INVESTICE DO ROZVOJE VZDĚLÁVÁNÍ

Silesian University in Opava
School of Business Administration in Karviná

ENTREPRENEURSHIP

IN SMALL AND MEDIUM SIZED BUSINESSES

For the full-time study form

Jarmila Šebestová

Karviná 2014

OP VK No. CZ.1.07/2.2.00/28.0017 Project „Innovation of study programmes at Silesian university in Opava, School of Business Administration in Karvina“

Subject: Organization and Management.

Annotation: The Mission of each business is to effectively provide its services so as to meet customer requirements and at the same time to contribute to the creation of value in the enterprise. The textbook called "Entrepreneurship in Small and Medium Sized Businesses" represents a comprehensive overview of the means needed to provide your own business with the capability of creating plans, budgeting, preparing strategies along with their monitoring and implementation within the scope of achieving targets. A business proprietor must often make decisions about portfolio services and their pricing; he must be able to analyze the strengths and weaknesses of each product on the basis of financial and non-financial indicators. One part of the study is also dedicated to the creation of a business plan, which is a natural part of the start-up phase. This publication is a new textbook for the subject “Small and Medium Sized Entrepreneurship” in the field of Economics and Management..

Key words: Entepreneurship, business plan, small business, management, strategies for success

Author: **Ing. Jarmila Šebestová, Ph.D.**

Recenzenti: Doplňte jména a příjmení včetně titulů

ISBN Doplní oddělení vědy a výzkumu.

CONTENT

INTRODUCTION

Create something that is unique ... If you set up a company selling widgets like the bloke down the road and the only difference is that yours are cheaper, you will make a living, but that is all you will achieve. If you can be truly differentiated and unique, then you really have something.

Martyn Dawes, founder of Coffee Nation

Entrepreneurship is seen as encouraging creativity and innovation in order to make things happen. Most of the chapters are connected with real stories of successful small businesses. This is about motivating you to develop your knowledge in the area of management, marketing, accounting, finance, personnel management and strategy development in the area of small business as the dominant form of business in the world today.

In any small business, there is always plenty of work to be done. This work includes physical labour as well as planning, organizing, and evaluating. What jobs need to be performed? How are these jobs going to be designated? Who is responsible for what? If problems or questions arise, who does a person go to for help or to get answers?

Someone will answer all of these questions and others about personnel. However, in many cases, the answers are not explicitly stated. Often a problem arises, and a decision on a solution is made without giving sufficient thought to the long-term implications of the quick-fix solution or the message that the solution may be sending to other co-operating family members or business employees.

In a practical sense, a “good” business idea has to become something more than just an idea. If you are interested in generating income from your idea, you will probably need to turn it into a product that satisfies a need so that you can market it. If you want to develop a product, you will need some type of organisational system to coordinate the resources necessary to turn it into reality (in other words, a business).

For the sake of argument, let us say that you would like to know a little more about going into business for yourself, in which case, you will want some answers to questions such as the following (Collins, 2008):

- Should I start a business?
- What are the advantages and disadvantages of starting a business?
- How do I come up with a business idea?
- Should I build a business from scratch, buy an existing business, or invest in a franchise?
- How do I go about planning a business?
- What steps are involved in developing a business plan?
- Where would I find help in getting my business started and operating it through the start-up phase?
- How can I increase the likelihood that I will succeed?

This textbook is designed to motivate you to find your own way of developing your entrepreneurial skills. These ideas are supported by examples of business plans, practical activities and pro forma business plans in enclosures. After studying this textbook student will be able to:

- Describe what entrepreneurship is and how it influences the economy.
- Recognise the risks and rewards of entrepreneurship.
- Understand the challenges and the motivations faced by an entrepreneur or an entrepreneurial team.
- Analyze the characteristics of a successful entrepreneur.
- Present an evaluation of an entrepreneurial activity.
- Outline a proposal for an entrepreneurial project.

1 INTRODUCTION TO ENTREPRENEURSHIP

Everywhere you turn; you will read or hear about entrepreneurs. If you open a current newspaper or general news magazine or log on to one of the Internet's news sites, chances are that you will find at least one story about successful entrepreneur. However, what exactly is it?

1.1 DEFINITION OF AN ENTREPRENEURSHIP

The modern interpretation of entrepreneurship derives from the French verb *entreprendre*, which means 'to undertake'. In this interpretation, the entrepreneur is describing as a 'go-between".

Entrepreneurship we could simplify into the process whereby an individual or a group of individuals uses organized effort to pursue opportunities to create value and grow by fulfilling needs through uniqueness of products or services. Therefore, entrepreneurship is about pursuing environmental trends and changes that no one else has seen or paid attention to.

DEFINITION 1 ENTREPRENEURSHIP

Entrepreneurship is the process of creating something new, with value, by devoting the necessary time and effort, assuming the accompanying financial, psychic, and social risks, and receiving the resulting rewards of monetary and personal satisfaction and independence (Hisrich and Peters, 2002).

This definition stresses four (4) basic concepts of entrepreneurship regardless of the field:

- **Entrepreneurship involves the creative process**; creating something new of value. The creation has to have value to the entrepreneur and value to the audience like customers of which it is developed.
- **Entrepreneurship requires** the devotion of the necessary time and effort to create something ***new*** and make it operational.
- **Assuming the necessary risk**. These risks concentrate on financial, psychological and social areas.
- **Rewards of being an entrepreneur**. The most important of these is independence, personal satisfaction and monetary rewards.

1.1.1 FORMS OF ENTREPRENEURSHIP ACTIVITY

Two major forms of entrepreneurial activities mainly discussed in literature, which are (Pinchot, Pellman, 1999):

- **Intrapreneurship**

Intrapreneurship describes innovative processes within the context of existing organizations; it would be private or public. The definition of intrapreneurship is similar to that of entrepreneurship except that intrapreneurship takes place within an organization. The major thrust of intrapreneuring, then, is to create or develop the entrepreneurial spirit within corporate boundaries, thereby allowing an atmosphere of innovation to prosper.

The need for intrapreneurship has arisen in response to the rapidly growing number of pressing problems organizations face, including a rapidly growing number of new and sophisticated competitors, an exodus of some of the best and brightest people who are leaving corporations to become small – business entrepreneurs, downsizing of major corporations, and an overall desire to improve efficiency and productivity. Finally, intrapreneurs are employees who are willing to take risk, innovate, and provide open opportunities for others. It is often more difficult to be an intrapreneur within an organization than an entrepreneur who may develop his or her own small business. The intrapreneur or organizational champion is seeing as not risking his / her own resources but those belonging to his company or firm.

Table 1 Comparison of Entrepreneurship and Intrapreneurship activities

Entrepreneurship	Intrapreneurship
It is run and managed by individual(s); they are known as entrepreneur(s).	Its evolution is by individual(s) known as intrapreneur(s).
This practice occurs outside a formal establishment (firm).i.e. the entrepreneur forms a new business.	It happens within a formal establishment. For instance coming out with an innovation in a firm which is not your own.
The person/entrepreneur is credited with the idea/concept both within and outside the business establishment.	The person/intrapreneur is known to the firm as the originator but not to the public.
The entrepreneur has full control over the idea.	Intrapreneurs do not exercise full control over their ideas.
The person/entrepreneur enjoys the full benefit over his/her initiatives as well as suffers the risk thereof.	Intrapreneur(s) do not enjoy the full benefit over initiatives developed.

Source: Pinchot, Pellman, 1999, Stokes, Wilson, 2008

- **Extrapreneurship**

It is a venturing process where employees of a company *spin-off* from their former employing company or place of work to establish a supplementary business. The business so established is often in the same line as business from the former place of work, since that individual has already acquired some experience in this line of business from the former place of work.

Finally, we would say that entrepreneurship (E) is a function of entrepreneurs (e) (Rwigema, 2008, p.7).

$$\boldsymbol{E} = \boldsymbol{f}\,(\boldsymbol{e}) \quad 1\text{-}1$$

1.2 DEFINITION OF AN ENTREPRENEUR

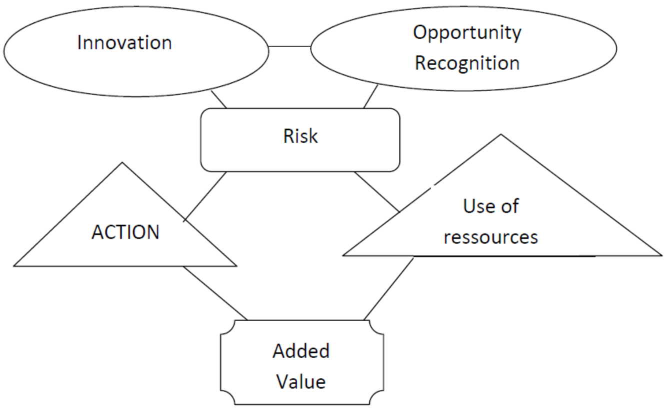
The entrepreneur we would define from many points of view. There are four main ways, how to deal with this phenomenon (Stokes, Wilson, 2010):

- **Economists** define an entrepreneur as one who brings resources, labour, raw material and other assets into combinations that increase their value.
- **Psychologists** define an entrepreneur as a person, who is driven by some forces, which create a desire to obtain or attain something.
- **Sociologists** define ‘entrepreneur’ as a person whose actions would determine his social status and who contributes to the development of society.
- **Management experts** define ‘entrepreneur’ as a person who has a vision and generates an action plan to achieve it.

Filion (2011) interrogates the origin and development of the term ‘entrepreneur’, revealing that it acquired its meaning in the 17th century, with Richard Cantillon being the first to offer a clear conception of the entrepreneurial function and its relation to innovation.

Entrepreneurs have existed throughout history. At various times, individuals spotted an opportunity and set up a structure to exploit it. They mobilised resources and traded or manufactured something for profit (Rwigema, 2008). According to the definition of entrepreneur, the model should include at least those six elements (see fig. 1).

Figure 1 Elements of an Entrepreneur



Source: Fillion, 201, p.49

Following this, an entrepreneur is an actor who innovates by recognizing opportunities; he or she makes moderately risky decisions that lead into actions requiring the efficient use of resources and contributing a benefit.

SOLVED EXERCISE 1 AM I AN ENTREPRENEUR?

Evaluate your own skills and make judgments about whether you are ready to own your own business. The following list of personal characteristics is designed to help you to analyse if you have what it requires being a successful entrepreneur. Analyze yourself carefully and honestly as you answer each question (Winston, 1979, p.34-35, Pickle, Abrahamson, 1990, p.656-657). The following questions are designed to help you analyse whether or not you have what it takes to be an entrepreneur. There are no right or wrong answers. You just need to be honest with yourself when answering the questions.

The results will give you an indication of whether you share the typical traits of an entrepreneur and allow you decide whether self-employment is the best route for you. **Imagine yourself in these situations and answer "Yes" if you are agree with the statement and "No" if you do not agree**.

1. Do I really have the desire to be my own boss rather than work for someone else?
2. Am I a self-starter?
3. Do I have management skills (managing finances, employees, and other aspects of the business)?
4. Do I have experience in the type of business I am interested in owning and operating?
5. Can I accept the responsibility of seeing things through the end?
6. Am I a well-organized person?
7. Do I have the desire to lead and direct others?
8. Can I make decisions quickly if I have to?
9. Do I have good health and the high level of energy necessary to be an entrepreneur?
10. Do I have the financial resources, as well as future credit resources I need to begin?
11. Can I sustain my business through the early, formative years?
12. Can people (customers and employees) trust what I say?
13. Do I have the need to set and achieve difficult goals and move on to other challenges?
14. Do I have the desire to be innovative and creative?

15. Do I prefer having a plan of action (business plan) before I begin an activity?
16. Are my partner and / or family supportive of my plan?
17. Am I on time for appointments?
18. Am I willing to work the long hours it takes to be an entrepreneur?
19. Do I have the desire to stick with the business even in troubled times?
20. Am I willing to do all the tasks necessary for the successful operation of the business?
21. Even though it is scary to try something new, am I the kind who tries it?
22. If I want something, do I ask for it rather than wait for someone to notice and just give it to me?
23. Even though people tell me it cannot be done, do I have to find out for myself?
24. I want to be financially independent.
25. I will speak up for an unpopular cause if I believe in it.
26. Can I take risks with money, that is, invest, and not know the outcome?
27. Have I taken a risk in the last 6 months?
28. Do I like trying new food, new places, and very new experiences?
29. Can I walk up to a total stranger and strike up a conversation?
30. Have I ever intentionally travelled on an unfamiliar route?

Result:

However, if most of your answers are yes, you probably have what it takes to become an entrepreneur. If you answered no to about half of the questions, you may need assistance to reinforce the areas where you are weak. If the majority of your answers are no, then entrepreneurship is likely not for you.

1.3 ENTREPRENEURIAL TRAITS

Entrepreneurial situations like those described in the test above attract individuals who possess attributes that are adapted to their challenges. People who possess these attributes are comfortable with, and have the qualities to succeed in, entrepreneurial situations. These attributes are commonly referred to as “traits,” “personality” or “mindset.” They consist of values, beliefs, attitudes, and behaviours that are functional within entrepreneurial contexts. Individually, non-entrepreneurs may possess many of these traits (see examples in the table 2).

Table 2 Examples of Entrepreneurial Traits

Area of Experience, knowledge	Examples of Traits
Opportunity focused	Inquisitiveness, opportunity-recognition, action-orientation (pro-active), need for achievement
Unstructured, uncertain	Tolerance of ambiguity, uncertainty, independence, self-starting, internal locus of control, individualism, risk propensity, creativity, innovative
Scarce resources	Networking, coalition building, teamwork, hero making, belief in personal efficacy, niche-craft, persistence, determination.
Dynamic, turbulent, fluid	Improvisation, empirical, pragmatic experimental, muddle through

Source: Pendergast, 2003, p.41

Remember, that entrepreneurs think differently than non-entrepreneurs. It could be seen from the work of Stokes and Wilson (2010), who present two sources of motivation to start own business:

- Pull influences
  - *desire for independence,*
  - *desire to exploit an opportunity,*

  - *turning a hobby or previous work experience into a business,*
  - *financial incentive.*
- Push influences
  - *redundancy,*
  - *threat of unemployment,*
  - *disagreement with previous employer.*

It seems that for start you would need to find the "need for achievement", for independence, ability to control the environment, risk taking propensity and self-efficacy, it means belief in your ability to undertake and accomplish some particular task or activity (compare the table 2 with the table 3).

Table 3 Activities and characteristics often attributed to entrepreneurs

1. Learning	Experience of a sector; memorized information; use of feedback.
2. Choosing a sector	Interest; motivation; assessment of potential benefit for the future.
3. Identifying a niche	Care; analytical capacities; precision; target.
4. Recognizing and developing an entrepreneurial opportunity	Originality; differentiation; creativity; intuition; initiative; culture that value innovation.
5. Visualizing protectively	Ability to dream realistically; conceptual skills; systemic thinking; anticipation; foresight; ability to set goals and objectives; visioning.
6. Managing risk	Thriftiness; security; conservatism; moderate risk-taker; ability to tolerate uncertainty and ambiguity; independence.
7. Designing (products, services, organizations)	Imagination; problem-solving skills.
8. Committing to action	Self-confidence related to clearly defined identity; long-term commitment; hard-worker; energy; result-orientation; decision-making; passion; locus-of-control; determination; perseverance; tenacity.
9. Using resources	Resourcefulness; coordination; control.
10.Building relations systems	Networking skills; flexibility; empathy; listening and communication skills; use of mentors; vision.
11.Managing – sales; negotiations; people – and delegating	Versatility; adaptability; capacity to design tasks; ability to trust.
12.Developing	Leadership; seeks challenges.

Source: Fillion, 2011 p.47

SOLVED EXERCISE 2 ENTREPRENEURIAL SELF-ASSESSMENT TEST

This survey is for your personal information[1]. Please answer each of the following questions as honestly as possible. Use following scale 5 to 1, when 5 is Strongly Agree, four is Mostly Agree, three is Somewhat Agree, two is Mostly Disagree and one is Strongly Disagree. Total the numbers you placed before the statements and enter the total in the space provided. **Compare your results with other test in the Enclosure no.1 – What is your Entrepreneurial Quotient (EQ).**

______1. I am willing to work 50 hours or more per week regularly.
______2. My family will support my going into business.
______3. I am willing to accept both financial and career risks when necessary.
______4. I do not need all the fringe benefits provided by conventional employment.
______5. I would like to take full responsibility for the successes and failures of my business.
______6. I would experience more financial success by operating my own business.
______7. I feel a great deal of pride when I complete a project successfully.

[1]Entrepreneurial Self-Assessment Test [online]. [Accessed: 17 Jan 2013]. Available at: http://www.wrdf.org/assets/docs/Entrepreneur%20Self-Assessment%20Survey.pdf

_____8. I have a high energy level that can be maintained over a long time.
_____9. I enjoy controlling my own work assignments & making all decisions affecting my work.
____10. I believe that I am primarily responsible for my own successes and failures.
____11. I have a strong desire to achieve positive results even when it requires a great deal of additional effort.
____12. I have a good understanding of how to manage a business.
____13. I can function in ambiguous situations.
____14. One or both of my parents were entrepreneurs.
____15. I believe that my abilities and skills are greater than those of most of my co-workers are.
____16. People trust me and consider me honest and reliable.
____17. I always try to complete every project I start, regardless of obstacles and difficulties.
____18. I am willing to do something even when other people laugh or belittle me for doing it.
____19. I can make decisions quickly.
____20. I have a good network of friends, professionals, and business acquaintances.
TOTAL: _____

Score Assessment (points)
80 - 100
You have outstanding ability to be an entrepreneur.
60 - 79
You have satisfactory ability to be an entrepreneur.
40 - 59
Self-employment may not be an appropriate career for you.
0 - 39
You should probably avoid entrepreneurship.

Characteristics of an Entrepreneur

The following list describes some common characteristics of an entrepreneur. The number(s) after each characteristic indicates the related statement(s) in the assessment form. This list interprets the form qualitatively. Note that arriving at a conclusive portrait of a typical entrepreneur is very difficult. Therefore, you may score low on the assessment and still succeed as an entrepreneur.

Works Hard (Statements 1 & 8)

Self-employment requires a great deal of time and effort. The entrepreneur must perform a wide variety of time-consuming tasks. 77 % of all entrepreneurs report working 50 hours or more per week, and 54% say that they work more than 60 hours per week. Such a time commitment requires that you have a high energy level.

Is Energetic (Statements 1 & 8)

Self-employment requires long work hours. You will frequently be unable to control the number of hours required to fulfil all the necessary tasks. The entrepreneur must have a high energy level to respond to the job's demands

Has Family Support (Statement 2)

A successful entrepreneur needs family support. If you are married, your spouse must believe in your business because it will require that both of you sacrifice time and money. The stress may create disruptions in family relationships. If you have children, they will need encouragement in understanding your need to spend so much time away from the family. The more positive support you receive from your family, the more you can concentrate on making the business a success.

Takes Risks (Statement 3)

Entrepreneurs are risk takers. They risk their careers, time and money in order to make a success of their businesses. To be successful in self-employment, you should feel comfortable taking reasonable risks.

Sacrifices Employment Benefits (Statement 4)

One of the major realities of self-employment is that you will not receive a regular paycheck. You pay for your own fringe benefits. A nice office, secretarial assistance, equipment and other features of employment you have grown to expect are no longer available unless you provide them for yourself.

Is Independent (Statements 5 & 9)

Entrepreneurs like to be independent and take in control of situations. Many people who become self- employed consider the opportunity to be their own boss as one of the major benefits of self-.employment. Although being independent may not be a major concern for you, it is certainly an aspect of self-employment that you need to feel comfortable. If you cannot afford to hire other employees when you begin your business, you may be at first lonely as a self-employed person.

Wants Financial Success (Statement 6)

A primary reason that most entrepreneurs have for going into business is to achieve financial success. If you want to be an entrepreneur, you need to establish a reasonable financial goal that you want to achieve through self-employment. This goal will help you measure how well you are doing in fulfilling your personal needs through an entrepreneurial career.

Has a Need to Achieve (Statements 7 & 11)

Entrepreneurs have a strong need for achievement. They strive to excel and accomplish quite high objectives. You should be willing to set high goals for yourself and enjoy striving to achieve those goals.

Has an Internal "Locus of Control" (Statement 10)

Successful entrepreneurs have an internal locus of control or inner sense of responsibility for the outcome of adventure. To be an entrepreneur, you should have a strong sense of being a "victor" who is responsible for your actions. If, however, you often consider yourself a "victim" and blame other people, bad luck, or difficult circumstances for your failures, entrepreneurship might not be the right career move for you.

Has Self-confidence (Statements 10, 15, and 18)

An important characteristic of entrepreneurs is self-confidence. This factor is particularly important when you face major challenges and difficulties with your business. You need to believe in yourself. Your belief will help you overcome the problems that inevitably affect all self-employed persons at some point in their careers.

Has Business Experience (Statement 12)

An entrepreneur should have extensive business experience to be successful. General management experience is beneficial because an entrepreneur should know something about all types of management. Formal training and education in management also are helpful

Adapts to Change (Statement 13 and 19)

A new business changes rapidly, so an entrepreneur must be able to adapt to change. Two primary skills are required for adaptation to change the capacity to solve problems, and the ability to make quick decisions. Another skill is the ability to learn from your mistakes.

Has a Self-employed Parent as a Role Model (Statement 14)

Research has shown that entrepreneurs are more likely to have a parent, who is self-employed. A parent's inspiration and knowledge about operating a business can contribute to an entrepreneur's success.

Has Integrity (Statement 16)

People often cite honesty and integrity as characteristics of entrepreneurs. Customers do not want to deal with business owners who are dishonest and unethical. You should feel positive about your ethical treatment of people and be committed to conducting your business with the utmost integrity.

Has Determination (Statement 17)

One of the most important characteristics of entrepreneurs is determination. This trait is closely related to self-confidence. The more you believe in yourself, the more likely you are to continue to struggle for success when faced with tremendous obstacles. You need determination in order to overcome the problems that beset every new venture.

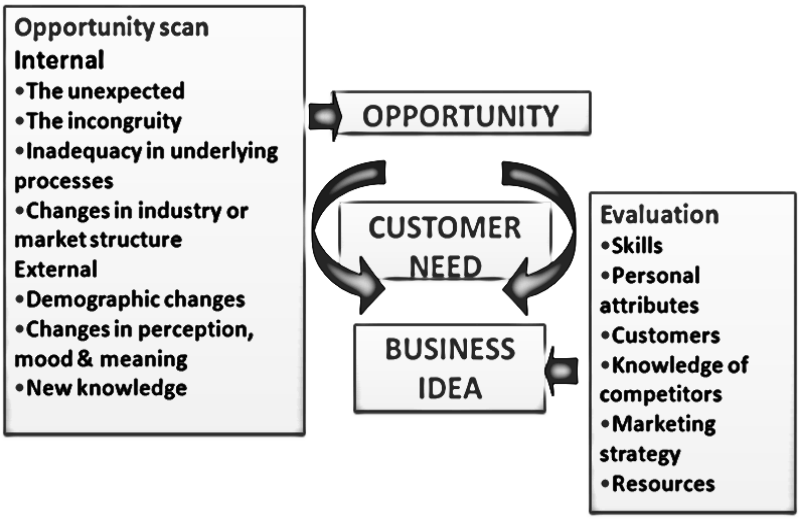
Has a Good Network of Professionals (Statement 20)

An entrepreneur has a good network of professionals. This network provides access to those who can be consulted for advice, information, and referrals. You should have an extensive network of professionals to whom you can turn for assistance.

1.4 Entrepreneurship as a process

The best way, how to start a business is to understand it as a process. This process involves finding, developing and evaluating an opportunity (based on customer´s needs) by overcoming the strong forces that might bring the creation of something new.

Figure 2 Start-up decision



Source: Hisrich and Peters, 2002

Hisrich and Peters (2002) explain the entrepreneurial process as follows:

- **Identifying and evaluating the opportunity**

Entrepreneurs use both formal and informal mechanisms for identifying business opportunity while formal mechanism are generally found within macro established companies, most entrepreneurs use informal sources for their ideas. This behaviour include also being sensitive to complains and listening to comments from friends and families offer an opportunity, or what is frequently called assessment analysis, is undertaken to establish the feasibility of an opportunity.

