is complete until the owner puts it into action.

  Step 9. Establish accurate controls. Actual performance rarely, if ever, matches plans exactly. Operating data from the business assembled into a comprehensive scorecard serves as an important guidepost for determining how effective a company's strategy is. This information is especially helpful when plotting future strategies.

- The strategic planning process does not end with these nine steps; rather, it is an ongoing process that an entrepreneur will repeat.

- The three basic strategies a business can pursue are low cost, differentiation, and focus.
- Controls are essential for the effective implementation of a strategic plan. A balanced scorecard is a set of measurements unique to a company that includes both financial and operational measures and gives managers a quick yet comprehensive picture of the company's total performance.

Discussion Questions

5-1. Why should an entrepreneur develop a business plan?
5-2. Describe the three tests that an entrepreneur needs to pass in order to obtain external financing from potential lenders and investors.
5-3. Describe the major components of a business plan.
5-4. How are the three components of intellectual capital likely to become the source of a company's competitive advantage in the marketplace?
5-5. What are the 5 Cs of credit?
5-6. How do lenders and investors use the 5 Cs of credit when evaluating a request for financing?
5-7. How would you prepare to make a formal presentation of your business plan to a venture capital forum?
5-8. Why is strategic planning important to a small company?
5-9. What is a competitive advantage?
5-10. Why is a competitive advantage important for a small business to establish one?
5-11. How does an entrepreneur examine a company's competitive advantage?
5-12. Strategic management is a continuous process that consists of nine steps. List these nine steps.
5-13. How does an investor or lender evaluate the character of an entrepreneur before providing money for the small business?
5-14. What are the three components of a company's intellectual capital?
5-15. How does a company gain its sustainable competitive advantage?
5-16. Define core competency and discuss how important it is to a company's ability to compete successfully.
5-17. Why is setting objectives important?
5-18. What are business strategies?
5-19. Describe the three basic strategies available to small companies.
5-20. Under what conditions is each of the three basic strategies most successful?
5-21. Explain how a company can gain a competitive advantage using each of the three strategies described in this chapter: cost leadership, differentiation, and focus.
5-22. Give an example of a company that is using each of the three strategies.
5-23. How is the controlling process related to the planning process?
5-24. What are the five important perspectives that need to be included in an ideal balanced scorecard?
5-25. What value does a balanced scorecard offer entrepreneurs who are evaluating the success of their current strategies?

Beyond the Classroom . . .

5-26. Contact the owner of a small business that competes directly with an industry giant, such as Home Depot, Wal-Mart, or Barnes & Noble.

5-27. What does the owner see as his or her competitive advantage?

5-28. How does the business communicate this competitive advantage to its customers?

5-29. What competitive strategy is the owner using?

5-30. How successful is the competitive strategy?

5-31. What changes would you suggest the owner make?

5-32. In his book *The HP Way*, Dave Packard, cofounder of Hewlett-Packard, describes the seven commitments of the HP Way:

- Profit—the ultimate source of corporate strength.
- Customers—constant improvement in the value of the products and services the company offers them.
- Field of interest—seeking new opportunities but limiting them to complementary products and services based on company core competencies.
- Growth—a measure of strength and a requirement for survival.
- Employees—provide opportunities for advancement, share in their success, and offer job security based on performance.
- Organization—foster individual motivation, initiative, and creativity by giving employees the

freedom to work toward established goals and objectives.

- Citizenship—contribute in a positive way toward the community and society at large.

In what ways do these values help HP define its vision?

5-33. In what way do these values help HP define its competitive edge?

5-34. How important is it for entrepreneurs to define a system of values to guide their companies?

5-35. Contact a local entrepreneur and help him or her devise a balanced scorecard for his or her company.

5-36. What goals did you and the owner establish in each of the four perspectives?

5-37. What measures did you use to judge progress of the owner toward those goals?

5-38. Use the strategic tools provided in this chapter to help a local small business owner discover his or her firm's strengths, weaknesses, opportunities, and threats.

5-39. Use the strategic tools provided in this chapter to help identify the relevant KSFs.

5-40. Use the strategic tools provided in this chapter to help analyze its competitors.

5-41. Help the owner devise a strategy for success for his or her business.

5-42. Choose an entrepreneur in your community and interview him or her.

5-43. Does the company have a strategic plan?

5-44. Does the company have a mission statement?

5-45. Explain why the company does or does not have a mission statement.

5-46. What does the owner consider the company's strengths and weaknesses to be?

5-47. What opportunities and threats does the owner perceive?

5-48. What image is the owner trying to create for the business?

5-49. Has the effort been successful?

5-50. Do you agree with the owner's assessment of its effectiveness?

5-51. Which of the generic competitive strategies is the company following?

5-52. Who are the company's primary competitors?

5-53. How does the owner rate his or her chances for success in the future using a low [1] to high [10] scale?

5-54. Compare your evaluation with other classmates.

5-55. What, if any, generalizations can you draw from the interview?

Endnotes

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