- **Developing a Business Plan**

A good plan must be developed in order to exploit the opportunity defined, because is not only important in developing the opportunity, but is also essential in determining the resources required, obtaining those resources, and successfully managing the resulting venture.

- **Requiring Resources**

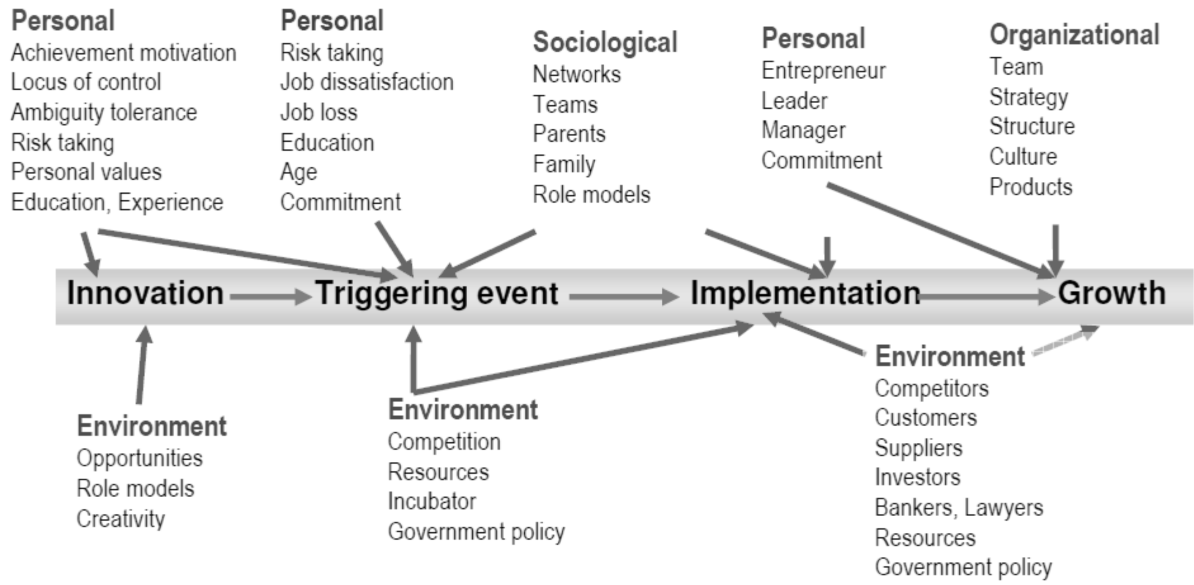
The resources needed for the opportunity must be assessed. This process starts with an appraisal of the entrepreneur's present resources. Then, any resources, which are critical, must be distinguished from those that are just helpful. Care must be taken not to underestimate the amount and variety of resources needed. The downside risks associated with insufficient resources should also be assessed.

- **Managing The Enterprise**

After resources are acquired, the entrepreneur must employ them through implementation of the business plan. The operational problems of the growing enterprise must be dealt with. This involves implementing a management style and structure as well as determining the key variable for success. A control system must be identified so that any problem areas can be carefully monitored.

According this knowledge, we are able to connect entrepreneurial process with the real business stage development (see fig. 3).

Figure 3 Entrepreneurial process



Source: Hisrich and Peters, 2002, p.48

If we look a little more closely at the definition of entrepreneurship, we can identify three characteristics of entrepreneurial activity (Dollinger, 2003)

- **Innovation**. Entrepreneurship generally means offering a new product, applying a new technique or technology, opening a new market, or developing a new form of organization for the purpose of producing or enhancing a product.
- **Running a business**. A business combines resources to produce goods or services. Entrepreneurship means setting up a business to make a profit.
- **Risk taking**. The term risk means that the outcome of the entrepreneurial venture cannot be known. Entrepreneurs, therefore, are always working under a certain degree of uncertainty, and they cannot know the outcomes of many of the decisions that they have to make. Consequently, many of the steps they take are motivated mainly by their confidence in the innovation and in their understanding of the business environment in which they are operating.

Stages mentioned in the picture above include four main bricks, which you have to understand to start successfully your business life.

1. **Invention and Innovation** - generating an idea, identifying a market opportunity, searching for information sources, developing supply for product or service (chapters 1-4).
2. **Triggering event** – motivation to start a business, analyzing (chapters 5-7).
3. **Implementation** – setting up the adventure, setting the business model and strategy (chapters 8-9).
4. **Growth** – adolescence of the business unit, maximizing profit, various types of business (chapters 10-12).

SOLVED EXERCISE 3 UNDERSTANDING YOUR BELIEFS ABOUT SUCCESSFUL ENTREPRENEURS

Read each of the following ten statements, and to the left of each indicate your agreement or disagreement. If you fully agree with the statement, put a 10 on the line at the left. If you totally disagree, put a one. If you tend to agree more than you disagree, give a response between six and depending on how much you agree. If you tend to disagree, give a response between two and five. (Kuratko, 2009)

____1. Successful entrepreneurs are often methodical and analytical individuals who carefully plan what they are going to do and then do it.

____2. The most successful entrepreneurs are born with special characteristics such as high achievement drive and a winning personality, and these traits serve them well in their entrepreneurial endeavours.

____3. Many of the characteristics needed for successful entrepreneur ship can be learned through study and experience.

____4. The most successful entrepreneurs are those who invent a unique product or service.

____5. Highly successful entrepreneurs tend to have very little formal schooling.

____6. Most successful entrepreneurs admit that dropping out of school was the best thing they ever did.

____7. Because they are unique and individualistic in their approach to business, most successful entrepreneurs find it hard to socialize with others; they just do not fit in.

____8. Research shows that although it is important to have adequate financing before beginning an entrepreneurial venture, it is often more important to have man-agerial competence and proper planning.

____9. Successful entrepreneurship is more a matter of preparation and desire than it is of luck.

____10. Most successful entrepreneurs do well in their first venture, which encourages them to continue; failures tend to come later on as the enterprise grows.

Put your answers on the following list in this way:

(a) Enter answers to numbers 1, 3, 8, and 9 just as they appeal; and then b) subtract (S) the answers to 2, 4,5,6,7, and 10 from 11 before entering them here. Thus, if you gave an answer of S to number 1, put an eight before number 1 here. However, if you gave an answer of 7 to number 2 here, place a 4 before number 2 here. Then add both columns of answers and enter your total on the appropriate line.

____ 1 ____ 6*
____ 2* ____ 7*
____ 3 ____ 8
____ 4* ____ 9
____ 5* ____10*
____ Total

Interpretation: This exercise measures how much you believe the myths of entrepreneurship. The lower your total, the stronger your beliefs; the higher your total, the less strong your beliefs. Numbers 1, 3, 8, and 9 are accurate statements; numbers 2, 4, 5, 6, 7, and 10 are inaccurate statements. Here is the scoring key:

80-100 Excellent. You know the facts about entrepreneurs.

61-79 Good, but you still believe in a couple of myths.

41-60 Fair. You need to review the chapter material on the myths of entrepreneurship.

0-40 Poor. You need to reread the chapter material on the myths of entrepreneurship and study these findings.

EXAMPLE 2 BE OR NOT TO BE? ...ENTREPRENEUR

First, identify five advantages of small business ownership. Next, rank these advantages according to their importance to you. Why did you rank them as you did? What factors discourage individuals from small business ownership? Indicate which of these factors might discourage you from starting a business. Explain why.

EXAMPLE 3 PAUL'S FOUR SHORT COMINGS

Paul Enden has always been very reliable and a hard worker. For the past eight years, Paul has been working in a large auto service garage. During this time, he has made a number of recommendations to the owner regarding new services that could be provided to cus-tomers. One of these is called the "'fast lube." With the service, people who want to have their oil changed and their car lubricated do not have to leave the auto and come back later in the day. Three service racks handle this job. It generally takes less than 10 minutes to take care of a car, and most people can have the job completed within 25 minutes of the time they arrive. The service, which has become extremely popular with customers, resulted in an increase in overall profits of 5 percent last year.

Paul's wife believes he has a large number of ideas that could prove profitable. "You ought to break away and open your own shop," she has told him, Paul would like to do so, but he believes four things help account for entrepreneurial success and he has none of them. Here is how he explained it to his wife:

"To be a successful entrepreneur, you have to be a thinker, not a doer. I am a doer. Thinking bores me. I would not like being an entrepreneur. Second, those people who do best as entrepreneurs tend to the inventors. I am not an inventor. If anything, I think of new approaches to old ways of doing business. I am more of a tinkerer than an inventor. Third, you have to be lucky to be a successful entrepreneur. I am hard working; I am not lucky. Fourth, you have to have a lot of money to do well as an entrepreneur. I do not have much money. 1 doubt whether €50,000 would get me started as an entrepreneur." (based on Kuratko, 2009).

Questions

1. Does Paul need to be an inventor to be an effective entrepreneur? Explain your answer.

2. How important is it that Paul has a lot of money if he hopes to be an entrepreneur? Explain your answer.

3. What is wrong with Paul's overall thinking? Be sure to include a discussion of the myths of entrepreneur’s hip in your answer.

2 POSITION OF SMALL BUSINESSES IN THE ECONOMY

"Micro, small and medium-sized enterprises (SMEs) are the engine of the European economy. They are an essential source of jobs, create entrepreneurial spirit and innovation in the EU and are thus crucial for fostering competitiveness and employment" (EU Commission, *2005).*

In the enlarged European Union of 28 countries, some 23 million SMEs provide around 75 million jobs and represent around 99% of all enterprises in each country. They answer to many crucial questions:

- **Development of personal relationships** - small businesses are well placed to build personal relationships with customers, employees, and suppliers.
- **Almost all small businesses respond flexibly to problems and challenges** - in a small business there is little hierarchy or chain of command, opposite to large businesses which may have set ways of operating and establish procedures that are hard to change.
- **Inventiveness and innovation** - small businesses are well positioned to introduce and develop new ideas.
- **Low overheads** - due to the small scale of operation, small businesses have lower overhead costs.
- **Catering for limited or niche markets**.

In addition, they complement the economic activity of large organizations by providing them with components, services, and distribution of their products.

DEFINITION 2 SME SIZE IN THE EU COUNTRIES[2]

The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.

The use of the definition is voluntary for Member States, but is widely recommended in areas such as regional development and research funding within EU funded projects or to be able to compare national data. Finally, under that guideline they defined criteria for capital-related ties between enterprises to solve the problems with measurement of real balance sheet. The unification of conditions solved the problems with:

- common definitions,
- size definitions,
- capital limits.

DEFINITION 3 AN ENTERPRISE

An enterprise is any entity engaged in an economic activity, irrespective of its legal form (EU Commission, 2005, p.12).

[2] Extract of Article 2 of the Annex of Recommendation 2003/361/EC

It means that the scope of the new SME definition is now clearly marked out. Thus, the self-employed, family firms, partnerships and associations regularly engaged in an economic activity may be considered as enterprises. When you start to collect the data, you must know following numbers:

- staff headcount,
- annual turnover,
- annual balance sheet.

Figure 4 Criteria for being SME

Enterprise category	Headcount: Annual Work Unit (AWU)	Annual turnover		Annual balance sheet total
Medium-sized	< 250	≤ €50 million (in 1996 € 40 million)	or	≤ €43 million (in 1996 € 27 million)
Small	< 50	≤ €10 million (in 1996 € 7 million)	or	≤ €10 million (in 1996 €5 million)
Micro	< 10	≤ €2 million (previously not defined)	or	≤ €2 million (previously not defined)

Source: EU Commission, 2005, p. 14

To work out with the individual data, they will have to establish whether the enterprise is autonomous – by far the most common category – a partner or linked.

DEFINITION 4 TYPES OF OWNERSHIP [3]

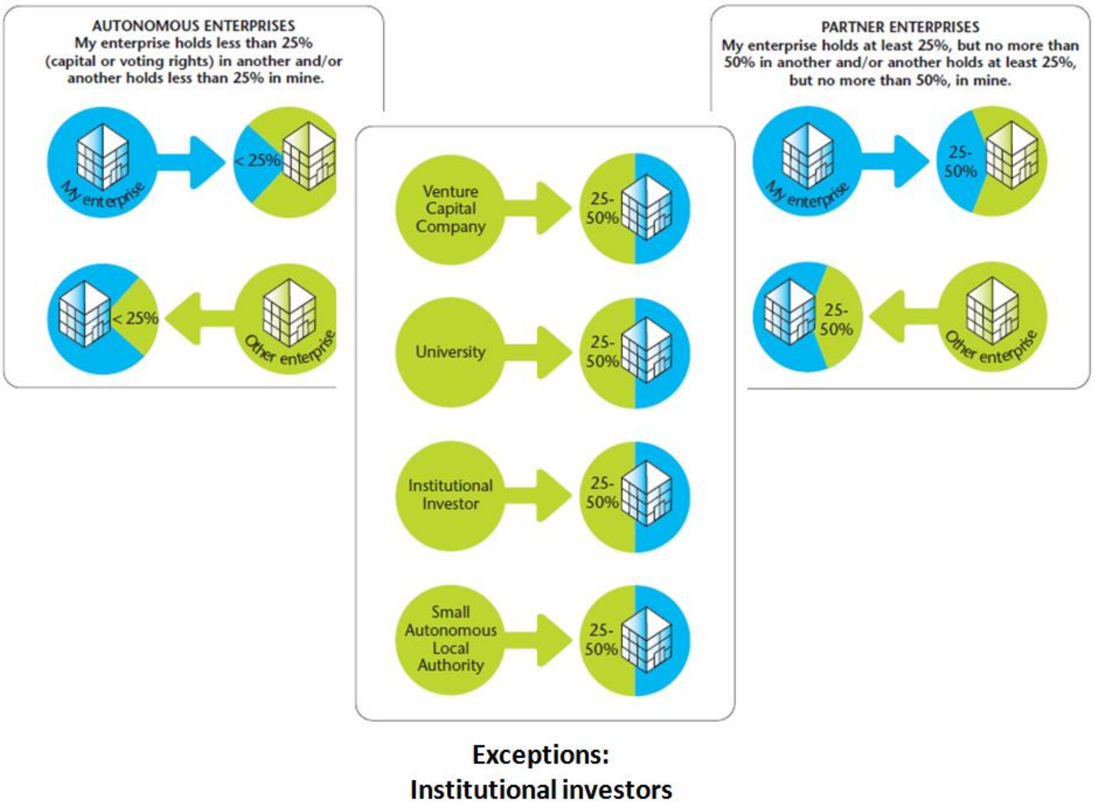
Autonomous Enterprises do not have a partner or link to another enterprise or they have a share to another enterprise less than 25%. You may still be ranked as autonomous, and thus as not having any partner enterprises, even if this 25% threshold is reached or exceeded by any of the following investors as:

1. Public investment corporations (Universities and non-profit research centres).
2. Institutional investors (including regional development funds).
3. Autonomous local authorities with an annual budget of less than 10 million euro and fewer than 5,000 inhabitants.

Partner Enterprises represent the situation of enterprises, which establish major financial partnerships with other enterprises, without one exercising effective direct or indirect control over the other. They have a holding equal to or greater than 25%, of the capital or voting rights in another enterprise and/or another enterprise has a holding equal to or greater than 25% in other.

[3] EU Commision, 2005 ,p. 16-22

Figure 5 Autonomous and Partners Enterprises

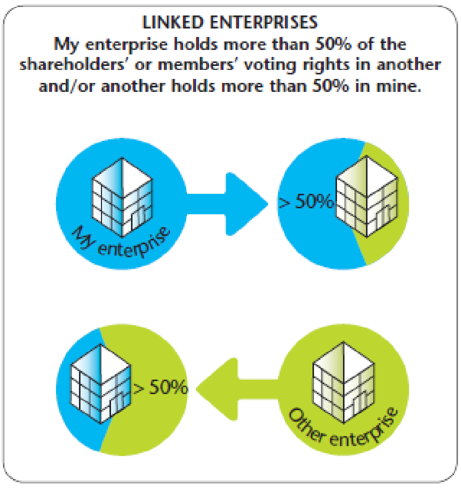


Source: EU Commission, 2005, p. 17, 19-20

DEFINITION 5 LINKED ENTERPRISES

Linked enterprises represent a form, when group through the direct or indirect control of the majority of voting rights of an enterprise by another or through the ability to exercise a dominant influence on an enterprise. Such cases are, thus, less frequent than the two preceding types. A typical example of a linked enterprise is the wholly owned subsidiary. (Compare fig. 5 and 6)

Figure 6 Linked Enterprises



Source: EU Commission, 2005, p. 24

2.1 OTHER DEFINITIONS

Opposite of that, USA Small business Administration (SBA) uses 500 employees as the limit for the business size. The SBA definition of a small business has evolved over time and is dependent on the particular industry. In the 1950s, the SBA defined small business firm as *"independently owned and operated…and not dominant in its field of operation."* (Blackford, 2003, p. 4). This is still part of their definition. At that time, the SBA classified a small firm as being limited to 250 employees for industrial organizations. Currently, this definition depends on the North American Industry Classification System (NAICS) for a business. The SBA recognizes that there are significant differences, across industries, with respect to competitiveness, entry and exit costs, distribution by size, growth rates, and technological change. Although the SBA defines 500 employees as the limit for the majority of industrial firms and receipts of $7 million for the majority of service, retail, and construction firms, there are different values for some industries (Cadden, Lueder, 2008, p.31).

Table 4 Quantitative differences in SME definition by number of Employees

	Australia	U.S	EU
Micro	1-2	1-6	<10
Small	<15	<250	<50
Medium	<200	<500	<250
Large	<500	<1000	<1000
Enterprise	>500	>1000	>1000

Source: own

2.1.1 CONTRIBUTION TO THE ECONOMY

The majority of people first entered the business world by working for small businesses. These enterprises are constantly creating jobs and providing opportunities for a vast number of workers. Given the financial resources available to large businesses, you would expect them to introduce virtually all the new products that hit the market. Over the years, the list of important innovations by small firms has included the airplane and air-conditioning, the defibrillator and DNA fingerprinting, oral contraceptives and overnight national delivery, the safety razor, strobe lights, and the zipper.

Small business owners are also particularly adept at finding new ways of doing old things. In 1994, for example, a young computer-science graduate working on Wall Street came up with the novel idea of selling books over the Internet. During the first year of operations, sales at Jeff Bezos's new company—Amazon.com—reached half a million dollars. In less than ten years, annual sales had topped $3 billion. Not only did his innovative approach to online retailing make Bezos enormously rich, but it also established a viable model for the e-commerce industry.

Why are small businesses so innovative? For one thing, they tend to offer environments that appeal to individuals with the talent to invent new products or improve the way things are done. Fast decision-making is encouraged, their research programs tend to be focused, and their compensation structures typically reward top performers. According to one SBA study, the supportive environments of small firms are roughly thirteen times more innovative per employee than the less innovation-friendly environments in which large firms traditionally operate.

The success of small businesses in fostering creativity has been unnoticed by big businesses. In fact, many large companies have responded by downsizing to act more like small companies. Some large organizations now have separate work units whose purpose is to spark innovation. Individuals working in these units can focus their attention on creating new products that can then be developed by the company.

Small business is the portal through which many people enter the economic mainstream. Business ownership allows individuals, including women and minorities, to achieve financial success, as well as pride in their accomplishments. While the majority of small businesses are still owned by white males, the past two decades have seen a substantial increase in the number of businesses owned by women and minorities.

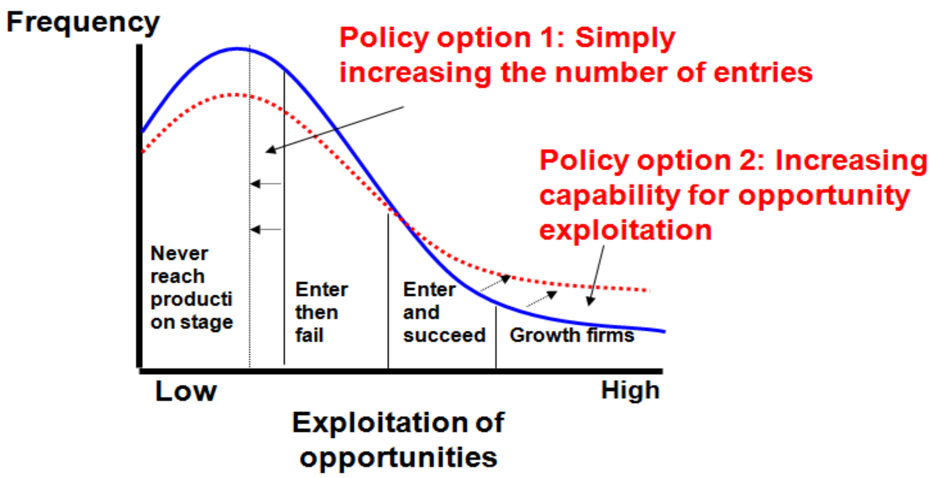
Small firms complement large firms in a number of ways. They supply many of the components needed by big companies. Small firms also provide large ones with such services as accounting, legal, and insurance. Many small firms provide outsourcing services to large firms—that is, they hire themselves out to help with special projects or handle certain business functions. A large firm, for example, might hire a small one to handle its billing or collection services or to manage its health care benefits. A large company might contract with a small information technology firm to manage its Web site or oversee software upgrades.

Small companies provide another valuable service to large companies by acting as sales agents for their products. For example, automobile dealerships, which are generally small businesses, sell vehicles for the big carmakers. Local sporting goods stores sell athletic shoes made by industry giants, such as Adidas and Nike (Collins, 2008).

2.2 SME AND ENTREPRENEURSHIP POLICY

Entrepreneurship policy is primarily concerned with creating an environment and support system that will foster the emergence of new entrepreneurs and the start-up and early-stage growth of new firms. Lundstrom and Stevenson (2005) make an important distinction between SME policy and Entrepreneurship policy. *SME policy* instruments are focused upon existing businesses, so they include loans and grants or business advice. In this sense, SME policy is conventional, industrial or sector-based policy targeted towards smaller firms.

Figure 7 Policy options



Source: Burns 2007, p.60

*Entrepreneurship poli*cy, however, is focused on influencing the creation of new firms, so it focuses not on businesses but on individuals or groups of individuals. Examples of Entrepreneurship policy include 'enterprise awareness' programmes in schools, colleges and universities. It also includes the provision of information and advice to those considering starting a business, often with a focus upon ‘under-represented’ groups such as young people, females or those from ethnic minorities.

While the distinction between SME and Entrepreneurship policy is an important one, the rationale for the existence of either policy must be based on evidence of market failure. For example, those seeking to persuade governments to use taxpayer’s money to fund ‘enterprise-awareness’ campaigns need to show that, for some reason, the market provides a sub-optimal number of enterprises, and that intervention will lead to a cost-effective move towards optimality. The distinction between policies is clearly shown in table below. It takes examples or elements of both SME and Entrepreneurship policy (Storey, 2008).

Table 5 Relationship between SME and Entrepreneurship policy

SME POLICY	ENTREPRENEURSHIP POLICY
Reducing red-tape and paperwork burden	Reducing red-tape and paperwork burden
Access to capital/financing	Access to micro loans and seed funds
Provision of information services	Entrepreneurship education
Export and marketing services	Facilitating networking services
Provision of training and consultancy	Provision of information about start-up
Technology transfer	Highlighting entrepreneurs as role models

Storey, 2008, p.251

From Table above it is clear that a number of elements are common to both SME and Entrepreneurship policy, for example, both SME policy and entrepreneurship policy are concerned to minimize bureaucratic and paper work burdens, although the precise nature of these burdens does vary sharply between start-ups and established businesses. In addition, bureaucratic burdens of establishing a limited company vary considerably from one country to another. According that, we could define four main positions of SMEs in the economy.

Figure 8 Typology of policy and SME position

	LIMITING	COMPETING
Low Direct assistance	[Developing Countries]	[USA]
	COMPENSATING	NURTURING
High Direct assistance	[EU]	[US Minority]
	High impediments	Low impediments

Storey, 2008, p.252

Unsurprisingly, different countries make different choices about this balance of policies on lowering burdens and supporting SMEs. Most EU countries choose to have, comparatively high impediments (support) to start a business, and they have considerable sums of public money devoted to encouraging smaller enterprises, as compensating for the impediments. For this reason, this box is labelled ‘**compensating**’. These countries also seem to place relatively more emphasis on SME rather than Entrepreneurship policy.

The approach in the USA is very different. There is a low direct assistance, but also are the barriers to starting a business. Competition is therefore seen as the focus of US policy and this box is labelled ‘competing’. The US however, does have some exceptions to this, its programmes to promote the interests of technology-based firms, and in the promotion of minorities. The barriers are low but there is a high level of direct assistance provided. This is shown in the box labelled 'nurturing'. Finally, there are many countries where the barriers to starting a business are high, but where public assistance is low. This box is labelled as 'limiting' but contains often large numbers of less developed countries in Africa, South America and some former communist countries.

2.2.1 ENTREPRENEURSHIP POLICY PRIORITIES

Each area of Entrepreneurship policy has to develop following areas:

- motivation to start the business,
- opportunity evaluation tools,
- business skills development.

According to Lundstrom et al. (2008), an ideal entrepreneurship policy support has to include:

- Promotion

It means governmental incentives to promote entrepreneurship, the policy directives to increase awareness of entrepreneurship, to promote award programmes for entrepreneurs, whether the government cooperates with the mass media to promote entrepreneurship and whether efforts are being made to track the attitudes of the population towards entrepreneurship.

- Education

This section is concerned on entrepreneurship education system. There is the question, for example, if the entrepreneurship is included in the National Educational Curriculum Guidelines, as a plan to promote the teaching of entrepreneurship within funding support for extracurricular entrepreneurial activities. It is also investigated to promote entrepreneurship classes to be widely offered to university students. This is also an area of increasing interest even if not much so far has been done in a number of countries. It is most common for countries to have allocated a budget for the development of programmes in schools and to support different initiatives especially specific programmes like Young Enterprise.

- Administrative Burden

This section of the policy has to serve to investigate the governments to ease the process of starting a business. Is there a stated policy objective to ease this process? Has business registration been streamlined for new firms? Does the government have a special unit for simplifying the rules? Every country has, for example, a stated objective for the area and makes efforts to examine barriers to entry and exit. In almost every country, there is also a single entry point and the government has acted to reduce SME administrative burdens. Least common are tax incentives to increase informal or formal venture capital for start-ups and early-stage ventures.

- Financing

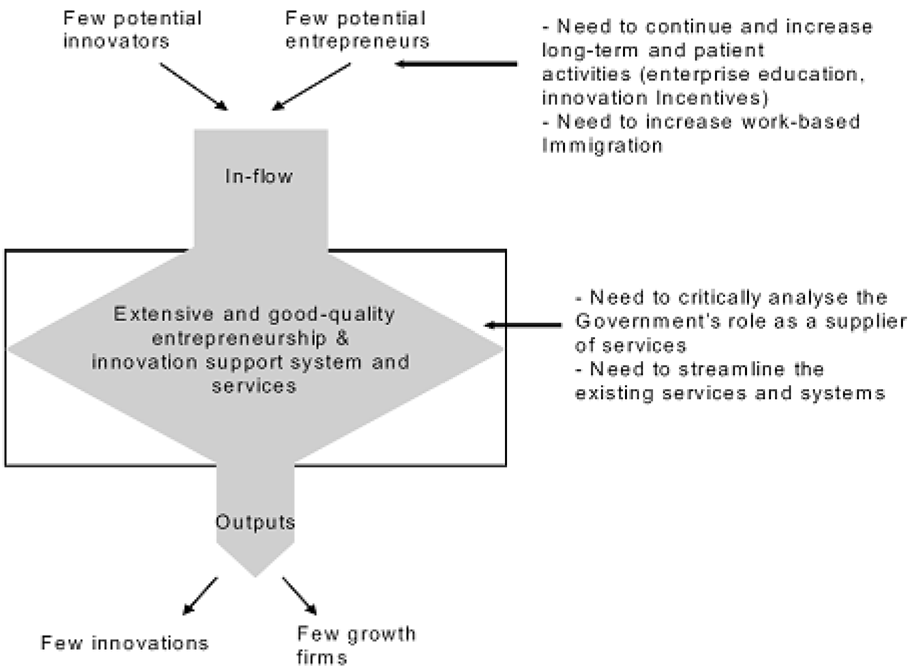
This section includes questions on the extent of access to start-up and early-stage financing in the country. Has the government undertaken a review of financing gaps for new entrepreneurs?; Does the government deliver its own loan or equity programmes for new and early-stage firms and are there micro-loan programmes for underrepresented groups? Almost every country also has an objective to increase financing activities in the area, to support angel networks or to create databases between entrepreneurs and informal investors. It is less common to bridge information gaps between private investors and early-stage entrepreneurs.

- Counselling and Information

In this sub-area, items raised include how the delivery system is built up, whether there is a first- or one-stop-shop system, the use of web portals and whether there is a mentor programme. All of the countries have networks of business enterprise centres. There is also an incubator strategy in place in all countries. In general, there are high values for almost every item. The exception is the item on whether there is a performance standard in place for service providers.

From those areas, we would identify main possible factors, which have an influence for start-up, such as political stability, security, access to finance, free flow for information and good regulation on the business market. The summary of our knowledge is presented in the figure below.

Figure 9 Model of Outcomes Entrepreneurship and innovation policy support system



Source: Lundström, Almerud, Stevenson, 2008, p.56

WHY SMALL ARE DIFFERENT?

Burns (2007) explained that all the "magic" of being small come from:

- personality of owner-manager,
- approach to risk & uncertainty,
- importance of cash,
- over dependence on single market,
- over dependence on small number of customers,
- effect of scale on economic decision-making.

WHAT THE WORK FOR SMES CAN OFFER?

- Promotion prospects and job satisfaction are often higher with small companies.
- A higher profile within the business due to more specialization.
- Variety, early responsibility, the opportunity to work on your own initiative, to work closely with other people (including senior management) and to have your work noticed.
- Flexibility to get involved in a number of different tasks and functions
- A working environment that may be more informal and less bureaucratic than in larger organisations
- Feeling that you are making a real contribution to the business.
- They do not offer, "graduate training schemes" – you are expected to learn on the job and take responsibility for your own training.
- The pay and benefits will be less than in larger companies.

3 DEVELOPING A WELL-CONCEIVED BUSINESS PLAN

Developing a Well-conceived Business Plan According to the Small Business Administration (SBA), a government agency that provides assistance to small businesses, the most common reasons for starting a business are the following:[4]

- To be your own boss
- To accommodate a desired lifestyle
- To achieve financial independence
- To enjoy creative freedom
- To use your skills and knowledge

The SBA points out, though, that these are likely to be advantages only "for the right person." In addition, how do you know if you are one of the "right people"? The SBA suggests that you assess your strengths and weaknesses by asking yourself a few relevant questions:[5]

- Am I a self-starter? You will need to develop and follow through on your ideas. You will need to be able to organize your time.
- How well do I get along with different personalities? You will need to develop working relationships with a variety of people, including unreliable vendors and sometimes-cranky customers.
- How good am I at making decisions? You will be making decisions constantly and often under pressure.
- Do I have the physical and emotional stamina? Can you handle six or seven workdays of as long as twelve hours every week?
- How well do I plan and organize? If you cannot stay organized, you will be swamped by the details. In fact, poor planning is the culprit in most business failures.
- Is my drive strong enough? You will need to be highly motivated to withstand bad periods in your business, and simply being responsible for your business's success can cause you to burn out.
- How will my business affect my family? Family members need to know what to expect before you begin a business venture, such as financial difficulties and a more modest standard of living.

One business analyst cites four reservations (or fears) that prevent people from starting businesses:[6]

- **Money.** Granted, without the cash, you cannot get very far. What to do: Conduct some research to find out where funding is available.
- **Security**. Many people do not want to sacrifice the steady income that comes with the nine-to-five job. What to do: Do not give up your day job. At least at first, think about hiring someone to run your business while you are gainfully employed elsewhere.

---

[4] U.S. Small Business Administration, 2013. Follow These 10 Steps to Starting a Business | SBA.gov. [online] [Accessed: 17 Oct 2013]. Available at: http://www.sba.gov/content/follow-these-steps-starting-business

[5] U.S. Small Business Administration, *Is Entrepreneurship For You? | SBA.gov*. [online]. [Accessed: 17 Oct 2013]. Available at: http://www.sba.gov/content/entrepreneurship-you

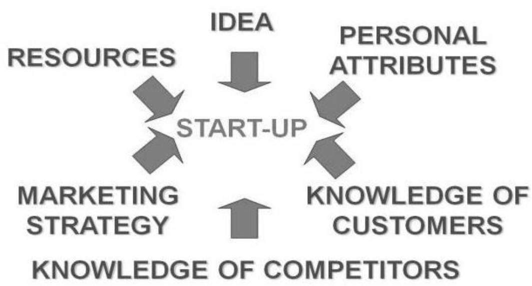
[6] Waters, S. 2013. *Four Reasons People Don't Start a Business*. [online] . [Accessed: 23 Oct 2013]Available at: http://retail.about.com/od/startingaretailbusiness/tp/overcome_fears.htm

- **Competition**. Many people do not know how to distinguish their business ideas from similar ideas. What to do: Figure out how to do something cheaper, faster, or better.
- **Lack of ideas**. Some people simply do not know what sort of business they want to get into. What to do: Find out what trends are successful. Turn a hobby into a business. Think about a franchise.

If you are still interested in going into business for yourself, feel free to regard these potential drawbacks as mere obstacles to be overcome by a combination of planning and creative thinking.

When you definitely decide to start up, because you have an idea, you need to develop your business plan first to be able to evaluate your potential in real situation. The process is shown in the figure below.

Figure 10 Start-up process



Source: Burns, 2007, p.97

There are two main reasons for developing a comprehensive business plan:

1. A plan will be extraordinarily useful in ensuring the successful operation of your business; and
2. If one is seeking to secure external funds from banks, venture capitalists, or other investors, it is essential that you be able to demonstrate to them that they will be recovering their money and making a profit.

Many small business owners operate under a mistaken belief, that the only time when they need to create a business plan is at the birth of the company or in attempting to raise additional capital from external sources. They fail to realize that a business plan can be an important element in ensuring day-to-day success.

Every business plan should be written with a particular audience in mind. The business plan should be written with a management team and for the employees who have to implement the plan.

However, one of the prime reasons for writing a business plan is to secure investment funds for the firm. Of course, funding the business could be done by an individual using own personal wealth, personal loans, or extending credit cards. Individuals also can seek investments from family and friends. The focus here will be on three other possible sources of capital like banks, venture capitalists, and angel investors. It is important to understand what they look for in a business plan. Remember that these three groups are investors, so they will be anticipating, at the very least, the ability to recover their initial investment if not earn a significant return (Cadden and Lueder, 2008, p.243).

Each business plan is particular-to-particular business and it is connected with special needs in chosen industry. You have to ensure you, that you are clear and specific and each key areas of your proposal. The main goals of the business plan are to market your company and show the excitement of the company. Finally, you present a clear and compelling strategy and vision for your future investors.

Any business plan is a future-oriented document. Business plans are required to look between three and five years into the future. To produce them and accurately forecast sales, you will need estimates of expenses and other items, such as the required number of employees, interest rates and general economic conditions (techniques and methods see chapter 4).

Before you start writing your business plan, ask yourself or go through that advice:

- What is my product? What are you proposing to do?
- Who are my target customers? Who will buy my product? Classify customers by demographic group, geography, income, etc.
- What problem is my product solving?
- May need to do background research first, before speaking with customers
- Talk to customers, experts, competitors
- Attend trade show conferences
- Research trade organizations and publications
- Google and public libraries
- Focus on published research, which may address you.

Table 6 Priorities in Business plan

What Interests a Banker	What Interests an Equity Investor
A 'safe' (low risk) loan that can pay interest and repay capital	Trustworthy and credible owner-manager and team
Trustworthy owner-manager	An owner-manager and a team that understands the business
An owner-manager that understands the business	High growth, high return
CAMPARI style: Character: show confidence business, style Means: explain clear how you will use and repay the loan Purpose: professionally presented, logical and display knowledge of your industry and target markets. Amount: clear financial part, with ratios Repayment: repayment terms, milestones, security of loans Insurance: protection of risk	A sustainable business model

Source: based on Burns, 2007

CASE STUDY 1 THE SHAKESPEAREAN GUIDE TO ENTREPRENEURSHIP

Everyone knows Shakespeare is the greatest writer in the English language. Did you know he was also a highly successful entrepreneur?[7] Everyone knows Shakespeare is the greatest writer in the English language.

In the course of his career in the great city, Shakespeare became a shareholder in an acting troupe called the Lord Chamberlain's Men, who beat off fierce competition to become the most famous and successful theatre company in the land. They played to packed houses of paying customers and received regular summons to perform before Queen Elizabeth and King James. Shakespeare rose from the ranks of commoners to the status of a person; taking great pride in the coat of arms, he was awarded. In addition, he earned enough money to buy the biggest house in his hometown and retire there in comfort.

This story does not quite fit the Romantic image of the starving artist or the poet wandering lonely as a cloud – but Shakespeare lived 200 years before Romanticism, so

[7] McGuinness, M, 2009. *The Shakespearean Guide to Entrepreneurship. Lateral Action*. [online] . [Accessed: 23 Oct 2013]. Available at: http://lateralaction.com/articles/shakespeare-entrepreneurship.

perhaps we can forgive him. In fact, if you ask me, entrepreneurship was not only compatible with Shakespeare's art; it made him a better writer. Here is why.

The Problem with Working for Hire

Even as the sun with purple-colour's face
Had taken his last leave of the weeping morn,
Rose-cheeked Adonis heeds him to the chase;
Hunting he loved, but love he laughed to scorn;
Sick-toughed Venus makes amain unto him,
And like a bold-faced suitor 'gins to woo him.

Do not worry if they do not ring a bell for you – you are in the majority. Many people have never heard of Shakespeare's poem Venus and Adonis, let alone cracked the covers and read these opening lines. I have read the whole thing – but only because I had to for my English degree. Moreover, if I am perfectly honest, it was a bit of a chore. However, in Shakespeare's day the poem was a bestseller. For a long time, he was much more famous as the poet of Venus and Adonis than as a dramatist. These days however, critics tend to agree that if he had stuck to 'pure' poetry like this, Shakespeare would have been one of the also-rans of English literature. Why was Shakespeare writing for such a narrow audience? **Because of his business model at the time**. Shakespeare was working within an established tradition of patronage, whereby a rich and noble patron would reward an artist for producing work in his or her honour. Looking at the poems now, we can see that Shakespeare did a good job for his client, but no one would argue that it was his best writing. This kind of work was not his first choice. He already had several successful plays under his belt, but had turned to poetry, when London's theatres were closed because of the plague. The results suggest his heart was not really in it.

Enter the Entrepreneur

'To be, or not to be: that is the question.'
'If music be the food of love, play on'
'All the world's a stage'
'Is this a dagger which I see before me?'
'The course of true love never did run smooth.'
'Once more unto the breach dear friends!'

What accounts for the difference? How did Shakespeare go from writing conventional verse to writing so many lines that are instantly recognisable and vivid after 400 years? There are plenty of literary explanations, but I would like you to consider the difference made by his change of business model. I put it to you that Shakespeare is writing blossomed when he gave up being an artist in search of a patron and became an entrepreneur in earnest.

The English poet Ted Hughes[8], who knew the Bard's work inside out, gives a memorable description of Shakespeare's attitude to business: "*Throughout his life, notoriously, the money-lending, corn-chandelling, property-speculating, wheeling and dealing dramatist displayed a flexible opportunism, nimbly tuned to market forces*". I will suggest what 21st-century creative entrepreneurs can learn from Shakespeare's example.

1. Innovate with Your Business Model

While he relied on a patron, Shakespeare's income was limited by the patron's generosity. Even an Earl's pockets were not bottomless (Wriothesley was actually in financial trouble at the time). In addition, while he relied on a single client, Shakespeare was vulnerable – to the patron's whims, illness or death, or fall from political favour. Elizabethan theatre, on the other hand, was highly lucrative mass entertainment. It is estimated that the Globe Theatre

[8] Ted Hughes, Shakespeare and the Goddess of Complete Being, 1992

held almost 3,000 spectators. The ‘groundlings’ only paid a penny each to stand and watch the plays in the theatre yard, exposed to the elements – but the pennies soon added up when the crowds were packed inside. There were plenty of gentlefolk prepared to pay considerably more for seats in the galleries.

Takeaway: Do not rely on a single source of income. Grow your revenue exponentially by making your work available to a wider audience.

2. Good Partners Bring Out the Best in Each Other

Shakespeare was a competent actor, but he was not the star of the show. In performance, he usually played minor parts, leaving the limelight to Elizabethan celebrity actors such as Richard Burbage, William Kempe and Robert Armin. Where Shakespeare excelled, of course, was in writing. Elizabethan audiences had an insatiable thirst for new plays containing fantastic adventures in high fantastical language – which Shakespeare delivered in spades. The partnership structure of the company meant that each shareholder could concentrate on delivering exceptional value through his specialist expertise; when the individual contributions were multiplied through collaboration, the creative and commercial results were spectacular.

Takeaway: Do not try to do it all yourself. Find partners whose talents complement yours, and allow you to do what you do best.

3. Work for Equity, Not for Hire

Shakespeare’s company, the Chamberlain’s Men, was the first in the history of the English theatre where the actors were shareholders. Shakespeare invested £70 for his share of the company – a significant amount, considering freelance playwrights were earning about £6 a play at the time. Nevertheless, it paid off handsomely over the course of his career. Because he received a share of the profits on every performance by the company, he earned far more than he would ever have managed as a freelancer.

Takeaway: If a job is worth doing, it is worth owning the results. You will get more profit and pleasure from building a business you own than you ever will from working for someone else.

4. Own Your Domain

The Lord Chamberlain’s men owned the Globe Theatre in which they performed for most of their career. Unfortunately, they did not own the land in Shoreditch where it originally stood – they leased it from the owner, Giles Allen. When the lease expired, the landlord claimed ownership of the building, forcing the actors to desperate measures: on 28th December 1598, while the landlord was still celebrating Christmas, they armed themselves, and ‘liberated’ the theatre building, dismantling it and hiding it in a warehouse. They later shipped it across the Thames to a new site in Southwark. Moreover, because the new site was outside the official limits of the city, it meant they were beyond the jurisdiction of the city leaders, who were often keen to close down the theatres.

Takeaway: Establish your business on your own domain – do not become someone else’s user generated content. Otherwise, your enterprise will be ‘Like a fair house built on another man’s ground’ (The Merry Wives of Windsor).

5. Play Live

Comparing Shakespeare’s courtly poetry with his plays is like comparing a studio album with a live gig. While some artists thrive in the studio, Shakespeare came alive in front of an audience. In addition, he faced the most demanding audience in the history of the theatre. At the actors' feet was the rough-and-tumble of the crowd, like a football terrace. These people were after entertainment – the more riotous and rude, the better – and they were quick to heckle if they did not get what they wanted. As well as keeping them happy, Shakespeare also had to 'play to the gallery', providing the educated elite in the posh seats with sophisticated literary fare. Shakespeare responded with a unique mix of high art and low entertainment, intermingling masters and servants, lords and peasants on the stage. He did the same with his language, at one moment flinging a crude joke to the groundlings, then in the next breath offering a philosophical reflection or a burst of pure poetry to the gallery. Words like 'puking', 'clot pole' and 'bastard' rubbed shoulders with fancy new inventions such as 'captious', 'intangible', 'multitudinous' and 'incarnadine'.

Takeaway: Get your work in front of an audience. If you are a writer, do not lock your words in the study – write a blog, where the comments push up against your words, like the crowd at the edge of a stage. The same goes for music, photography, design etc. The web tools now available give you an unprecedented opportunity to get feedback on your work from real people – and potential customers.

6. Keep the Content Coming

Elizabethan playgoers craved novelty and excitement – to keep them coming back and to stay ahead of the competition, acting companies had to produce a constant stream of new plays. A large part of Shakespeare's success was down to stamina – 38 plays by him have survived, and it is likely that several more have been lost. Most contemporary playwrights resorted to co-authorship to keep up with demand. This could reduce the time taken to write a new play from months to weeks – but it also reduced the fee each writer received, contributing to the financial hardship suffered by many playwrights of the time. Unlike Shakespeare, who was a shareholder and could therefore afford to devote most of his time to sole authorship of plays that would bring him a handsome reward in his own theatre.

Takeaway: Creativity + productivity = success. Make sure your business is set up to sustain your productivity.

7. An Experience Can't Be Pirated

There was no copyright protection for authors in Shakespeare's day. Every time he premiered a new play, there would be bootleggers in the audience – representatives of other theatre companies, memorising and writing down the script, to sell the text or use it in rival productions. Legally, there was very little Shakespeare could do about this. Nevertheless, it does not seem to have done him much harm, financially or artistically. Like most bootlegs, the copies were poor quality, and rival productions were second to market and second best. The bootlegs may even have benefited Shakespeare by introducing his work to new people. None of the bootleggers built a reputation like the Chamberlain's Men for quality, consistency and sheer spectacle. The Globe remained the place to go for the real thing.

Takeaway: Your work is vulnerable if you reduce it to a simple format such as a text file or MP3. However, it is impossible to pirate a live event or an interactive experience such as a blog, forum or membership site.

Finally, each business needs not only good idea, but also a good plan!

3.1 Components of a Business Plan

The most common use of a business plan is persuading investors, lenders, or both, to provide financing. These two groups look for different things. Investors are particularly interested in the quality of your business concept and the ability of management to make your venture successful. Bankers and other lenders are primarily concerned with your company's ability to generate cash to repay loans. To persuade investors and lenders to support your business, you need a professional, well-written business plan that paints a clear picture of your proposed business.

In preparing to build a business plan, there are some problem areas or mistakes that you should be on guard to avoid. In preparing to build a business plan, there are some problem areas or mistakes that you should be on guard to avoid. Some may be technical in nature, while others relate to content issues. For the technical side, first, one should make sure that there are no misspellings or punctuation errors. The business plan should follow a logical structure. No ideal business plan clearly specifies the exact sections that need to be included nor is there an ideal length. Literature concerning business plans indicates that the appropriate length of the body of a business plan line should be between twenty and forty pages. This does not include appendixes that might provide critical data for the reader.

There is no idealized structure for a business plan. The following subsections discuss the outline of a plan for a business start-up and identify some of the major sections that should be part of the plan.

COVER PAGE

The cover page provides the reader with information about the author either of the plan or the person to contact concerning the business plan. It should contain all the pertinent information to enable the reader to contact the author, such as the name of the business, the business logo, and the contact person's address, telephone number, and e-mail address. The table of contents enables the reader to find the major sections and components of the plan. It should identify the key sections and subsections and on which pages those sections begin. This enables the reader to turn to sections that might be of particular importance.

EXECUTIVE SUMMARY

The executive summary is a section of critical importance and is perhaps the single most important section of the entire business plan. Quite often, it is the first section that a reader will turn to, and sometimes it may be the only section of the business plan that investor will read. The executive summary should provide an accurate overview of the entire document, which cannot be done until the whole document is prepared.

If the executive summary fails to adequate description the idea behind the business or if it fails to do so in a captivating way, some readers may discard the entire business plan. As one author put it, the purpose of the executive summary is to convince the reader to "read on." (Brown, 1996) The executive summary should contain the following pieces of information:

- What is the company's business?
- Who are its intended customers?
- What will be its legal structure?
- What has been its history (where one exists)?
- What type of funding will be requested?
- What is the amount of that funding?
- What are the capabilities of the key executives?

All parts must be done in an interesting way. The great challenge is that executive summaries should be relatively short, between one and three pages.

Main components of an Executive Summary are:

- Business Concept:
  - The business problem and the solution
  - Analysis of Market size, Customer, and Industry
  - Marketing and Sales Strategy
  - Organization (type) and Key Leaders
  - Company's unusual qualifications
- Financial Plan:
  - Four years of summary results (projection)
  - Sources of Financing and Key investments Required

Even though the executive summary is the first thing read, it is written after the other sections of the plan are completed. Therefore, chronologically, it should probably be the last section written (Timmons et al., 2004). An effective approach in writing the executive summary is to paraphrase key sentences from each section of the business plan. This process will ensure that the key information of each section is included in the executive summary.

3.1.1 THE BUSINESS SECTION OF THE PLAN

GOALS

These are broad statements about what you would like to achieve some point in the near future. Goals are useful, but they can mean anything to anyone. It is therefore necessary to translate the goals into objectives to bring about real meaning so that they can guide the organization. Ideally, objectives should be SMART—specific, measurable, achievable, realistic, and have a specific timeline for completion (see table 7).

Table 7 SMART guideline

Letter	Major Term	Minor Terms
S	Specific	Significant, Stretching, Simple
M	Measurable	Meaningful, Motivational, Manageable
A	Attainable	Appropriate, Achievable, Agreed, Assignable, Actionable, Action-oriented, Ambitious, Aligned, Aspirational
R	Relevant	Realistic,Results/Results-focused/Results-oriented,Resourced,Rewarding
T	Time-bound	Time-oriented, Time framed, Timed, Time-based, Time boxed, Timely, Time-Specific, Timetabled, Time limited, Tractable, Tangible

Source: Burns, 2007

For example:

A goal is a significant rise in sales and profits. When translating that goal into an objective, you might word the objectives as follows: a 15 percent increase in sales for the next three years followed by a 10 percent increase in sales for the following two years and a 12.5 percent increase in profits in each of the next five years. These objectives are quite specific and measurable.

In developing the plan, owners are often very happy to develop goals because they are open to interpretation, but they will avoid objectives. Goals are sufficiently ambiguous, whereas objectives tie you to particular values that you will have to hit in the future. People may be concerned that they will be weighed on a scale and found wanting for failing to achieved their objectives. However, it is critical that your plan contains both goals and objectives.

Objectives allow investors and your employees to see clearly, where the firm intends to go. They produce targeted values to aim for and, therefore, are critical for the control of the firm's operations.

VISION AND MISSION STATEMENTS

There is some degree of confusion concerning the difference between a vision statement and a mission statement. **Vision** statements articulate the long-term purpose and idealized notion of what a business wishes to become.

Mission statements, which are much more common in small business plans, articulate the fundamental nature of the business. This means identifying the type of business, how it will leverage its competencies, and possibly the values that drive the business. Put simply, a mission statement should address the following questions:

- Who are we? What business are we in?
- Whom do we see as our customers?
- How do we provide value for those customers?

Sometimes vision and mission statements are singularly written for external audiences, such as investors or shareholders. They are not written for the audience for whom it would have the greatest meaning—the management team and the employees of the business. Sometimes a firm will write a mission statement that provides customers, investors, and employees with a clear sense of purpose of that company.

EXAMPLE 4 EXAMPLES OF MISSION

"*Our goal is to position Zappos as an online service leader. If we can get customers to associate Zappos as the absolute best in service, then we can expand beyond shoes.*"[9]

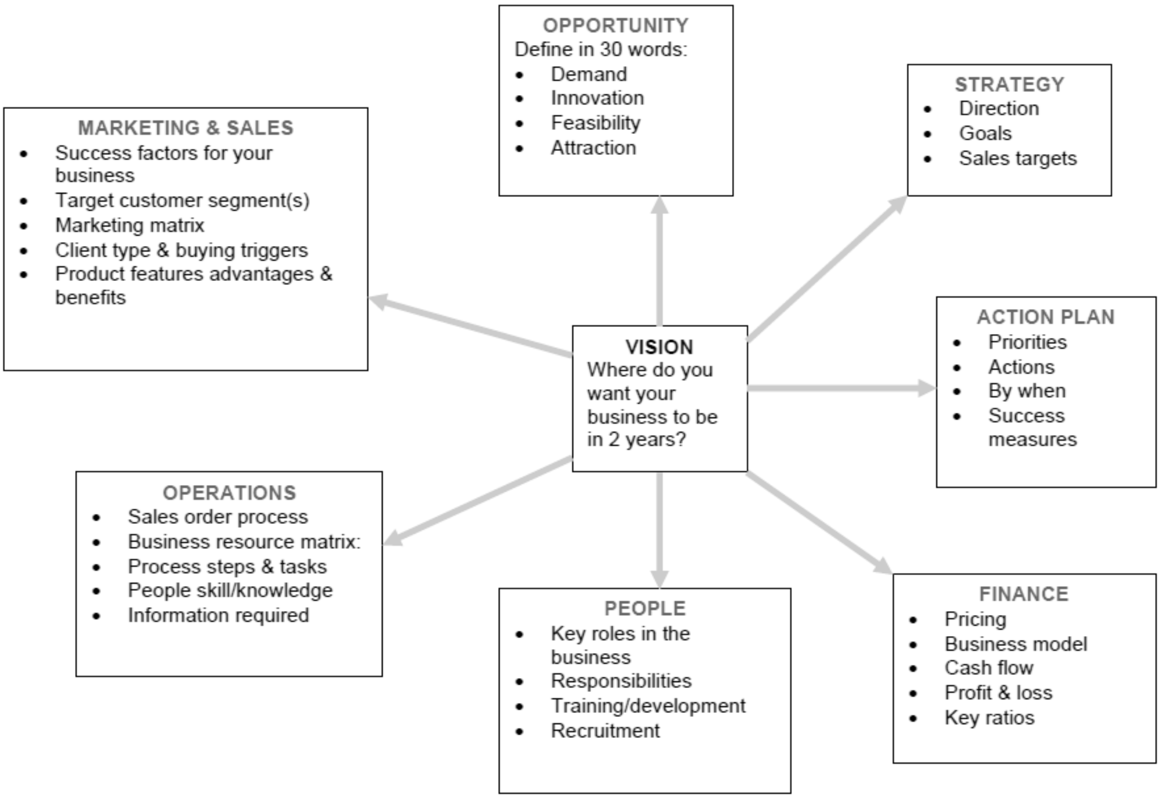
Ben & Jerry's Ice Cream focuses both on defining their product and their values: "*To make, distribute and sell the finest quality all-natural ice cream and euphoric concoctions with a continued commitment to incorporating wholesome, natural ingredients and promoting business practices that respect the Earth and the Environment.*"[10]

KEYS TO SUCCESS

This section identifies those specific elements of your firm that you believe will ensure success. It is important for you to be able to define the competencies that you intend to leverage to ensure success. What makes your product or service unique? What specific set of capabilities do you bring to the competitive scene? These might include the makeup of and the experience of your management team; your operational capabilities (e.g., unique skills in design, manufacturing, or delivery); your marketing skill sets: your financial capabilities (e.g., the ability to control costs); or the personnel that make up the company.

[9] Inc. 500 Mission Statements. *Inc. 500 Mission Statements*. [online]. [Accessed: 17 Sep 2013] Available at: http://www.missionstatements.com/inc_500_mission_statements.html.
[10] Ben & Jerry's. 2013. *Mission Statement Ben & Jerry's*. [online] [Accessed: 19 Sep 2013] Available at: http://www.benjerry.com/activism/mission-statement.

Figure 11 Summary of key areas of Business plan



Source: Rae, 2007, p.151

INDUSTRY REVIEW

In this section, you want to provide a comprehensive overview of the industry. A thorough understanding of the industry that you will be operating in is essential to understand the possible returns that your company will earn within that industry. Investors want to know if they will recover their initial investment. When will they see a profit? Remember, investors often carefully track industries and are well aware of the strengths and limitations within a particular industry. Investors are looking for industries that can demonstrate growth. They also want to see if the industry is structurally attractive. This might include conducting Porter's five forces analysis; however, this is not required in all cases. If there appear to be some issues or problems with industry level growth, then you might want to be able to identify some segments of the industry where growth is viable. This section includes information from those areas:

1. **Industry Analysis**
   - market size and relevant market size,
   - market trends,
   - customers and competition.
2. **Customer analysis**
   - customer identification /definition,
   - customer demographics, needs and decision-making,
   - the customer's customer.
3. **Competitive analysis**
   - defining competition,
   - describing competitors,
   - competitive advantage.

PRODUCTS OR SERVICES

This section should be an in-depth discussion of what you are offering to customers. It should provide a complete and clear statement of the products or the services that you are offering. It should also discuss the core competencies of your business. You should highlight what is unique, such as a novel product or service concept or the possession of patents. You need to show how your product or service specifically meets particular market needs. You must identify how the product or the service will satisfy specific customers' needs. If you are dealing with a new product or service, you need to demonstrate what previously unidentified needs it will meet and how it will do so.

- This section could include a discussion of technical issues. If the business is based on a technological innovation—such as a new type of software or an invention—then it is necessary to provide an adequate discussion of the specific nature of the technology.
- This section also might discuss the future direction of the product or service, where will you be changing the product or the service after the end of the current planning horizon. This may require a discussion of future investment requirements or the required time to develop new products and services.
- This section may also include a discussion of pricing the product or the service, although a more detailed discussion of the issue of pricing might be found in the marketing plan section.
- It is important to discuss how your pricing scheme will compare with competitors. Will it be higher than average or below the average price? How does the pricing fit in with the overall strategy of the firm?

This section must have a high degree of honesty. Investors will know much about the industry and its limitations. You need to identify any areas that might be possible sources of problems, such as government regulations, issues with new product development, securing distribution channels, and informing the market of your existence. Further, it is important to identify the current competitors in the industry and possible future competitors.

MARKETING PLAN

An introductory marketing course always introduces the four Ps: product, price, place, and promotion (see chapter 7). The marketing section of the business plan might provide more in-depth coverage of how the product or the service better meets customer value than that of competitors. It should identify your target customers and include coverage of who your competitors are and what they provide. The comparison between your firm and its competitors should highlight differences and point to why you are providing superior value. Pricing issues, if not covered in the previous section, could be discussed or discussed in more detail.

The issue of location, particularly in retail, should be covered in detail. Perhaps one of the most important elements of the marketing plan section is to specify how you intend to attract customers, inform them of the benefits of using your product or service, and retain customers. Initially, customers are attracted through advertising. This section should delineate the advertising plan. What media will be used in real business like flyers, newspapers, magazines, radio, television, web presence, direct marketing, and/or social media campaigns? This section should cover any promotional campaigns that might be used. Do not forget to analyse:

- products and services,
- price, placement, promotions, customer relationship,
- partnerships.

MANAGEMENT TEAM

Readers of your business plan and potential investors should have a clear sense of the management team that will be running a business. They should know the team with respect to the team's knowledge of the business, their experience and capabilities, and their drive to succeed. The human resources available to a firm will play a critical role in determining its success (see chapter 5 and 6).

This section of the business plan has several elements. It should contain an organizational chart that will delineate the responsibilities and the chain of command for the business. It should specify who would occupy each major position of the business. You might want to explain who is doing what job and why. For every member of the management team, you should have a complete résumé. This should include educational background (both formal and informal) and past work experience, including the jobs they have held responsibilities, and accomplishments. You might want to include some other biographical data such as age, although that is not required.

Depending on the nature of the business, you might wish to include in this section the personnel (employees) that will be required. You should identify the number of people that are currently working for the firm or that will have to be hired; you should also identify the skills that they need to possess. Further discussion should include the pay that will be provided: whether they will be paid a flat salary or paid hourly, when you intend to use overtime, and what benefits you intend to provide. In addition, you should discuss any training requirements or training programs that you will have to implement.

An additional element of your discussion of the management team will be the intended compensation schemes. You should specify the intended salaries for the management team while also including issues of their benefits and bonuses or any stock position that they may take in the company. This section should also identify any gaps in the management team.

Those fourteen sentences (Sahlman, 2008) could help you to mention main information into your personnel plan:

- Where are the founders from?
- Where have they been educated?
- Where have they worked-and for whom?
- What have they accomplished-professionally and personally-in the past?
- What is their reputation within the business community?
- What experience do they have that is directly relevant to the opportunity they are pursuing?
- What skills, abilities, and knowledge do they have?
- How realistic are they about the venture's chances for success and the tribulations it will face?
- Who else needs to be on the team?
- Are they prepared to recruit high-quality people?
- How will they respond to adversity?
- Do they have the mettle to make the inevitable hard choices that have to be made?
- How committed are they to this venture?
- What are their motivations?

Company Analysis could include:

- company profile,
- past accomplishments of company / team,

- unique qualifications,
- business milestones,
- funding, revenue, employee additions,
- exit strategy.

Management Team

- Description of key members,
- Identify management team gaps,
- Description of Board Members / Advisors.

Think about appropriate business form, because it has an influence on future financial statements. There is a short description of advantages and disadvantages of common legal forms (see fig.12)

Figure 12 Comparison of Common Business forms

Factors	Sole Proprietorship	Partnership	Regular C Corporation	S Corporation	LLC
Owners Personal Liability	Unlimited	Unlimited	Limited	Limited	Limited
Taxation	Proprietor's Personal Tax Forms	Partner's Personal Tax Forms	Profits Taxed at Corporation and Owner's Pay Tax on Distributions	Profits or Losses Flow Through to owners	Profits or Losses Flow Through to owners
Continuity of Business	Terminated by Proprietor	Dissolved by Partners	Perpetual	Perpetual	Limited to Fixed Number of Years
Cost of Formation	Very Low	Low	Moderate	Moderate	Moderat e
Ability to Raise Capital	Low	Moderate	High	Moderate	High

Source: Burns, 2007

3.1.2 FINANCIAL STATEMENTS

The opening section of the financial statements section should also include, in summary format, projections of sales, the sales growth rate, key expenses and their growth rates, net income across the forecasting horizon, and assets and liabilities (more in chapter 9). The financial statements section of the business plan should be broken down into three key subsections (Hormozi et al., 2002):

- the income statement,
- the balance sheet, and
- The cash-flow statement.

The business plan should contain clear statements of the underlying assumptions that were used to make these financial projections. The clearer the statements and the more realistic the assumptions behind these statements, then the greater the confidence the reader will have in these projections. The future planning horizon for financial projections is normally between three and five years.

INCOME STATEMENT

The income statement examines the overall profitability of a firm over a particular period. As such, it is also known as a profit-and-loss statement. It identifies all sources of revenues generated and expenses incurred by the business. For the business plan, one should generate annual plans for the first three to five years. Some of the key terms found in the income statement are as follows:

- **Income (I)**. All revenues and additional incomes produced by the business during the designated period.
- **Cost of goods sold (CGS)**. Costs associated with producing products, such as raw materials and costs associated directly with production.
- **Gross profit margin (GPM)**. Income minus the cost of goods sold.
- **Operating expenses (OE)**. Costs in doing business, such as expenses associated with selling the product or the service, plus general administration expenses.
- **Depreciation (D)**. Long-term assets (LTA), whose useful life is longer than one year; decline in value over time. Depreciation considers this fact. This declining value can be determined in several ways. It is a non-cash expenditure expense.
- **Total expenses (TE)**. The cost of goods sold plus operating expenses and depreciation.
- **Net profit before interest and taxes**. This is the gross profit minus operating expenses; another way of stating net profit is income minus total expenses.
- **Interest.** The required payment on all debts for the period.
- **Taxes**. All tax payments for the firm.
- **Net profit**. This is the net profit after interest and taxes.

BALANCE SHEET

The balance sheet examines the assets, liabilities, and owner's equity of the business at some particular point in time. It is divided into two sections as the credit component (the assets of the business) and the debit component (liabilities and equity). These two components must equal each other. The business plan should have annual balance sheet for the three or five-year planning horizon. The elements of the credit component are as follows:

- **Current assets (CA)**. These are the assets that will be held for less than one year, including cash, marketable securities, accounts receivable, notes receivable, inventory, and prepaid expenses.
- **Fixed assets (FA)**. These assets are not going to be turned into cash within the next year; these include plants, equipment, and land. It may also include intangible assets, such as patents, franchises, copyrights, and goodwill.
- **Total assets (TA)**. This is the sum of current assets and fixed assets.

Liabilities consist of the following:

- **Current liabilities(CL)**. These debts are to be paid within the year, such as lines of credit, accounts payable, other items payable (including taxes, wages, and rents), short-term loans, dividends payable and current portion of long-term debt.
- **Long-term liabilities (CTL)**. These are debts payable over a period greater than one year, such as notes payable, long-term debt, pension fund liability, and long-term lease obligations.
- **Total liabilities (TL)**. This is the sum of current liabilities and long-term liabilities.

- **Owner's equity**. This represents the value of the shareholders' ownership in the business. It is sometimes referred to as net worth. It may be composed of items such as preferred stock, common stock, and retained earnings.

CASH-FLOW STATEMENT

From a practical and survival standpoint, the cash-flow statement may be the most important component of the financial statements. The cash-flow statement maps out where cash is flowing into the firm and where it flows out. It recognizes that there may be a significant difference between profits and cash flow. It will indicate if a business can generate enough cash to continue operations, whether it has sufficient cash for new investments, and whether it can pay its obligations.

Cash flows can be divided into three areas of analysis:

- **Cash flow from operations**. Cash flow from operations examines the cash inflows from revenues and interest and dividends from investments held by the business. It then identifies the cash outflows for paying suppliers, employees, taxes, and other expenses.
- **Cash flow from investing**. Cash flow from investing examines the impact of selling or acquiring current and fixed assets and
- **Cash flow from financing**. Cash flow from financing examines the impact on the cash position from the changes in the number of shares and changes in the short- and long-term debt position of the firm.

Financial Plan in short includes:

- pro-forma financial statements,
- validating assumptions and projections,
- sources and uses of funds

In preparing the financial section of your business plan, specify the company's cash needs and explain how you will be able to repay debt. This information is vital in obtaining financing. It reports the amount of cash needed by the company for start-up and initial operations and provides an overview of proposed funding sources. It presents financial projections, including expected sales, costs, and profits (or losses). It refers to a set of financial statements included in an appendix to the business plan.

Business plans are analyses of the future; they can be at the side of either optimistic projections or conservative projections. From the standpoint of the potential investor, it is always better to write it the side of conservatism. Regardless of either bias, business plans are generally built because of expected futures and experience. Unfortunately, the future does not always emerge in a clearly predicated manner. There is the reason, why it is so important to know how to analyse business environment.

3.2 ADVANTAGES AND DISADVANTAGES OF OWNERSHIP

Several advantages generally speaking, come with success in business ownership:

- **Independence**. As a business owner, you are your own boss.
- **Lifestyle**. Because you are in charge, you decide when and where you want to work.
- **Financial rewards**. In spite of high financial risk, running your own business gives you a chance to make more money than if you were employed by someone else.

- **Learning opportunities**. As a business owner, you'll be involved in all aspects of your business
- **Creative freedom and personal satisfaction**. As a business owner, you will be able to work in a field that you really enjoy, and you will gain personal satisfaction from watching your business succeed.

There are also a number of potential disadvantages to consider in deciding whether to start a small business:

- **Financial risk**. The financial resources needed to start and grow a business can be extensive, and if things do not go well, you may face substantial financial loss. In addition, you will have no guaranteed income.
- **Stress.** You'll have a bewildering array of things to worry about competition, employees, bills, equipment breakdowns, customer problems.
- **Time commitment**. Running a business is extremely time-consuming. In fact, you will probably have less free time than you would have working for someone else.
- **Undesirable duties**. You will be responsible for either doing or overseeing just about everything that needs to be done, and you will probably have to perform some unpleasant tasks, like firing people.

EXAMPLE 5 STARTING BUSINESS

Because you are convinced that the best way to get rich is to work for yourself, you are thinking about starting your own business. You have an idea and €100,000 that you just inherited from a great-aunt. You even have a location: Palo Alto, California, which (according to a Forbes magazine article) is the best place in the United States to get rich.

However, there is a downside: to move to California and start your own business, you will have to drop out of college. What financial risks should you consider in making your decision? What are your chances of succeeding with your plan? Are you willing to take the financial risk needed to start a business? Why, or why not? Are you likely to make more money running your own business than working for someone else?

4 ENVIRONMENTAL ASSESSMENT: PREPARATION FOR A NEW START-UP

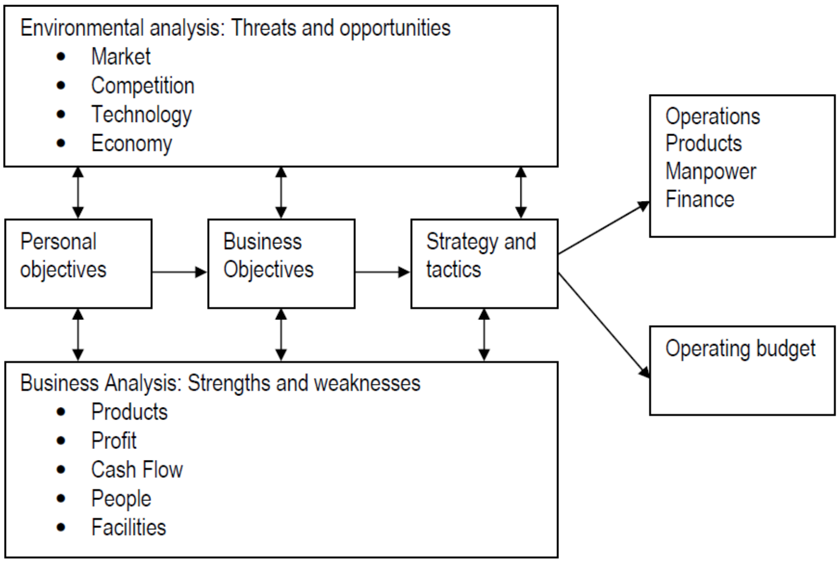
The environment in which it operates and the success of any business is dependent on its ability to adapt to its environment influences a business. A business is any activity that provides goods or services to consumers for making a profit. A figure 13 sums up the relationship among the participants in a business, its functional areas, and the external forces that influence its activities.

Figure 13 Business and its Environment

Source: Collins, 2008

First step for completing successfully the business plan is to provide environmental analysis to be sure in successful implementation of the plan. The analysis consists on some individual steps, which are in one logical frame (see fig.14)

Figure 14 Environmental analyses in relationship with other parts of business plan



Source: Baard, Van Den Berg, 2003, p.3

The complexity of this reality for business owners affects the fact that there are many different environments within each business operates. There is the macro-environment, which in today's global economy refers to the whole world, where events often indirectly affect businesses and there is the microenvironment, local events and circumstances that directly affect and interact with a business:

- **Macro – contextual level**. The contextual level consists of 'global forces', think about economic developments, demographics, politics, technological developments and social developments.
- **Meso – transactional level**. The transactional level consists of 'market forces', think about suppliers, supply and demand, distribution, competitors and strategic alliances.
- **Micro – organizational level**. The organizational level involves forces that address the internal environment of the firm. Think about vision, mission, strategy, resources, processes, products and services.

4.1 ANALYSING MACRO-ENVIRONMENT

Macro environment factors are uncontrollable external forces that affect how a business operates. They are largely out of the control of the business, and often require changes in operating, management, production, and marketing. Analysts often categorize them using the acronyms by using tools PEST or PESTLE. They exist some other techniques like:

- PEST (political, economic, socio-cultural, technological);
- PESTEL (political, economic, socio-cultural, technological, environmental or ecological, legal);
- PESTLIED (political, economic, socio-cultural, technological, legal, international, environmental or ecological, demographic);
- STEEPLE (socio-cultural, technological, environmental or ecological, economic, political, legal, ethical).

Political factors. Examples of political factors could be a potential change of government, with the corresponding changes to policies and priorities, or the introduction of a new government initiative.

Economic factors may also be limited to the home country, but as global trade continues to grow, economic difficulties in one nation tend to have a broad, often worldwide, impact. Examples of economic factors could be the level of growth within an economy, or market confidence in the economies within which the organisation operates.

Technological area covers factors arising from the development of technology. There are two types of technological change: there can be developments in IT, and there can be developments in technology specific to an industry or market, for example enhancements to manufacturing technology.

Legal area - it is vital to consider factors arising from changes to the law, since the last decade has seen a significant rise in the breadth and depth of the legal regulations within which organisations have to operate. Legal compliance has become such an important issue during this period that many business analysis assignments have been carried out for the purpose of ensuring compliance with particular laws or regulations.

Ecological factors arising from concerns about the natural environment, in other words the 'green' issues include increasing concerns about packaging and the increase of pollution.

Table 8 Example of PEST analysis

Political criteria examples	Economical criteria examples	Social criteria examples	Technological criteria examples
• ecological/environmental current legislation • future legislation • international legislation • regulatory bodies and processes • government policies • government term and change • trading policies • funding, grants and initiatives • home market pressure-groups • international pressure-groups • wars and conflicts	• home economy • economy trends • overseas economies • general taxation • taxation specific to product/services • seasonality issues • market/trade cycles • specific industry factors • market routes trends • distribution trends • customer/end-user drivers • interest/ exchange rates • international trade and monetary issues	• lifestyle trends • demographics • consumer attitudes and opinions • media views • law changes affecting social factors • brand, company, technology image • consumer buying patterns • fashion and role models • major events and influences • buying access and trends • ethnic/religious factors • advertising and publicity • ethical issues	• competing technology development • research funding • associated/dependent technologies • replacement technology/ solutions • maturity of technology • manufacturing maturity and capacity • information and communications • consumer buying mechanisms/technology • technology legislation • innovation potential • technology access, licensing, patents • intellectual property issues • global communications

Source: Businessballs, 2009. [online] [Accessed: 19 Jan 2014] Available at: http://www.businessballs.com/freepdfmaterials/pest-analysis-free-template.pdf.

Identifying factors might affect that issue in analysed area. Each factor would analyse to see how it might affect the plan. Not all factors under consideration can consider equally important, so it is very important to see which factors are most important so that decision makers can focus on the ramifications of those factors in the analysis. Having identified the relative importance of the factors, the next stage would be to develop a limited number of possible scenarios (no more than two or three). Each scenario would map out possible outcomes for each key factor. Based on these values, the group conducting the scenario planning exercise would develop insights into this possible future world.

4.1.1 FORECASTING TECHNIQUES IN MACRO-ANALYSING

There are many different techniques and tools, which could be used to forecast these items. These types of techniques are influenced by many factors, such as the following (Cadden and Lueder, 2012):

- **The size of the business**. Smaller businesses may have fewer resources to apply a wide variety of forecasting techniques.
- **The analytical skills of people who will be conducting the forecast**. The owner of a home business may have no prior experience with forecasting techniques.
- **The type of the organization**. A small firm is operating in a new or a chaotic environment might have to rely on significantly different techniques.
- **Historical records**. Does the firm have historical records for sales that can be used to project into the future?

A brief review of basic forecasting techniques shows that it would be divided into two broad classes: qualitative forecasting methods and quantitative forecasting methods. Actually, these terms can be somewhat misleading because qualitative forecasting methods do not imply that no numbers will be involved. A start-up business has no past sales that can be used to project future sales. Likewise, if there is a significant change in the environment, one may feel uncomfortable using past data to project into the future.

QUALITATIVE METHODS

- **Simple extrapolation**. This approach uses some data and simply makes a projection based on these data. The data might indicate that a particular section of town has many people walk through the section each day. Knowing that number, a store might make a simple estimate of what sales might be. Its success depends on the “correctness” of the assumptions and the ability to carry them over to reality. You might have the correct number of people passing your store, but that does not mean that they will buy anything.
- **Sales force**. In firms with dedicated sales forces, you would ask them to estimate what future sales might be. These values would be pieced together with a forecast for next year. The sales force should have the pulse of your customers and a solid idea of their intentions to buy. Its greatest strength is in the B2B environment. It is difficult to use in business-to-customer (B2C) environments. Sales force members are compensated when they meet their quotas, but this might be an incentive to “low-ball” their estimates.
- **Expert opinion**. Similar to sales force approach, this technique ask experts within the company to produce estimates of future sales. These experts may come from marketing, R&D, or top-level management. Sales forecasts of experts should lead to better forecasts.
- **Delphi method**. A panel of outside experts would be asked to estimate sales for a particular product or service. The results would be summarized in a report and given to the same panel of experts. They would then be asked to read their forecast. This might go through several iterations. Best used for entirely new product service categories. One has to be able to identify and recruit “experts” from outside the organization.
- **Historical analogy**. With this technique, one finds a similar product’s or service’s past sales (life cycle) and extrapolates to your product or service. A new start-up has developed an innovative home entertainment product, but nothing like it has been seen in the market. It is relatively easy and quick to develop. One can select the wrong past industry to compare, and the future may not unfold in a similar manner.
- **Market research**. They use questionnaires and surveys to evaluate customer attitudes toward a product or a service. One gains very useful insights into the stated desires and interests of consumers. They can be highly accurate in the short term. They can take time to conduct and are relatively expensive.

QUANTITATIVE SALES FORECASTING METHODS

- **Trend analysis**. This forecasting technique assumes that sales will follow some form of pattern, for example, sales are projected to increase at 15 percent a year for the next five years. Sales seldom follow the same growth rate over any length of time.

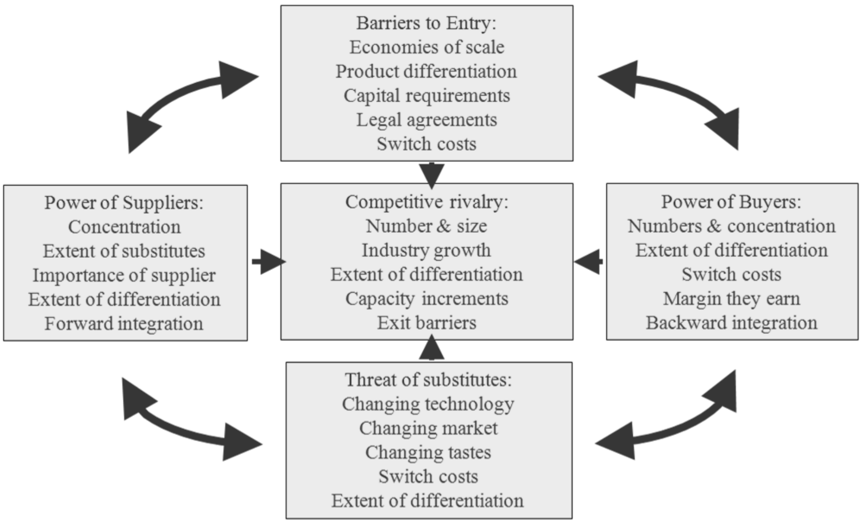
- **Moving average**. This technique takes recent class data for N number of periods, adds them together, and divides by the number N to produce a forecast. The basic use of this type of model fails to consider the existence of trends or seasonality in the data.
- **Seasonality analysis**. Many products and services do not have uniform sales throughout the year. They exhibit seasonality. This technique attempts to identify the proportion of annual sales sold for any given time. The sales of swimming pool supplies in the Northeast, for example, would be much higher in the spring and summer than in the fall and winter. Many products and services have seasonal demand patterns. By considering such patterns, forecasts can be improved. This technique requires several years of past data and careful analysis. Useful for quarterly or monthly forecasts.
- **Exponential smoothing**. This analytical technique attempts to correct forecasts by some proportion of the past forecast error. Incorporates and weighs most recent data. Attempts to factor in recent fluctuations. Several types of this model exist, and users must be familiar with their strengths and weaknesses. Requires extensive data, computer software, and a degree of expertise to use and interpret results.
- **Causal models**. Causal models, of which there are many, attempt to identify why sales are increasing or decreasing. Regression is a specific statistical technique that relates the value of the dependent variable to one or more independent variables. The dependent variable sales might be affected by price and advertising expenditures, which are independent variables. Can be used to forecast and examine the possible validity of relationships, such as the impact on sales by advertising or price. Requires extensive data, computer software, and a high degree of expertise to use and interpret results.

Forecasting key items such as sales is crucial in developing a good business plan. However, forecasting is a very challenging activity. The further out the forecast, the less likely it will be accurate. Regardless of what technique is using of the data source employed in building a forecast for business plan, one should be prepared to justify why you are employing these forecasting models.

4.2 MESO-ENVIRONMENT ANALYSIS

Meso-environment decides the competitive position of the industry vis-a-vis the organisation we study. The environment comprises all those organisations or groups with which firm usually maintains contacts and the firm’s performance is being affected by those groups. Let us discuss the supply chain, of which customers are also part, which affects the performance largely. Meso-environment or competitive environment you can understand through Porter’s Five Forces Industry Analysis. (Burns, 2007).

Figure 15 Porter´ s five forces



Source: Burns, 2007

- **Industry:** What is the level of competition for the products or services in competitors: this industry? Is the organization in a good competitive position or is it a minor player? Are there several competitors that hold the power in the industry?
- **New entrants**: Are there barriers to entry, such as the need for large amounts of money or expertise? Is it possible to start up an organization offering these products or services without financial support? What is the likelihood of new entrants coming into the industry?
- **Substitutes**: What is the range of substitutes available? What is the position of the organisation when compared to the suppliers of these substitutes?
- **Buyers**: How much choice do buyers have? Can they switch suppliers easily? Do they have the power in the relationship or are they locked in to the supplier?
- **Suppliers**: How many suppliers are available? Is this a competitive situation where the organisation has a choice of suppliers? Do the suppliers have the power in the relationship because they operate in an area of limited supply?

4.2.1 MARKET RESEARCH

A market consists of all the consumers who purchase a particular type of good or service. The market may be sub-divided into separate segments each of which can be considered a separate market in its own right. It is very important for a business to be able to define its market:

- estimate the size of the market,
- forecast the growth of the market,
- identify the competitors in the market,
- break the market down into relevant segments to create an appropriate marketing mix to appeal to customers in the market.

Markets are typically structured into segments. Primary segmentation is between customers buying entirely different products. The size of the market can be calculated in terms of the number of customers that make up the market, or the value of sales in the market.

A business can then calculate its market share in terms of the number of customers its sells to, or the total value of its sales. A segmentation can be based on demographic and psychographic factors. Ask yourself:

- What is the price for your solution?
- What is the quantity consumed annually?
- Use Web research, analyst reports for public companies, other experts
- Define your personal focus
- Define a focused market segment
- In your niche, identify target customers, product offering, and compelling reasons to buy.

TYPES OF MARKET

- Business-to-Business (B2B) markets in which a business's customers are other businesses.
- Business to Consumer (B2C) markets in which businesses sell to other customers.
- Some markets take place in a physical location e.g. a street market, whereas others may be virtual markets.

EXAMPLE 6 MARKET STRUCTURE

What type of market structure will your firm operate? Why? Which market structure do you think benefits the producer the most?

	Perfect Competition	**Monopolistic Competition**	**Oligopoly**	**Monopoly**
Number of sellers				
Number of buyers				
Barriers to exit				
Prices higher or lower in the long run?				
Are the products that firms produce the same, or are they different?				

Is there any possibility that your firm can operate in that type of market structure? Why "yes" or why "not"?

4.3 MICRO ENVIRONMENTAL ANALYSIS

Microenvironment factors are factors close to a business that have a direct impact on its business operations and success. Before deciding on corporate strategy, businesses should carry out a full analysis of their microenvironment. From those factors came strength and weaknesses of the future company (using SWOT analysis tool).

The analysis covers mostly performance ratios like financial ratios analysis, analysis of value chains, analysis of current marketing strategies (see chapter 7), life cycle analysis, portfolio analysis.

The SWOT example is first step to find a new business opportunity. Many criteria can apply to more than one quadrant. You have to identify criteria appropriate to your own SWOT situation. The SWOT analysis is the first step in developing strategy (chapter 8).

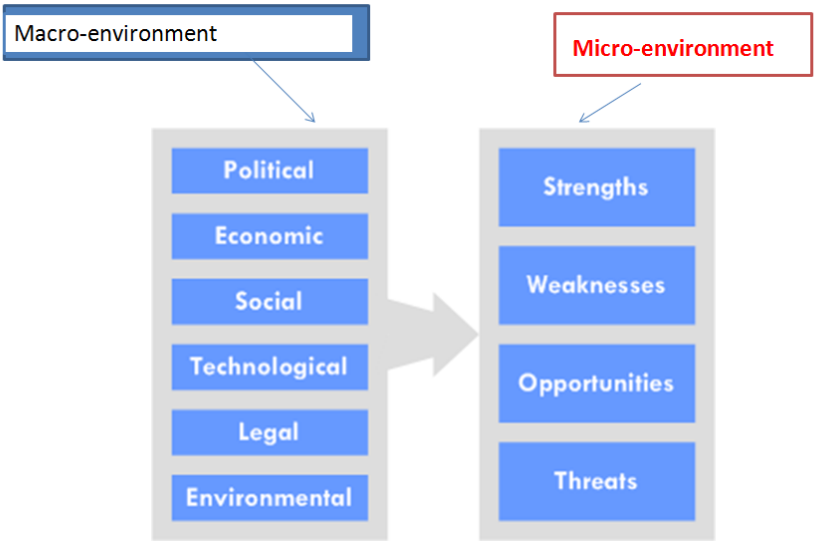
Strengths Criteria Examples	Weaknesses Criteria Examples
Advantages of proposition? Capabilities? Competitive advantages? USP's (unique selling points)? Resources, Assets, People? Experience, knowledge, data? Financial reserves, likely returns? Marketing - reach, distribution, awareness? Innovative aspects? Location and geographical? Price, value, quality? Accreditations, qualifications, certifications? Processes, systems, IT, communications? Cultural, attitudinal, behavioural? Management cover, succession? Philosophy and values?	Disadvantages of proposition? Gaps in capabilities? Lack of competitive strength? Reputation, presence and reach? Financials? Own known vulnerabilities? Timescales, deadlines and pressures? Cashflow, start-up cash-drain? Continuity, supply chain robustness? Effects on core activities, distraction? Reliability of data, plan predictability? Morale, commitment, leadership? Accreditations, etc? Processes and systems, etc? Management cover, succession?
Opportunities Criteria Examples	Threats Criteria Examples
Market developments? Competitors' vulnerabilities? Industry or lifestyle trends? Technology development and innovation? Global influences? New markets, vertical, horizontal? Niche target markets? Geographical, export, import? New USP's? Tactics: eg, surprise, major contracts? Business and product development? Information and research? Partnerships, agencies, distribution? Volumes, production, economies? Seasonal, weather, fashion influences?	Political effects? Legislative effects? Environmental effects? IT developments? Competitor intentions - various? Market demand? New technologies, services, ideas? Vital contracts and partners? Sustaining internal capabilities? Obstacles faced? Insurmountable weaknesses? Loss of key staff? Sustainable financial backing? Economy - home, abroad? Seasonality, weather effects?

Source: Businessballs, 2009. [online] [Accessed: 19 Jan 2014] Available at: www.businessballs.com/swotanalysisfreetemplate.htm

4.3.1 FINAL MODELLING FOR APPROPRIATE ACTION

PEST analysis (political, economic, social, and technological) assesses a market, including competitors, from the standpoint of a particular proposition or a business (macro analysis only). PEST analysis can be useful before SWOT analysis because PEST helps to identify OT factors. SWOT stands for strengths, weaknesses (micro, internal), opportunities, threats (macro, external).

Figure 16 PEST and SWOT connection



Source: own

What the process is seeking to achieve is an overlap between the business environment and internal resources. The final match is to achieve sustainable competitive advantage. This portfolio of resources is combined with various opportunities and treats to achieve company´s goals in a future. (See fig. 17)

Figure 17 SWOT evaluation

Source: IVTO, 2012. ivto.org[online] [Accessed: 19 Jan 2014] Available at: http://www.ivto.org/publicaties/toekomst-robuustheid-afzetmarkt-figuur-13-5.

Finally, we have to evaluate the information from the matrix. Environmental scanning is the process of seeking information about this environment. A six-step procedure, outlined below, systematically evaluates potential strategies by calculating the strategic value and the strategic risk associated with each alternative (Tavana, Banerjee,1995, p.732):

1. Define environment-related weights. Such weights have been assessed in the past directly by decision makers using a scale (e.g. ranging from 1 = unimportant to 5 = very important).
2. Identify opportunities and threats, strengths and weaknesses within each environment (macro, mezzo, micro analysis).
3. Define weights associated with opportunities and threats. Compute the weights associated with each opportunity and threat.

4. Develop subjective probabilities for each alternative. We use probabilistic phrases, like "impossible", 'possible", and "certain" to elicit required information and then convert these into numeric probabilities.
5. Calculate the strategic value for each alternative. Calculate the strategic value of each alternative by using the algebraic model. Relevant details of the model are presented in the next section. The strategic value of an alternative represents the attractiveness of an alternative calculated by subtracting the Total Threat Value of the alternative from its Total Opportunity Value. These two values are in turn calculated by summing the multiplication of the relative weight of each type of environment to the relative weight of each factor within that environment and the subjective probability of that factor for the selected alternative. The higher the strategic value the more attractive that alternative will be.

Table 9 Verbal probabilistic expressions and perceived probability estimates

Verbal expression	Probability
Impossible	0.00
Small possibility	0.10
Small chance	0.20
Somewhat doubtful	0.30
Possible	0.40
Toss-up	0.50
Somewhat likely	0.60
Likely	0.70
Very likely	0.80
Quite certain	0.90
Certain	1.00

Source: Tavana, Banerjee. 1995, p.733

6. Evaluate potential strategies. Compute the strategic value per unit of risk of an alternative by dividing the strategic value by its strategic risk. Higher strategic value increases the desirability, whereas higher risk decreases the desirability of that alternative.

Table 10 SWOT based strategies

INTERNAL FACTORS / EXTERNAL FACTORS	INTERNAL FACTORS	
	Internal Strengths (S)	Internal Weaknesses (W)
External Opportunities (O)	SO (MAXI-MAXI) Strategy	WO (MINI – MINI) Strategy
External Threats (T)	ST (MAXI – MINI) Strategy	WT (MINI – MINI) Strategy

Source: Gierszewska, Romanowska, 2009

The process of strategy formulation starts with, and critically depends on, the appraisal of the external and internal environment of the organization.

1. **WT or the mini – mini strategy** seeks to minimize the weaknesses and threats. Some of the weaknesses may be overcome or minimized. For example, managerial weaknesses may be solved by change of managerial personnel, conducting training etc. Weaknesses due to excess manpower may be addressed to by restructuring and volunteer retirement schemes. External threats may be met by strategic alliance, or by other types of joint ventures.

2. **WO or mini – maxi strategy** aims at minimizing the weaknesses and maximizing the opportunities. For an example: for a textile machinery manufacturer in India the main weaknesses were dependence on foreign firms for technology and the long-time taken on execute an order. The solutions are to give focus on R & D to develop technology and measures to reduce the time lag to be in a better position to the maximum the growing demand.
3. **ST or maxi-mini strategy** attempts to use the organizations strengths to deal with the environmental threats.
4. **SO or maxi-maxi strategy**, which is the most desirable and advantageous strategy, seeks to mass up a firm's strengths to exploit the opportunities. Therefore, it is clear to us that strategy formulation mainly based on strategic analysis and strategy selection by standard criteria's.

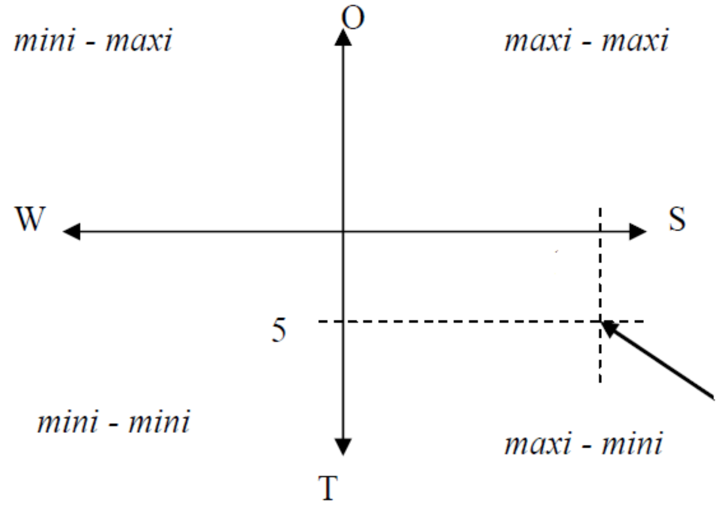
ALGEBRAIC METHOD OF DEFINING THE STRATEGY

1. Define the factors.
2. Give them the value (score), the best is to use the scale <-5;5>, the negative influence mark with the negative value of the scale.
3. Evaluate the probability of influence of your own business in the future. Use the table 9 to help you.
4. Compute real influence of each factor = step (2)* step (3)
5. Sum up each section
6. Use those relationships:
   - market's position $MP = S/(S+W)$
   - market's attractiveness $MA = \frac{O}{O+T}$
   - probability of strategy success $PSS = \frac{MP+MA}{2}$
7. Draw the position from MP and MA and make a comment from index of probability of success, choose the strategy.

	Competitiveness strategy			
	maxi-maxi	mini-maxi	maxi-mini	mini-mini
MP's value	> 0.5	< 0.5	> 0.5	< 0.5
MA's value	> 0.5	> 0.5	< 0.5	< 0.5
PSS value	Success > 0.5	Fail < 0.5		

Source: Gierszewska, Romanowska, 2009, Obłój,1999

Figure 18 Graphic interpretation – An example



Source: own, interpretation: Let us have S, W, O, T value 35, 25, 15 and 20. O minus T = 5, when T>O; S minus W= 10, when S >W. Finally we suggest maxi-mini strategy.MP index= 35/35+25=0.583(maxi); MA index=15/15+20=0.43(mini); PSS= 0.583+0.43/2=0.506=> 50.6% probability of success.

CASE STUDY 2 ANALYTICAL EVALUATION OF PEST AND SWOT [11]

The main goal of elaborating the business plan is to seek a business model, which would guarantee the growth of our company. The idea came from the willingness to satisfy observed need of potential customers. Evaluating the business plan might help us to emphasize the most important factors of success. At this point, it is important to be aware of the high risk of our project. Conducted analyzes will contribute to better understanding of our conception. The business plan refers to the pre-incubation period, which lasts maximum two years. Every analysis, which was made, and plans, which were involved in this paper, applies particularly to the pre-incubation period.

Our mission is to provide a constant improving smart phone device which would allow to create better entertainment offer in area of small and medium, local events, as well as open a channel of contact between event organizers and participants, while ensuring values necessary in economic growth.

The market of mobile application in Poland is still quite new and fresh. What is more, there is still a lot of "undeveloped space" and many possibilities to run the business at this field.

Macroeconomic analysis (PEST)

The PEST analysis was made to define the most important macroeconomic factors that influence the project. The analysis of the environment helped us to get to know the most favourable elements, and the ones, which we should be aware.

Political factors				
No.	Factor	probability	scale	P*S
1	Assistance programs	0,3	3	0,9
2	EU donations	0,1	2	0,2
3	Local regulations	0,1	2	0,2
4	Complicated and high taxation	0,3	-4	-1,2
5	Constantly changing and complicated law related to SMEs	0,2	-3	-0,6
Total		1	-	-0,5

[11] GWIZDOŃ, M and M. GŁUSZEK, 2013. *Start-up plan – innovative smart phone application for entertainment event promotion*. Small and medium entrepreneurship – project. Karviná: SU OPF. p. 15-17.

In those tables, the scale was made positive for opportunities, negative for threats. The sum for probability has to be 1 in total; be careful.

The most unfavourable environment is political. This is because of many difficult laws and restrictions, which appears in the Polish statute system. Creating and running business is very difficult and complicated. Moreover, the taxes are high, as well as the costs of running the business.

Economic factors				
No.	Factor	probability	scale	P*S
1	Possibilities of getting external capital	0,35	4	1,4
2	High costs of running a business	0,2	-3	-0,6
3	High costs of capital	0,2	-2	-0,4
4	Possibilities for taking a bank credit	0,1	1	0,1
5	Structure of investments	0,15	2	0,3
total		1	-	0,8

Social factors				
No.	Factor	probability	scale	P*S
1	Society's lifestyle	0,2	2	0,4
2	Age structure	0,2	-2	-0,4
3	Quality of relationships between people	0,3	3	0,9
4	Dependence on technology	0,1	3	0,3
5	Willingness to take part in entertainment events	0,2	3	0,6
SUM		1	-	1,8

Social and economic environment showed us standard structure, typical for start-ups and typical for Visegrad countries.

Technological factors				
No.	Factor	probability	scale	P*S
1	Speeding the process of information exchange	0,2	4	0,8
2	Changing possibilities of capitalization	0,2	3	0,6
3	Facilitations in creating smart phone application	0,1	1	0,1
4	Common habit of using every-day technological utilities	0,3	4	1,2
5	Evaluating models of smart phones	0,2	-2	-0,4
total		1	-	2,3

The most positive environment is technical. The market of Smartphone apps is growing rapidly, and we can observe more and more users of them. The trade of new technologies is the one with the biggest perspectives. In addition, people are getting use-to-use mobile applications in everyday life.

According to our analysis, we can observe that macroeconomic environment is quite favourable for running into practice the idea of creating the application. That might not last long, so we need to keep an eye on the situation at the market and react for every change.

Microeconomic analysis (SWOT)

Microeconomic analysis was performed in order to identify the most important and influencing factors related to our idea. The results of SWOT analysis point out the strategy that should be chosen, as well as, the direction of future moves.

Strengths				
No.	Factor	probability	scale	P*S
1	Innovative idea	0,4	5	2
2	"Fresh look"	0,1	3	0,3
3	Proposed solution based on social media network	0,2	3	0,6
4	Motivated team	0,2	4	0,8
5	Independence in decision making process	0,1	3	0,3
Total		1	-	4

Strength factors resulted in the highest rating. The main reason is the innovative idea, which is also based on social networking. It is always easier to create something new and build your own position on the market than trying to enter the market, which is already grown and full of competition.

Weaknesses				
No.	Factor	probability	scale	P*S
1	Lack of experience in running a business	0,25	4	1
2	Huge responsibility and commitment	0,1	3	0,3
3	Need for external capital/investments	0,2	4	0,8
4	Dependence on potential investor's conditions	0,15	3	0,45
5	Lack of technical knowledge	0,3	4	1,2
Total		1	-	3,75

The biggest issue for us is the lack of experience in running a business. We are aware how complicated that process is. In order to overcome it we can use the opportunities given by the business environment (trainings, counselling etc.). In addition, lack of technical knowledge is a high rank problem resulting in necessity of cooperation with IT developers. Finding the capital and investors is a big problem. Especially, the fact, that investors might influence our vision and idea in undesirable way.

Opportunities				
No.	Factor	probability	scale	P*S
1	Growing market of smart phone applications	0,2	4	0,8
2	Different possibilities to arise the capital	0,2	3	0,6
3	Market niche	0,25	4	1
4	Growing number of smart phones	0,2	5	1
5	Contests for start-up plans	0,15	3	0,45
total		1	-	3,85

The most important opportunities for us are the market niche and growing market, that we can use it on our benefit. Entering the new market, with weak competition is the opportunity, which has to be used. The most important thing is to act quickly and definitely as this opportunity might be taken advantage of by others.

Threats				
No.	Factor	probability	scale	P*S
1	Competitors might use our idea	0,3	5	1,5
2	Necessity to cooperate with developers	0,2	4	0,8
3	High dependence on user's acceptance	0,15	3	0,45
4	Constantly changing and complicated law related to SMEs	0,15	3	0,45
5	Sceptical event organizers	0,2	2	0,4
Total		1	-	3,6

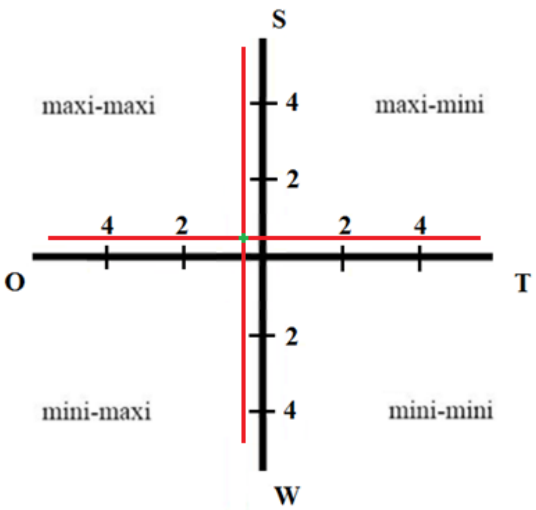
When looking at opportunities and threats, PEST Analysis can help to ensure that you do not overlook external factors, such as new government regulations, or technological changes in your industry.

Algebraic method of defining the strategy	
MP [S/(S+W)]- market's position =	0,5161
MA [O/(O+T)]- market's attractiveness =	0,5168
PSS [MP+MA/2]	0,51645

	Competitiveness strategy			
	maxi-maxi	mini-maxi	maxi-mini	mini-mini
MP's value	> 0.5	< 0.5	> 0.5	< 0.5
MA's value	> 0.5	> 0.5	< 0.5	< 0.5
PSS value	Success > 0.5	Fail < 0.5		

The SWOT analysis resulted in proposing the best strategy. In our case the competitiveness strategy, which should be used, is maxi-maxi.

It means that our strengths overcome the weaknesses and opportunities overcome the threats. In that situation, according to the management theory, we should enter the noticed market, invest in our idea and build the competitiveness advantage.



In other words, the value of planning is really as a continuing process, repeated regularly due to changes in the business environment. According those analysis you provide your business (managing, preparing general strategy – chapter 8, prepare marketing strategy (chapters 7); integrate operating needs like human resources (chapter 6) and financial needs (chapter 9).

EXAMPLE 7 TRY YOUR OWN DRAFT OF A BUSINESS PLAN

With lecturer´s help try to develop business plan according those story, see enclosure no. 2 for initial help:

Let us start with three givens: (1) college students love chocolate chip cookies, (2) you have a special talent for baking cookies, and (3) you are always broke. Given these three conditions, you have come up with the idea of starting an on-campus business—selling chocolate chip cookies to fellow students. As a business major, you want to do things right by preparing a business plan. First, you identified a number of specifics about your proposed business. Now, you need to put these various pieces of information into the relevant section of your business plan. Using the business plan format described in this chapter, indicate the section of the business plan into which you would put each of the following:

- You will bake the cookies in the kitchen of a friend's apartment.
- You will charge €1 each or €10 per pack of 12 cookies.
- Your purpose is to make the best cookies on campus and deliver them fresh. You value integrity, consideration of others, and quality.
- Each cookie will have ten chocolate chips and will be superior to those sold in nearby bakeries and other stores.
- You expect sales of €6,000 for the first year.

Chocolate chip cookies are irresistible to college students. There is a lot of competition from local bakeries, but your cookies will be superior and popular with college students. You will make them close to campus using only fresh ingredients and sell them for €1 each. Your management team is excellent. You expect first-year sales of €6,000 and net income of €1,500. You estimate start-up costs at €600.

- You will place ads for your product in the college newspaper.
- You will hire a vice president at a salary of €100 a week.
- You can ship cookies anywhere in the Czech Republic and in Slovakia.
- You need €600 in cash to start the business.
- There are six bakeries within walking distance of the college.
- You will bake nothing but cookies and sell them to college students. You will make them in an apartment near campus and deliver them fresh.

5 MANAGING THE SMALL BUSINESS

In general, small entrepreneur in role of manager would need to be an effective planner, organizer, problem solver and decision maker, and be able to manage people effectively (Stokes, Wilson, 2010). All small businesses need to be concerned about management principles. Management decisions will affect the success of a business, the health of its work environment, its growth if growth is an objective, and customer value and satisfaction.

A manager, someone like you, to make sure that the operations involved in preparing and selling notes were performed in both an effective and an efficient manner. You would make the process effective by ensuring that the right things were done and that they all contributed to the success of the enterprise. You would make the process efficient by ensuring that activities were performed in the right way and used the fewest possible resources. As you can see from Figure 19, "Managerial Efficiency and Effectiveness", that is the job that you perform as a manager: making a group of people more effective and efficient with you than they would be without you (Collins, 2008).

Figure 19 Managerial Efficiency and Effectiveness

Source: Collins, 2008

You will accomplish this task through management: the process of planning, organizing, directing, and controlling resources to achieve specific goals.

5.1 MANAGEMENT FUNCTIONS

5.1.1 PLANNING

Among the various functions of managing, planning perhaps contributes the most to new business performance. Planning offers a defined activity of action for the critical first initial period of the new business. Planning is often called the primary management function because it establishes the basis for all other functions. Planning involves two important elements: goals and plans.

Goals are desired outcomes for individuals, groups, or entire organizations. Plans are documents that outline how goals are going to be met and that typically describe resource allocations, schedules, and other necessary actions to accomplish the goals. The three levels of goals within an organization form a hierarchy of goals, with lower-level goals forming a mean-end chain with the next level of goals.

Strategic goals are broadly defined targets or future results set by top management.

- Tactical goals are the targets or future results usually set by middle management for specific departments or units.
- Operational goals are those targets or future end results set by lower management that address specific, measurable outcomes required from the lower levels.

LINKAGE BETWEEN GOALS AND PLANS

Goal and plans are closely linked. Plans specify the means how to achieve the goals. Plans, like goals, enter into a hierarchy of levels and priority.

Strategic plans are detailed action steps mapped out to reach strategic goals. Strategic plans are organizational wide and are developed by top management. The time horizon tends to be long 3 to 5 years or more.

Tactical plans are the means charted to support implementation of the strategic plan and achievement of tactical goals. Tactical plans tend to be more specific and concrete than strategic plans. Tactical plans are important to the success of strategic plans. The time horizon tends to be intermediate in range 1 to 3 years.

Operational plans are the means devised to support implementation of tactical plans and achievement of operational goals. Operational plans spell out specifically what must be accomplished to achieve operational goals. The time horizon is relatively short-tem—usually less than 1 year as a maximum.

Plans can be categorized according to the extent to which they will be used on a recurring basis. Single-use plans are plans aimed at achieving a specific goal that, once reached, will most likely not recur in the future.

- A program is a comprehensive plan that coordinates a complex set of activities related to a major non-recurring goal.
- A project is a plan that coordinates a set of limited-scope activities that do not need to be divided into several major projects in order to reach a major non-recurring goal. Programs are broader than projects.
- Standing plans are plans that provide ongoing guidance for performing recurring activities.
  - A policy is a general guide that specifies the broad parameters within which organization members are expected to operate in pursuit of organizational goals.
  - A procedure is a prescribed series of related steps to be taken under certain recurring circumstances.

The overall planning process

Planning is a two-part function—setting goals and determining how to try to achieve the goals. A **goal** (often used interchangeably with “objective”) is a future target or end result that an organization wishes to achieve. A **plan** is the means devised for attempting to reach a goal.

An organization’s **mission** is the organization’s purpose or fundamental reason for existence. A mission statement is a broad declaration of the basic, unique purpose and scope of operations that distinguishes the organization from others of this type. A mission statement serves a variety of purposes. For managers, a mission statement can be a benchmark against which to evaluate success. For employees, mission statements define a common purpose, nurture organizational loyalty, and help foster a sense of community among members. For external groups, mission statements help provide unique insights into an organization's values and future directions. The mission statement typically defines the organization in terms of the important attributes of the organization.

- Customers: Who are the organization's customers?
- Products or services: What are the organization's major products or services?
- Location: Where does the organization compete?
- Technology: What is the firms' basic technology?
- Philosophy: What are the basic beliefs, values, aspirations, and philosophical priorities of the organization?
- Self-concept: What are the organization's major strengths and competitive advantages?
- Concern for public image: what are the organization's public responsibilities and what image is desired?
- Concern for employees: What is the organization's attitude toward its employees?

The planning process can be used to promote innovation in organizations. The organizational mission statement can be a primary means of encouraging innovation. The goals component can translate the mission in a way supporting innovation. The plans component can provide actual plans for achieving innovative outcomes. Obstacles to planning threaten the ability of organizations to develop effective plans.

- Plans in a rapidly changing environment require frequent revisions. Manager may resist formalized planning if they believe planning is unnecessary. The pressure of day-to-day responsibilities may keep managers from planning. Managers may be poorly prepared. Staff specialists may come to dominate the planning process
- Organizations can take steps to reduce the obstacles to planning. Top-level managers may demonstrate their support of the planning process.
- Planning staffs is a small group of individuals who assist top-level managers in developing the various components of the planning process. This staff should focus on helping rather than taking over the planning process.
- Contingency planning is the development of alternative plans for use in the event that environmental conditions evolve differently than anticipated, rendering original plans unwise or unfeasible.

Developing Plans

The process of developing plans is influenced by three contingency factors and by the planning approach followed. **Operational planning** usually dominates the planning activities of lower-level managers. As managers move up through the levels of the organization, their planning becomes strategic. The greater the environmental uncertainty, the more plans should be directional and emphasis placed on the short term. When uncertainty is high, plans should be specific, but flexible.

- Managers must be prepared to rework and amend plans, or even to abandon their plans.
- Planning for too long or for too short a time period is inefficient and ineffective.

5.1.2 ORGANIZING

The organizing function would involve developing an organizational structure through job design, departmentalization, determining span of control, and delegating authority. Effectively, these tasks would provide a structure of relationships and authority that coordinates the organization's efforts. Organization structure is the formal pattern of interactions and coordination designed by management to link the tasks of individuals and groups in achieving organizational goals. An organizational structure is the formal framework by which job tasks are divided, grouped, and coordinated. Except for a small business run solely by its owner, every small business needs a management hierarchy—no matter how small. Each person in the business should know who is responsible for what, have the authority to carry out his or her responsibilities, and not get conflicting instructions from different bosses.

This formal pattern designed by management is to be distinguished from the informal pattern of interactions that simply emerges within an organization. Organization design is the process of developing an organization structure. Organizational design is the process of developing or changing an organization's structure. It involves decisions about six key elements: work specialization, departmentalization, and chain of command, span of control, centralization/decentralization, and formalization. We need to take a closer look at each of these structural elements.

The organization chart is a line diagram that depicts the broad outlines of an organization's structure. While varying in detail from one organization to another, typically organization charts show the major positions or departments in the organization, the way positions are grouped together, reporting relationships for lower to higher levels, official channels for communications, and possibly the titles associated with major positions in the organization.

The organization chart provides a visual map of the chain of command, the unbroken line of authority that ultimately links each individual with the top organizational position thorough a managerial position at each successive layer in between. Nearly all organizations having just a few members have an organization chart. Responsibility is the obligation or expectation to perform and carry out duties and achieve goals related to a position. Authority is the right inherent in a managerial position to tell people what to do and to expect them to do it, right to make decisions and carry out actions to achieve organizational goals. While part of a manager's work may be delegated, the manager remains accountable for results.

- Accountability is the requirement of being able to answer for significant deviations from duties or expected results.
- The fact that managers remain accountable for delegated work may cause them to resist delegation.

Delegation is assignment of part of manager's work to others along with responsibility and authority. In addition to issues of accountability, managers may resist delegation for a number of reasons.

- Managers may fear if subordinates fail.
- Managers may think they lack time to train subordinates.
- Managers may want to hold on to their power.
- Managers may enjoy doing the tasks subordinates could do.
- Managers may feel threatened by subordinates.
- Managers may not know how to delegate.
- Subordinates may resist delegation because of fear of failure or of risk taking.
- Failure to delegate may have serious negative consequences for a manager's career.

The organizing process raises some important questions: What jobs need to be done? Who does what? Who reports to whom? What are the formal relationships among people in the organization? You provide answers to these questions by developing an organizational structure: an arrangement of positions that is most appropriate for your company at a specific point in time. Remember, given the rapidly changing environment in which businesses operate a structure that works today might be outdated tomorrow. In building an organizational structure, you engage in two activities: job specialization (dividing tasks into jobs) and departmentalization (grouping jobs into units). We will now see how these two processes are accomplished.

5.1.3 MANAGING PEOPLE IN THE SMALL BUSINESS (DIRECTING)

A critical requirement of effective entrepreneurship is effectively managing and motivating employees. These activities make up the leadership function. This involves encouraging employees to work to achieve the business's goals by effectively communicating the tasks, which have to be done, rewarding good performance, and creating an environment that supports the employees' efforts and individual needs (more in chapter 6). Directing is providing focus and direction to others and motivating them to achieve organizational goals.

LEADERSHIP STYLES

Actually, it is fairly easy to pick up a baton, cue each section, and strike up the band. However, it does not follow that the music will sound good. What if your cues are ignored, misinterpreted, or ambiguous? Maybe your musicians don't like your approach to making music and will just walk away. On top of everything else, you don't simply want to make music: you want to inspire your musicians to make great music. How do you accomplish this goal? How do you become an effective leader? What style, or approach, should you use to motivate others to achieve organizational goals?

Unfortunately, there are no definitive answers to questions like these. Over time, every manager refines his or her own leadership style, or way of interacting with and influencing others. Despite a vast range of personal differences, leadership styles tend to reflect one of the following approaches to directing and motivating people: the autocratic, the democratic, or the laissez-faire. Let's see how managerial styles reflect each of them in a work situation.

- **Autocratic style**. Managers who have developed an autocratic leadership style tend to make decisions without soliciting input from subordinates. They exercise authority and expect subordinates to take responsibility for performing the required tasks without undue explanation.
- **Democratic style.** Managers who favour a democratic leadership style generally seek input from subordinates while retaining the authority to make the final decisions. They are also more likely to keep subordinates informed about things that affect their work.
- **Laissez-faire style**. In practicing a laissez-faire leadership style, managers adopt a "hands-off" approach and provide relatively little direction to subordinates. They may advise employees but usually give them considerable freedom to solve problems and make decisions on their own.

5.1.4 CONTROLLING

The process of comparing actual to planned performance and taking necessary corrective action is called controlling. The-controlling function would involve establishing standards, obtaining information that provides a comparison of actual with desired results, and taking actions to correct any adverse.

Control responsibilities differ according to managerial level. There are five commonly identified steps in the controlling process.

Figure 20 Steps in the controlling process

Source: Collins, 2008

Setting performance standards is the first step. Standards let employees know what to expect in terms of time, quality, quantity, and so forth. The second step is measuring performance, where the actual performance or results are determined. Comparing performance is step three. This is when the actual performance is compared to the standard. The fourth and last step, taking corrective action, involves making whatever actions are necessary to get things back on track. The controlling functions should be circular in motion, so all the steps will be repeated periodically until the goal is achieved.

- Strategic control involves monitoring critical environmental factors that could affect the viability of strategic plans, assessing the effects of organizational strategic actions, and ensuring that strategic plans are implemented as intended. Strategic control is typically the domain of top-level managers who must insure core competencies are developed and maintained. Long periods are involved, although shorter periods may be appropriate in turbulent environments.
- Tactical control focuses on assessing the implementation of tactical plans at departmental levels, monitoring associated periodic results, and taking corrective action as necessary. Tactical control is primarily under the direction of middle managers, but top-level managers may at times get involved. Periods are periodic, involving weekly or monthly reporting cycles. Tactical control involves department-level objectives programs, and budgets.
- Operational control involves overseeing the implementation of operating plans, monitoring day-to-day results, and taking corrective action when required. Operational control is the responsibility of lower-level managers. Control is a day-to-day process. The concern is with schedules, budgets, rules, and specific outputs of individuals. For controls and three levels to be effective, they must operate in concert with one another.

Types of controls

Controls can be classified according to their timing or place in the productive cycle.

- **Feed forward control** focuses on the regulation of inputs to ensure that they meet the standards necessary for the transformation process. The emphasis is upon preventing problems. Other names for feed forward control are "preliminary control," "pre-control," "preventative control" and "steering control."
- **Concurrent control** involves the regulation of ongoing activities that are part of the transformation process to ensure that conform to organizational standards. Checkpoints are in place to determine whether to continue the process, take corrective action, or stop worked altogether. Other names for concurrent control are "screening" and "yes-no control." This type of control is not appropriate for work that requires creativity or innovation.
- **Feedback control** is regulation exercised after a product or service has been completed in order to ensure that the final output meets organizational standards and goals. Feedback control is used when feed forward and concurrent controls are not feasible or are too costly. Other names for feedback control are "post action control" or "output control." Feedback control serves a number of functions:
    - To serve as a final means to check for deviations not detected earlier
    - To provide information that will facilitate the planning process
    - To provide information regarding employee performance
- **Multiple control systems** are systems that use two or more of the feed forward, concurrent, and feedback control processes and involve several strategic control points. Multiple control systems develop because of the need to control various aspects of a productive cycle, including inputs, transformation, and outputs. Computer software companies provide examples of processes complex enough to require multiple controls. Managers might use any of the following types of performance control tools: financial controls, information controls, balanced scorecard approach, or benchmarking best practices approach.
- **Financial Controls.** Financial ratios are calculated by taking numbers from the organization's primary financial statements—the income statement and the balance sheet. The four key categories of financial ratios are as follows.
    - Liquidity ratios measure an organization's ability to meet its current debt obligations.
    - Leverage ratios examine the organization's use of debt to finance its assets and whether it is able to meet the interest payments on the debt.
    - Activity ratios measure how efficiently the firm is using its assets.
    - Profitability ratios measure how efficiently and effectively the firm is using its assets to generate profits. We have also discussed budgets as a planning tool. However, budgets are also control tools. They provide managers with quantitative standards against which to measure and compare actual performance and resource consumption.
    - **Other Financial Control Measures**. Managers are using measures such as EVA (economic value added) and MVA (market value

added). Economic value added is a tool for measuring corporate and divisional performance by calculating after-tax operating profit minus the total annual cost of capital. Market value added adds a market dimension by measuring the stock market's estimate of the value of a firm's past and expected capital investment projects.

- **Information Controls.** Controlling information can be vital to an organization's success. We need to look at the development and use of management information systems. A management information system is a system that provides managers with needed and usable information on a regular basis. Managers need usable information, not just data. Information can help managers control the various organizational areas efficiently and effectively. It plays a vital role in the controlling process.
- **Balanced Scorecard Approach.** The balanced scorecard is a performance measurement tool that looks at four areas—financial, customer, internal processes, and people/innovation/growth assets—that contribute to a company's performance. The intent of the balanced scorecard is to emphasize that all of these areas are important to an organization's success.
- **Benchmarking of Best Practices.** Benchmarking is the search for the best practices among competitors or non-competitors that lead to their superior performance. Internal benchmarking best practices program.
- **Establishing Quality Management Systems.** By implementing international quality standards like ISO-9000, European Quality Award, Deming Prize, or Malcom Balridge Award; an organization can boost its productivity and quality. This will give advantage for a continuous improvement and consistent quality products for customers and keeping the employees happy as well. One can also adapt TQM philosophy of Deming, Juran or Crosby or Taguchi to outperform their competitors in the global market.

CASE STUDY 3 GREEN THUMB[12]

The motivation to set up your own business can come from deep inside and wait a long time to find the best opportunity. The process is not linear or necessarily sequential – and many might say luck is involved.

Case questions:

1. In what ways did Stephen minimise his start-up and growth costs?
2. How much of Stephen has success was down to luck?
3. Would Stephen have succeeded in any business?

Stephen Waring's entrepreneurial instinct kicked in at the age of 14 when he started framing old prints and selling them at local fetes around his hometown in North Wales in his spare time. Stephen's father was the sales director for a loft insulation firm and by the age of 16, he was helping canvas potential customers by knocking on doors. He was good at selling, and so when he left school at 17 he set up his own loft insulation firm – it came naturally. He was so successful he even persuaded his older brother to come and help him. Therefore, when his brother married an American girl in 1985, Stephen went to the USA for his wedding. There he met her uncle who owned a lawn treatment-company. He also found out that 24% of homes in the USA hired someone to treat their lawns in some way.

Despite sceptical parents, Stephen researched the idea. First, he set out to find competitors by looking through the Yellow Pages telephone directories, but he could not find

[12] Burns, 2007, p.120

anybody offering the same service in the UK. The question was whether nobody else had thought about this idea or whether there was no demand for this sort of service. Stephen could not believe that a service that sold to millions of people in the USA would not sell in the UK so he decided to persevere. Next, he set out to find the best mix of fertilizer ingredients for the UK. He experimented on his parents' lawn, turning it orange and black in the process. Having perfected a suitable mix, Stephen next spent £64 on printing 1000 leaflets and hand delivered them around housing estates near his home. Then he went around doing what he did best – knocking on doors and selling. In this way, he secured 70 customers.

In this way Green Thumb was born. Stephen quickly developed a routine of visiting customers four or five times a year to treat their lawns, like in the USA. The treatment worked and word-of-mouth brought in more customers, so Stephen brought in his younger brother to help him. By 1995, Green Thumb had several thousand regular customers and that was when the next stage in the business's development came about. A customer asked him to sell him a Green Thumb franchise. By 1996, Stephen was selling franchises around the UK. By 2005 there were some 113 franchises servicing over seven million customers, each spending about £26 on lawn treatment. Franchisees had sales of £25 million a year, giving the company royalties of £5 million. Green Thumb is growing at 5% per year.

'When people ask me if I ever imagined that my business would be as successful as it has turned out to be, I have to say yes. And we are still embryonic in our growth….The challenge was developing an industry from scratch as opposed to jumping on the bandwagon of somebody else who was already doing it….It helps to have a strong belief in your abilities and not to feel insecure.'

Sunday Times, 2 October 2005

Case suggestions:

1. To minimise costs Stephen did things himself like:
   - • Market research
   - • Product research
   - • Leaflet distribution
   - • Selling
   - - Used his family (brother)
   - - Grew the business through franchise

2. How much is luck and how much being alert to opportunities? He spotted the business opportunity on a visit to the USA, but he customised it to UK conditions. A customer asked him for a franchise, but he decided to roll it out in this way.

3. This is anybody's guess. According this story, he would.

5.1.5 DECISION MAKING AND DECISION TAKING

Decision-making situations differ according to the types of problems that must be handled. Certainty is a situation in which a manager can make accurate decisions because the outcome of every alternative is known. However, this is not characteristic of most managerial decisions. Uncertainty is a condition in which the decision maker chooses a course of action without complete knowledge of the consequences that will follow implementation. Risk is the possibility that a chosen action could lead to losses rather than the intended results.

- Uncertainty is seen as the reason why situation is risky.
- A rapidly changing environment is a major cause of uncertainty.

RATIONAL DECISION-MAKING

Although we know about the decision-making process, we still do not know much about the manager as a decision maker. In this session, we will look at how decisions are made, the types of problems and decisions managers face, the conditions under which managers make decisions, and decision-making styles. Decision-making is the process through which managers identify organizational problems and attempt to resolve them. Decision makers face three types of problems.

- A crisis problem is a serious difficulty requiring immediate action.
- A non-crisis problem is an issue that requires resolution, but does not simultaneously have the importance and immediacy characteristics of crises.
- An opportunity problem is a situation that offers a strong potential for significant organizational gain if appropriate actions are taken. Opportunities involve ideas that could be sued, rather than difficulties that must be resolved. Non-innovative managers tend to focus on problems rather than upon opportunities.

TYPES OF PROBLEMS AND DECISIONS

Managers will face with different types of problems and will use different types of decisions.

- Well-structured problems are straightforward, familiar, and easily defined. In handling this situation, a manager can use a programmed decision, which is a repetitive decision that can be handled by a routine approach. There are three possible programmed decisions.
    - A procedure is a series of interrelated sequential steps that can be used to respond to a structured problem.
    - A rule is an explicit statement that tells managers what they ought or ought not to do. A policy is a guide that establishes parameters for making decisions rather than specifically stating what should or should not be done.
- Poorly structured problems are new or unusual problems in which information is ambiguous or incomplete. These problems are best handled by a non-programmed decision that is a unique decision that requires a custom-made solution.

DECISION-MAKING STYLES

Managers have different styles when it comes to making decisions and solving problems. One perspective proposes that people differ along two dimensions in the way they approach decision-making.

- One dimension is an individual’s way of thinking—rational or intuitive. The other is the individual’s tolerance for ambiguity—low or high.
- These two dimensions lead to a two by two matrix with four different decision-making styles.
    - The directive style is one that is characterized by low tolerance for ambiguity and a rational way of thinking.
    - The analytic style is one characterized by a high tolerance for ambiguity and a rational way of thinking.

- The conceptual style is characterized by an intuitive way of thinking and a high tolerance for ambiguity.
- The behavioural style is one characterized by a low tolerance for ambiguity and an intuitive way of thinking.

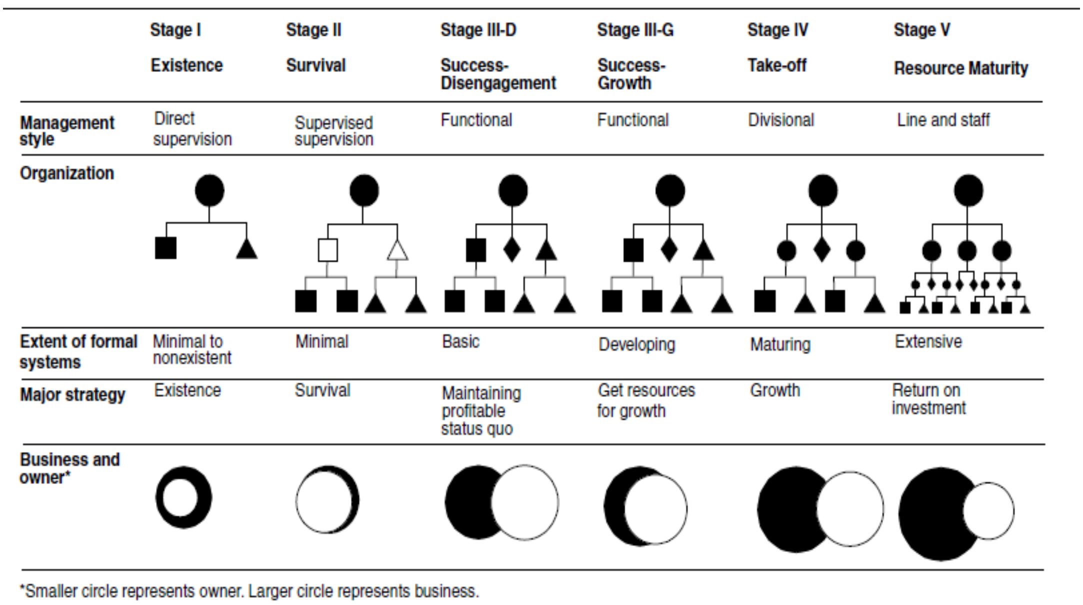
- Most managers realistically probably have a dominant style and alternate styles, with some relying almost exclusively on their dominant style and others being more flexible depending on the situation.

5.2 A MANAGER AND CURRENT BUSINESS STAGE

A classic study by Churchill and Lewis (1983) identified five stages of small business growth: existence, survival, success, take-off, and resource maturity. Each stage has its own challenges and requirement to the management position.

Stage I: Existence. This is the beginning. The business is up and running. The primary problems will be obtaining customers and establishing a customer base, producing products or services, and tracking and conserving cash flow. The organization is simple, with the owner doing everything, including directly supervising a small number of subordinates. Systems and formal planning do not exist. The companies that stay in business move to Stage II. Managerial position is creative, mainly connected with the owner.

Figure 21 Business stage by Churchill and Lewis



Source: Churchill and Lewis, 1983 p.34

Stage II: Survival. The business is now a viable operation. There are enough customers, and they are being satisfied well enough for them to stay with the business. The company's focal point shifts to the relationship between revenues and expenses. Owners will be concerned with (1) whether they can generate enough cash in the short run to break even and cover the repair/replacement of basic assets and (2) whether they can get enough cash flow to stay in business and finance growth to earn an economic return on assets and labour. The organizational structure remains simple. Little systems development is evident, cash forecasting is the focus of formal planning, and the owner still runs everything. Managerial position is innovative.

Stage III: Success. The business is now economically healthy, and the owners are considering whether to leverage the company for growth or consider the company as a means of support for them as they disengage from the company. There are two tracks within the success stage. The first track is the success-growth sub stage, where the small business owner pulls all the company resources together and risks them all in financing growth. Systems are installed with forthcoming needs in mind. Operational planning focuses on budgets. Strategic planning is extensive, and the owner is deeply involved. The management style is functional, but the owner is active in all phases of the company's business. The second track is the success-disengagement sub stage, where managers take over the owner's operational duties, and the strategy focuses on maintaining the status quo. Cash is plentiful, so the company should be able to maintain itself indefinitely, barring external environmental changes. The owners benefit indefinitely from the positive cash flow or prepare for a sale or a merger. The first professional managers are hired and basic financial, marketing, and production systems are in place. Managerial position is focused on task.

Stage IV: Take-off. This is a critical time in a company's life. The business is becoming increasingly complex. The owners must decide how to grow rapidly and how to finance that growth. There are two key questions: (1) Can the owner delegate responsibility to others to improve managerial effectiveness? (2) Will there be enough cash to satisfy the demands of growth? The organization is decentralized and may have some divisions in place. Both operational planning and strategic planning are being conducted and they involve specific managers. If the owner rises to the challenges of growth, it can become a very successful big business. If not, it can usually be sold at a profit. Managerial position is to get confidence.

Stage V: Resource Maturity. The company has arrived. It has the staff and financial resources to engage in detailed operational and strategic planning. The management structure is decentralized, with experienced senior staff, and all necessary systems are in place. The owner and the business have separated both financially and operationally. The concerns at this stage are to (1) consolidate and control the financial gains that have been brought on by the rapid growth and (2) retain the advantage of a small size (e.g., response flexibility and the entrepreneurial spirit). If the entrepreneurial spirit can be maintained, there is a strong probability of continued growth and success. If not, the company may find itself in a state of ossification. These are common traits in large corporations. Managerial position is independent from the owner.

5.3 A MANAGER AND THE LEGAL FORM SELECTION

Selecting the form of business organization that is adopted by a business depends on many factors. One could begin by anticipating the eventual size and nature of the business. The complexity of a business may dictate the type of business organization that is adopted. However, many of the factors that go into this determination are either directly or indirectly financial in nature. The indirect factors are as follows: the extent to which a business owner wishes to attain control of the business, the relationship that the owner would have with partners or investors, and the perceived risk associated with the business. This last factor is tied to the question of the extent to which the owner will invest his or her own money and assets. The direct financial factors that go into selecting the type of the business organization include the following: expected profits or losses, tax issues, the vulnerability and threat from lawsuits, and the ability to extract profits from the business for the owner's use. Decide whether you are running this business by yourself or with others involved

- If by yourself, you will be running a sole proprietorship.
- Is it more important to you to have a simple business and tax structure or less personal liability for debts and corporate judgements?

- If you want a simple business and tax structure with more than one person, choose a partnership.
- If you want to limit your personal liability for debts, choose to incorporate.
- If you were incorporating, would you trade more flexibility for greater confusion in the tax laws?

To establish a company in another country than the Czech Republic, it is critical to make a comparative analysis of future costs of carrying on business in our republic and the EU.

Table 11 Main areas of Start-up costs

Section	Criterion
Goods and services free mobility	• Basic principles in the integrated EU market
Free mobility of persons	• Wages and salaries costs, • Insurance costs paid by employer • Long-term residence in EU, permission for working in another country
Free mobility of capital	• Amount of registered capital for foundation of common company forms such as limited liability company, joint stock company or self proprietor • administrative costs and barriers, • VAT rate

When we intend to carry on business in the Czech Republic, we are obliged to follow the Czech Commercial Code, which stipulates the amount of the registered capital, which depends on the company legal form. In order to be permitted to establish a company with limited liability in the Czech Republic, you will need CZK 200,000 and for Joint Stock Company you need CZK 2,000,000[13].

Other business forms exist in our business law, such as self-proprietor, partnerships, limited partnerships, where you do not need to have a registered capital except in the case of a co-operative, but on our market, there are only two dominating forms - company with limited liability and Joint Stock Company.

Let´s compare main advantages and disadvantages in management style according chosen legal form.

Small businesses are normally:

- **Sole proprietorships**. The advantage of sole ownership is that you make all the decisions and take all the profits. However, the sole trader has a lot of responsibility and will need to work extremely hard.
- **Partnerships**. Forming a partnership makes it possible to share the workload, but profits have to be shared and there may be disagreements between partners.
- **Privately owned corporations**. Forming a private company makes it possible to raise extra capital for the business by selling shares, but setting up a company requires time and paperwork. In addition, shareholders take a share of the profits.

Every small business must select a legal form of ownership. The most common forms are sole proprietorship, partnership, and corporation. A limited liability company (LLC) is a relatively new business structure that is now allowed by all fifty states. Before a legal form is selected, however, several factors must be considered, not the least, which are legal and tax options. The legal form of the business is one of the first decisions that a small business owner will have to make. Because this decision will have long-term implications, it is

[13] New request in 2014: JSC: 80 000€, limited lability company 1 CZK

important to consult an attorney and an accountant to help make the right choice. The following are some factors the small business owner should consider before making the choice:

- **The owner's vision**. Where does the owner see the business in the future (size, nature, etc.)?
- **The desired level of control**. Does the owner want to own the business personally or share ownership with others? Does the owner want to share responsibility for operating the business with others?
- **The level of structure**. What is desired—a very structured organization or something more informal?
- **The acceptable liability exposure**. Is the owner willing to risk personal assets? Is the owner willing to accept liability for the actions of others?
- **Tax implications**. Does the owner want to pay business income taxes and then pay personal income taxes on the profits earned?
- **Sharing profits**. Does the owner want to share the profits with others or personally keep them?
- **Financing needs**. Can the owner provide all the financing needs? If outside investors are needed, how easy will it be to get them?
- **The need for cash**. Does the owner want to be able to take cash out of the business?

The final selection of a legal form will require consideration of these factors and tradeoffs between the advantages and disadvantages of each form. No choice will be perfect. Even after a business structure is determined, the favourability of that choice over another will always be subject to changes in the laws

5.3.1 SOLE PROPRIETORSHIP

The sole proprietorship is the simplest business form under which one can operate a business.

DEFINITION 6 SOLE PROPRIETORSHIP

The sole proprietorship is not a legal entity. It simply refers to a person who owns the business and is personally responsible for its debts.

A sole proprietorship can operate under the name of its owner or it can do business under a fictitious name. The fictitious name is simply a trade name--it does not create a legal entity separate from the sole proprietor owner. A business that legally has no separate existence from its owner. Income and losses are taxed on the individual's personal income tax return. The sole proprietorship is a popular business form due to its simplicity, ease of setup, and nominal costs[14].

Advantages:

- Easiest and least expensive form of ownership to organize.
- Sole proprietors are in complete control, and within the parameters of the law, may make decisions as they see fit.
- Sole proprietors receive all income generated by the business to keep or reinvest.

[14] Entrepreneur, 2013. *Sole proprietorship Definition . Small Business Encyclopedia*. [online] [Accessed: 19 Dec 2013] Available at: http://www.entrepreneur.com/encyclopedia/sole-proprietorship

- Profits from the business flow-through directly to the owner's personal tax return.
- The business is easy to dissolve, if desired.

Disadvantages:

- Have unlimited liability and are legally responsible for all debts against the business. Their business and personal assets are at risk. May be at a disadvantage in raising funds and are often limited to using funds from personal savings or consumer loans.

Sole Proprietorship	
+Easy to Organize + Owner Has Complete Control + Owner Receives All Income	- Owner Has Unlimited Liability - Benefits Are Not Tax Deductions

Many small businesses operated by a single individual adopt sole proprietorship format of business organization. It is the most basic type of business organization. It is also the least expensive to create and the easiest to operate and dissolve. Sole proprietorships can be incorporated if the owner so desires. Not being a legal entity, single scratch sole proprietorships disappear after the death of the owner. This type of business is essentially a format for a single-person business (although many have between one and ten employees), where the owner makes *all* the decisions related to the business's operations. The owner can extract all profits from the business for his or her personal use, or the owner can decide to reinvest any portion of the profits back into the business. Because a single proprietorship is not a legal entity, any income generated by the business goes directly on the owner's personal tax return. However, the single owner is also personally responsible for any debts that the business acquires. This means that the owner may put his or her own personal assets at risk. In addition, this business organization means unlimited liability for its owner. The format means that there is very little opportunity to raise funds from sources other than the owner's own capital or consumer loans.

5.3.2 PARTNERSHIPS

DEFINITION 7 PARTNERSHIP

Partnership is a legal form of business operation between two or more individuals, who share management and profits.

The two most common are general and limited partnerships. Generally, two or more people share ownership of a single business[15].

Advantages:

- Partnerships are relatively easy to establish; however, time should be invested in developing the partnership agreement.
- With more than one owner, the ability to raise funds may be increased.
- The profits from the business flow directly through to the partners' personal tax returns.
- Prospective employees may be attracted to the business if given the incentive to become a partner.
- The business usually will benefit from partners who have complementary skills.

[15] Entrepreneur, 2013. *Partnership Definition . Small Business Encyclopedia*. [online] [Accessed: 19 Dec 2013] Available at: http://www.entrepreneur.com/encyclopedia/partnership

Disadvantages:

- Partners are jointly and individually liable for the actions of the other partners.
- Profits must be shared with others.
- Since decisions are shared, disagreements can occur.
- Some employee benefits are not deductible from business income on tax returns.
- The partnership may have a limited life; it may end upon the withdrawal or death of a partner

PARTNERSHIP TYPES

- **Limited Partnership and Partnership with limited liability**

"Limited" means that most of the partners have limited liability (to the extent of their investment) as well as limited input regarding management decisions, which generally encourages investors for short term projects, or for investing in capital assets. This form of ownership is not often used for operating retail or service businesses. Forming a limited partnership is more complex and formal than that of a general partnership.

- **General Partnership**

Partners divide responsibility for management and liability, as well as the shares of profit or loss according to their internal agreement. Equal shares are assumed unless there is a written agreement that states differently.

- **Joint Venture Acts**

They are like a general partnership, but are clearly for a limited period of time or a single project. If the partners in a joint venture repeat the activity, they will be recognized as an ongoing partnership and will have to file as such, and distribute accumulated partnership assets upon dissolution of the entity.

Partnership	
+ Easy to Organize, But Needs Agreement + Partners Receive All Income	- Partners Have Unlimited Liability - Partners May Disagree - Life of Business May Be Limited

Partnerships generally are unincorporated businesses. From a financial standpoint, partnerships offer a few advantages over sole proprietorship. By having more than one owner (investor), it is often easier to raise additional capital. In some businesses, such as law firms and accounting firms, the prospect of becoming a partner may be an attractive inducement to gain employees. There are several versions of partnerships.

The general partnership is composed of two or more owners who contribute the initial capital of the business and share in the profits and any losses. It is similar to a sole proprietorship in that all partners are personally responsible for all the debts and the liabilities of the business. A general partnership is comparable to a sole proprietorship in that neither is a taxable entity; therefore, the partners' profits are taxed as personal income. They can deduct any business losses from their personal income taxes. The exact proportion of ownership of the firm is generally found in a written document known as the partnership agreement.

A limited partnership is a business that may have several general partners and several partners that are more limited. The major difference with a general partnership is that the limited partners do not have unlimited liability. Their losses are limited to their original investment in the business. Common practice means that these limited partners do not play a major decision-making role in the life of the business.

5.3.3 CORPORATIONS

The owners of a corporation are its shareholders. The shareholders elect a board of directors to oversee the major policies and decisions. The corporation has a life of its own and does not dissolve when ownership changes.

DEFINITION 8 CORPORATIONS

Corporations are viewed as legal entities, meaning that they can enter into legal agreements with individuals and other corporations. They are also subject to numerous local and state regulations. This often results in extensive paperwork that can be costly. Their shareholders own corporations.

Advantages:

- Shareholders have limited liability for the corporation's debts or judgments against the corporations.
- Generally, shareholders can only be held accountable for their investment in stock of the company. (Note however, that officers can be held personally liable for their actions, such as the failure to withhold and pay employment taxes.)
- Corporations can raise additional funds through the sale of stock.
- A corporation may deduct the cost of benefits it provides to officers and employees.
- Can elect corporation status if certain requirements are met. This election enables company to be taxed similar to a partnership.

Disadvantages:

- The process of incorporation requires more time and money than other forms of organization.
- Corporations are monitored by state or some local agencies, and as a result may have more paperwork to comply with regulations.
- Incorporating may result in higher overall taxes. Dividends paid to shareholders are not deductible form business income, thus this income can be taxed twice.

General types of corporations

- Limited Liability Company

A form of business organization with the liability-shield advantages of a corporation and the flexibility and tax pass-through advantages of a partnership Under the LLC rules, however, an individual isn't responsible for the firm's debt, provided he or she didn't secure them personally, as with a second mortgage, a personal credit card or by putting personal assets on the line.[16]

A limited liability company is an organizational form that can be limited to a single individual or several other owners or shareholders. Like a general partnership, there is a requirement for documents that define the distribution of responsibilities, profits, or losses. Generally, the members of a limited liability company are liable for the debts of the company. This format may provide tax and financial benefits for the participants. This format cannot be used in the banking or insurance industries.

- Joint stock company

[16] Entrepreneur, 2013. *Limited Liability Company Definition* . *Small Business Encyclopedia*. [online] [Accessed: 19 Dec 2013] Available at: http://www.entrepreneur.com/encyclopedia/limited-liability-company

A joint-stock company is a business entity, which is owned by shareholders. Each shareholder owns the portion of the company in proportion to his or her ownership of the company's shares (certificates of ownership). This allows for the unequal ownership of a business with some shareholders owning a larger proportion of a company than others do. Shareholders are able to transfer their shares to others without any effects to the continued existence of the company[17].

Corporation	
+ Shareholders Have Limited Liability + Can Raise Funds Through Sale of Stock + Life of Business Is Unlimited	- Incorporating Takes Time and Money - May Result in Higher Taxes Overall

The shareholders are liable only for their original investment in the business. They cannot be sued for more than that amount. One of the major advantages of adopting a corporate format is that in this type of business, it is sometimes much easier to raise capital through either debt or the issuance of stock. Profits derived from this type of business are taxed at the corporate rate. It is important to note that dividends paid to shareholders, unlike interest expenses, are not deductible. Therefore, actually, this form of income is doubly taxed.

5.3.4 KEYS FOR SUCCESS

Being successful as a business owner requires more than coming up with a brilliant idea and working hard. You need to learn how to manage and grow your business. In the process, you will face numerous challenges, and your ability to meet them will be a major factor in your success (or failure). To give yourself a fighting chance in making a success of your business, you should do the following (Collins, 2008):

- **Know your business**. It seems obvious, but it is worth mentioning: successful businesspeople know what they are doing. They are knowledgeable about the industry in which they operate (both as it stands today and where it is headed), and they know who their competitors are. They know how to attract customers and who the best suppliers and distributors are, and they understand the impact of technology on their business.
- **Know the basics of business management**. You might be able to start a business based on a great idea, but to manage it you need to understand the functional areas of business—accounting, finance management, marketing, and production. You need to be a salesperson, as well as a decision maker and a planner.
- **Have the proper attitude**. When you own a business, you are the business. If you are going to devote the time and energy needed to transform an idea into a successful venture, you need to have a passion for your work. You should believe in what you are doing and make a strong personal commitment to your business.
- **Get adequate funding**. It takes a lot of money to start a business and guide it through the start-up phase (which can last for over a year). You can have the most brilliant idea in the world, the best marketing approach, and a talented management team, yet if you run out of cash, your career as a business owner could be brief. Plan for the long term and work with lenders and investors to ensure that you will have sufficient funds to get open, stay open during the start-up phase, and, ultimately, expand.

[17] Courtney, Thomas B. The Law of Private Companies (2nd edition ed.). p. 26. ISBN 1-85475-265-0.

- **Manage your money effectively**. You will be under constant pressure to come up with the money to meet payroll and pay your other bills. That is why you need to keep an eye on cash flow—money coming in and money going out. You need to control costs and collect money that has owed you, and, generally, you need to know how to gather the financial information that you require to run your business.
- **Manage your time efficiently**. A new business owner can expect to work sixty hours a week. If you want to grow a business and have some type of no work life at the same time, you will have to give up some control—to let others take over some of the work. Thus, you must develop time-management skills and learn how to delegate responsibility.
- **Know how to manage people**. Hiring, keeping, and managing good people are crucial to business success. As your business grows, you will depend more on your employees. You need to develop a positive working relationship with them, train them properly, and motivate them to provide quality goods or services.
- **Satisfy your customers**. You might attract customers through impressive advertising campaigns, but you will keep them only by providing quality goods or services. Commit yourself to satisfying—or even exceeding—customer needs.
- **Know how to compete**. Find your niche in the marketplace, keep an eye on your competitors, and be prepared to react to changes in the marketplace. The history of business (and much of life) can be summed up in three words: "Adapt or perish."

EXAMPLE 8 GINA´S DECISION

When Gina Wilson[18] opened her boutique six years ago, she had only one full-time employee. Since then Gina has added two general partners and greatly expanded the operation. Over the past year, it has become obvious that the group could open another boutique that would be equally successful. The problem is money. The partnership lacks funds for expansion. Gina's banker has suggested that the company borrow €200,000 from the bank and pledge the firm's assets as collateral. "This will get you the money you need, and once you have the boutique going, you can repay the money," he told them. The idea sounds fine to the partners, although they are concerned about the risk involved. If the second boutique does not do well, it could affect the success of the first boutique by siphoning off funds to repay the loan.

Gina has been thinking about incorporating the business, selling stock, and using these funds for expansion purposes. She has not shared this idea with her banker because she wants to give it more thought, but she intends to talk it over with her partners later in the week. She is also pondering the value of a corporation. She has heard her accountant talk about this legal form, although she is unsure of the type of legal arrangement it involves.

Questions

1. What are the benefits of the company is becoming a corporation? Is this a better idea than the banker's proposal of taking a $200,000 loan? Why or why not?
2. How does a corporation work? Would this be a good idea for the firm? Why or why not?
3. What would you recommend to Gina? Explain in detail.

[18] Based on Kuratko, 2009.

6 HUMAN RESOURCES IN THE SMALL BUSINESS

Many small businesses operate without employees. In many cases, they cooperate with friends or family members and do not care about any personnel politics. Unfortunately, due to business development, the owner has to pass through information about all the processes in running your business. Do not forget, that the owner and a management team are bringing people together and there is a lot more work than just write resumes. It is what makes a company work or not work (Berry, 1998, p.59). The reason is simple; **human resources are the most important assets** we have in most small businesses.

DEFINITION 9 HUMAN RESOURCES

Human Resources refer to the labour, physical and mental abilities that the people in your organization contribute to producing the goods and services of your business.[19]

Small business employees have a direct impact on the working environment, relationship with final customers and the business success. Many small businesses prefer to get smaller jobs done through contractors who have contract labour. This is particularly true in the initial stages of the business. As operations expand, the business owner has to decide whether he would like to continue with his contracting arrangement or opt for recruiting full time employees, a task which the personnel manager can assist. When a one-person small business adds employees, some kind of hierarchy will be needed to indicate who does what. This hierarchy often becomes the formal organization—that is, the details of the roles and responsibilities of all employees.

Employees provide an organization’s human capital. The Society of Human Resource Management’s Research Quarterly defined an organization’s human capital as follows: *“A company’s human capital asset is the collective sum of the attributes, life experience, knowledge, inventiveness, energy and enthusiasm that its people choose to invest in their work”* (Weatherly, 2003).

6.1 MANAGEMENT OF HUMAN RESOURCES (HR) IN GENERAL

The new principles of management, however, require a focus on outcomes and results, not just numbers and compliance. Just as lawyers count how many cases they’ve won; not just how many words they used so, too must HR professionals track how employees are using the skills they’ve learned to attain goals, not just how many hours they’ve spent in training. To avoid outsourcing, HR needs to stay relevant and accept accountability for its business results. In short, the people strategy needs to be fully aligned with the company’s business strategy.

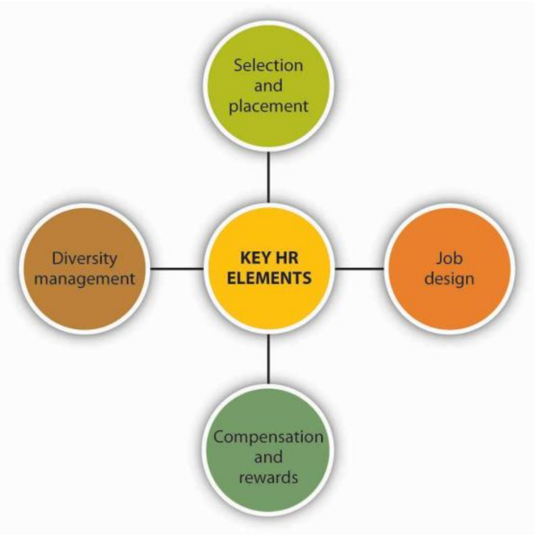
Beyond the basic need for compliance with HR rules and regulations, the four key elements of HR are summarized in the following figure. In high-performing companies, each element of the HR system is designed to reflect best practice and to maximize employee performance. The different parts of the HR system are strongly aligned with company goals.

The management of human resources involves those activities[20]:

[19] SMALLBUSINESSNOTES.COM., 2013. *Small Business Human Resources - Small Business Notes*. [online] [Accessed: 19 Nov 2013] Available at: http://www.smallbusinessnotes.com/managing-your-business/human-resources/#ixzz2jb74jtke

[20] Employmentoptionsemploi.ca. 2013. Managing Human Resources A Guide for Small Business Owners [online] [Accessed: 10 Dec 2013]Available at: http://www.employmentoptionsemploi.ca/pdfs/pdfs/Employeur_ENG.pdf.

Figure 22 Key HR elements



Source: Employmentoptionsemploi.ca. 2013. Managing Human Resources A Guide for Small Business Owners [online] [Accessed: 10 Dec 2013] Available at: http://www.employmentoptionsemploi.ca/pdfs/pdfs/Employeur_ENG.pdf

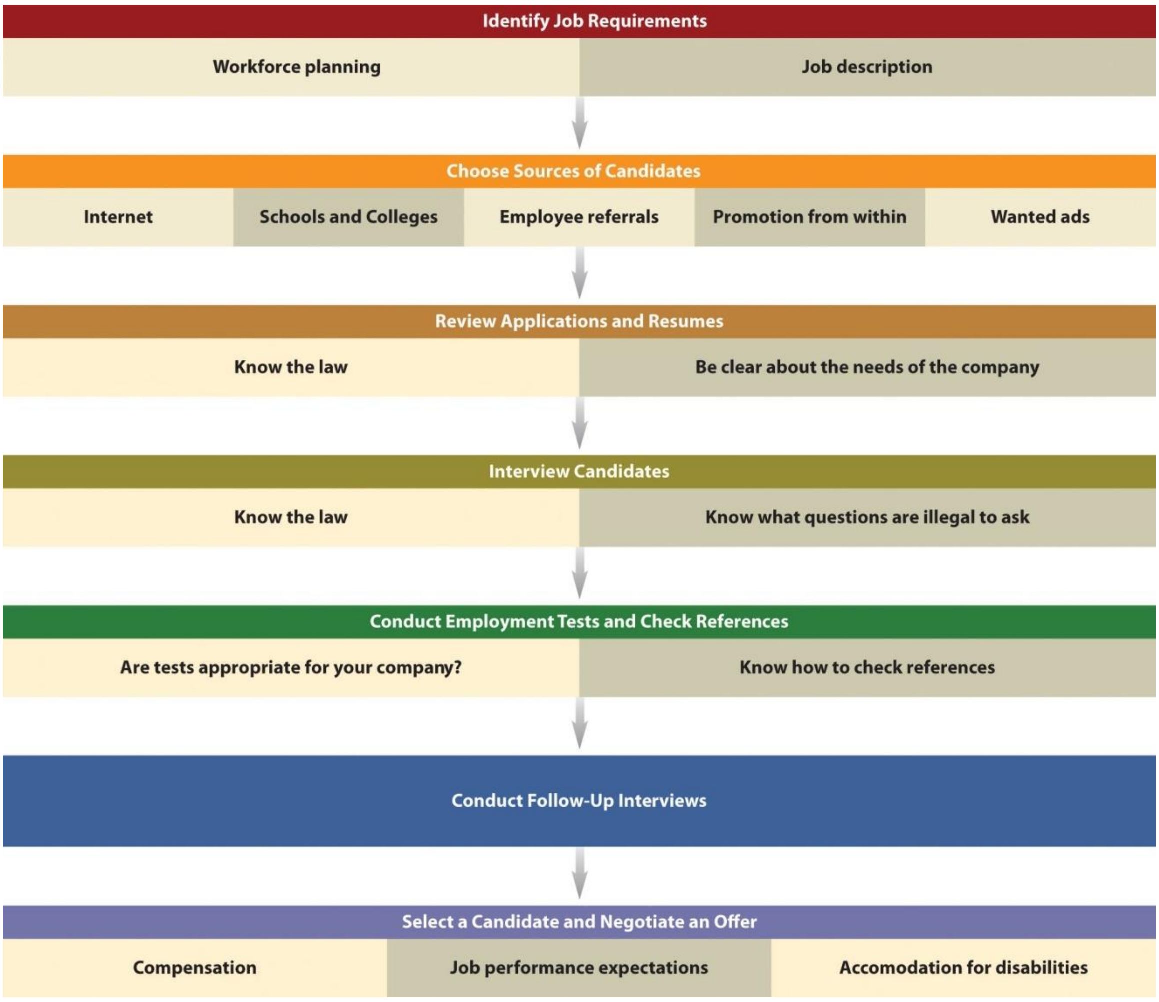
6.1.1 SELECTION AND PLACEMENT (STAFFING)

You have to begin your search by having a well-defined idea of what you want. All businesses want to attract, develop, and retain enough qualified employees to perform the activities necessary to accomplish the organizational objectives of the business. As an employer, you should prepare a job description before initiating the recruitment process. A good job description describes the major areas of an employee's job or position: the duties to be performed, who the employee will report to, the working conditions, responsibilities, and the tools and equipment that must be used on the job. Except in the most informal of situations, **hiring should always be done with an offer letter**. The letter should spell out all the particulars of the job including:

- compensation,
- benefits,
- responsibilities,
- performance expectations,
- probationary period,
- reporting requirements,
- desired start date,
- work location.

It needs to be made clear at the start what is being offered, and what is expected. If it is in writing, then it is difficult to have a misunderstanding. **The offer letter helps document the contractual relationship between the new employee and the employer**.

Figure 23 Selection and Placement process



Source: Kurtz, 2011, p. 289.

Because hiring a new employee is an expensive process, it is important to choose sources that have the greatest potential for reaching the people who will most likely be interested in what a small business has to offer. Unfortunately, it is not always possible to know what those sources are, so selecting a mix of sources makes good sense.

- **Internet**. The Internet offers a wealth of places to advertise a job opportunity. Monster.com, CareerBuilder.com, and LinkedIn.com are among the largest and most well known sites, but there may be local or regional job sites that might work better, particularly if a business is very small. A business will not have the resources to bring people in from great distances. If a business has a Facebook or a Twitter presence, this is another great place to let people know about job openings. There may also be websites that specialize in particular occupations.
- **Schools and colleges**. Depending on the nature of the job, local schools and colleges are great sources for job candidates, particularly if the job is part time. Full-time opportunities may be perfect for the new high school or college graduate. It would be worth checking out college alumni offices as well because they often offer job services.
- **Employee referrals**. Referrals are always worth consideration, if only on a preliminary basis. The employee making the referral knows the business and the person being referred. Going this route can significantly shorten the search process…if there is a fit.

- **Promoting from within is a time-honoured practice**. The owner sends a positive signal to employees that there is room for advancement and management cares about its employees. It is significantly less costly and quicker than recruiting outside, candidates are easier to assess because more information is available, and it improves morale and organization loyalty. On the downside, there may be problems between the person who is promoted and former co-workers, and the organization will not benefit from the fresh ideas of someone hired from the outside.
- **Want ads**. Want ads can be very effective for a small business, especially if a business is looking locally or regionally. The more dynamic they want ad, the more likely it will attract good candidates.

When hiring, acquaint prospective new hires with the nature of the jobs they will be expected to fulfil. This includes explaining the technical competencies needed (for example, collecting statistical data) and defining behavioural competencies. Behavioural competencies may have a customer focus, such as the ability to show empathy and support of customers' feelings and points of view, or a work management focus, such as the ability to complete tasks efficiently or to know when to seek guidance.

In addition, make the organization's culture clear by discussing the values that underpin the organization—describe your organization's "heroes." For example, are the heroes of your company the people who go the extra mile to get customers to smile? Are they the people who toil through the night to develop new code? Are they the ones who can network and reach a company president to make the sale? By sharing such stories of company heroes with your potential hires, you will help reinforce what makes your company unique. This, in turn, will help the job candidates determine whether they will fit into your organization's culture.

In addition to what is asked, it is also important that interviewers understand what they should not ask, largely because certain questions lead to answers that may be used to discriminate. There are five particularly sensitive areas:

- First, the only times you can ask about age are when it is a requirement of a job duty or you need to determine whether a work permit is required.
- Second, it is rarely appropriate or legal to ask questions regarding race, colour, national origin, or gender.
- Third, although candidates may volunteer religious or sexually orientated information in an interview, you still need to be careful not to discriminate. Ask questions that are relevant to work experience or qualifications.
- Fourth, firms cannot discriminate for health or disabilities; you may not ask about smoking, health-related questions, or disabilities in an interview.
- Finally, you may not ask questions about marital status, children, personal life, pregnancy, or arrest record. These kinds of questions could be tempting to ask if you are interviewing for a position requiring travel; however, you can only explain the travel requirements and confirm that the requirements are acceptable.

In addition to interviews, many employers use testing to select and place job applicants. Any tests given to candidates must be job related and follow guidelines set forth by the Equal Opportunity Employment Commission to be legal. The rationale behind testing is to give the employer more information before making the selection and placement decision—information vital to assessing how well a candidate is suited to a particular job. Most preemployment assessment tests measure thinking styles, behavioural traits, and occupational interests. The results are available almost immediately after a candidate completes the roughly hour-long questionnaire. Thinking styles tests can tell the potential employer how fast someone can learn new things or how well he or she can verbally communicate. Behavioural traits assessments measure energy level, assertiveness, sociability, manageability, and attitude. For example, a high sociability score would be a desirable trait for salespeople (Mrosko, 2006).

6.1.2 JOB DESIGN

Design jobs that involve doing a whole piece of work and are challenging but doable. Job design refers to the process of putting together various elements to form a job, bearing in mind organizational and individual worker requirements, as well as considerations of health, safety, and ergonomics. Train employees to have the knowledge and skills to perform all parts of their job and give them the authority and accountability to do so.

Job performance refers to the level to which an employee successfully fulfils the factors included in the job description. For each job, the content of job performance may differ. Measures of job performance include quality and quantity of work performed by the employee, the accuracy and speed with which the job is performed, and the overall effectiveness of the person on the job.

TRAINING AND DEVELOPMENT

- Initial Training
- Training Needs Analysis
- Preparation of training programs
- Management and supervisory development

It would be nice if employees came pre-programmed with all the skills they need to do their jobs. It would also be nice if job requirements stayed the same: once you have learned how to do a job (or been pre-programmed), you would know how to do it forever. In reality, new employees must be trained; moreover, as they grow in their jobs or as their jobs change, they will need additional training. Unfortunately, training is costly and time-consuming.

POLICIES AND PROCEDURES

- Instituting health and safety standards
- Privacy Issues
- Handling of employee grievances
- Preparing employee handbooks
- Setting employee work hours
- Union relations

RECORDKEEPING

- Making certain you adhere to all labour laws governing employers
- Maintaining individual employee files
- Maintaining all of the department records
- Preparing departmental reports for top management

TERMINATION

Firing someone is never a pleasant activity. It is something you hope you never have to do. Employees should see that they are a misfit and "fire" themselves voluntarily. If not, you will have to do the job for them.

First, make certain that you have gone "all the way through it" to be sure that you are making the right decision. Often discussion with the poor performing employee is necessary to be certain you have justification for their dismissal.

Next, sit down with the employee and discuss their performance, your attempts to change their performance to suit your needs, and explain that their performance has not met your expectations. Provide examples of unsatisfactory performance and explain that they are no longer a match for your organization.

6.1.3 COMPENSATION AND REWARDS

Evaluate and pay people based on their performance, not simply for showing up on the job. Offer rewards for skill development and organizational performance, emphasizing teamwork, collaboration, and responsibility for performance. Help employees identify new skills to develop so that they can advance and achieve higher pay and rewards. Compensation systems that include incentives, gain sharing, profit sharing, and skill-based pay reward employees who learn new skills and put those skills to work for the organization. Employees who are trained in a broad range of skills and problem solving are more likely to grow on the job and feel more satisfaction. Their training enables them to make contributions that are more valuable to the company, which, in turn, gains them higher rewards and greater commitment to the company.

When employees have access to information and the authority to act on that information, they are more involved in their jobs and more likely to make the right decision and take the necessary actions to further the organization's goals. Similarly, rewards need to be linked to performance, so that employees are naturally inclined to pursue outcomes that will gain them rewards and further the organization's success at the same time.

PAY SYSTEM ELEMENTS

As summarized in the following table, pay can take the form of direct or indirect compensation. Nonmonetary pay can include any benefit an employee receives from an employer or job that does not involve tangible value. This includes career and social rewards, such as job security, flexible hours and opportunity for growth, praise and recognition, task enjoyment, and friendships. Direct pay is an employee's base wage. It can be an annual salary, hourly wage, or any performance-based pay that an employee receives, such as profit-sharing bonuses.

Table 12 Elements of a Pay System

Nonmonetary pay	Includes benefits that do not involve tangible value.
Direct pay	Employee's base wage
Indirect pay	Everything from legally required programs to health insurance, retirement, housing, etc.
Basic pay	Cash wage paid to the employee. Because paying a wage is a standard practice, the competitive advantage can only come by paying a higher amount.
Incentive pay	A bonus paid when specified performance objectives are met. May inspire employees to set and achieve a higher performance level and is an excellent motivator to accomplish goals.
Stock options	A right to buy a piece of the business that may be given to an employee to reward excellent service. An employee who owns a share of the business is far more likely to go the extra mile for the operation.
Bonuses	A gift given occasionally to reward exceptional performance or for special occasions. Bonuses can show an employer appreciates his or her employees and ensures that good performance or special events are rewarded.

Source: Cadden and Lueder, 2008.

Indirect compensation is far varied, including everything from legally required public protection programs such as social security to health insurance, retirement programs, paid leave, childcare, or housing. Law requires some indirect compensation elements: social security, unemployment, and disability payments. Other indirect elements are up to the employer and can offer excellent ways to provide benefits to the employees and the employer as well. For example, a working parent may take a lower-paying job with flexible hours that will allow him or her to be home when the children get home from school. A recent graduate may be looking for stable work and an affordable place to live.

SETTING PAY LEVELS

When setting pay levels for positions, managers should make sure that the pay level is fair relative to what other employees in the position are being paid. Part of the pay level is determined by the pay level at other companies. If your company pays substantially less than others do, it is going to be the last choice of employment unless it offers something overwhelmingly positive to offset the low pay, such as flexible hours or a fun, congenial work atmosphere. Besides these external factors, companies conduct a job evaluation to determine the internal value of the job—the more vital the job to the company's success, the higher the pay level. Jobs are often ranked alphabetically—"A" positions are those on which the company's value depends, "B" positions are somewhat less important in that they don't deliver as much upside to the company, and "C" positions are those of least importance—in some cases, these are outsourced.

The most vital jobs to one company's success may not be the same as in other companies. For example, information technology companies may put top priority on their software developers and programmers, whereas for retailers such as Nordstrom, the "A" positions are those frontline employees who provide personalized service. For an airline, pilots would be a "B" job because, although they need to be well trained, investing further in their training is unlikely to increase the airline's profits. "C" positions for a retailer might include back office bill processing, while an information technology company might classify customer service as a "C" job.

When setting reward systems, it is important to pay for what the company actually hopes to achieve. Steve Kerr, vice president of corporate management at General Electric, talks about the common mistakes that companies make with their reward systems, such as saying, they value teamwork but only rewarding individual effort. Similarly, companies say they want innovative thinking or risk taking, but they reward people who "make the numbers." (Kerr, 1995)

- Pay for Performance

As its name implies, pay for performance ties pay directly to an individual's performance in meeting specific business goals or objectives. Managers (often together with the employees themselves) design performance targets to which the employee will be held accountable. The targets have accompanying metrics that enable employees and managers to track performance. The metrics can be financial indicators, or they can be indirect indicators such as customer satisfaction or speed of development. Pay-for-performance schemes often combine a fixed base salary with a variable pay component (such as bonuses or stock options) that varies with the individual's performance.

- Pay Structures for Groups and Teams

So far, we have discussed pay in terms of individual compensation, but many employers also use compensation systems that reward all of the organization's employees as a group or various groups and teams within the organization. Let us examine some of these less traditional pay structures.

- Gain sharing

Sometimes called profit sharing, gain sharing is a form of pay for performance. In gain sharing, the organization shares the financial gains with employees. Employees receive a portion of the profit achieved from their efforts. How much they receive is determined by their performance against the plan. Here is how gain sharing works: First, the organization must measure the historical (baseline) performance. Then, if employees help improve the organization's performance on those measures, they share in the financial rewards achieved. This sharing is typically determined by a formula. The effectiveness of a gain-sharing plan depends on employees seeing a relationship between what they do and how well the organization performs. The larger the size of the organization, the harder it is for employees to see the effect of their work. Therefore, gain-sharing plans are more effective in companies with fewer than 1,000 people. Gainsharing success also requires the company to have good performance metrics in place so that employees can track their process. The gain-sharing plan can only be successful if employees believe and see that if they perform better, they will be paid more. The pay should be given as soon as possible after the performance so that the tie between the two is established. When we design systems to measure performance, realize that performance appraisals need to focus on quantifiable measures. Designing these measures with input from the employees helps make the measures clear and understandable to employees and increases their buy-in that the measures are reasonable.

- Team-Based Pay

Many managers seek to build teams, but face the question of how to motivate all the members to achieve the team's goals. As a result, team-based pay is becoming increasingly accepted. With increasing acceptance and adoption come different choices and options of how to structure team-based pay. One way to structure the pay is to first identify the type of team you have—parallel, work, project, or partnership—and then choose the pay option that is most appropriate to that team type. Let us look at each team type in turn and the pay structures best suited for each.

Parallel teams are teams that exist alongside (parallel to) an individual's daily job. (For example, a person may be working in the accounting department but also be asked to join a team on productivity). Parallel teams are often inter-departmental; they meet part time, and they are formed to deal with a specific issue. The reward for performance on this team would typically be a merit increase or a recognition award (cash or noncash) for performance on the team.

A *project team* is likewise a temporary team, but it meets full time for the life of the project. For example, a team may be formed to develop a new project and then disband when the new product is completed. The pay schemes appropriate for this type of team include profit sharing, recognition rewards, and stock options. Team members evaluate each other's performance.

A *partnership team* is formed around a joint venture or strategic alliance. Here, profit sharing in the venture is the most common pay structure. Finally, with the *work team*, all individuals work together daily to accomplish their jobs. Here, skill-based pay and gain sharing are the payment schemes of choice, with team members evaluating one another's performance.

WAGE AND SALARY ADMINISTRATION

- Job analysis
- Preparation of job descriptions
- Pay surveys
- Compensation
- Employment Taxes
- **Fringe benefits**

While it is true that money is not everything when it comes to employee satisfaction, fair and equitable remuneration practices are essential to positive employee relations and employee retention. Most organizations offer some level of employee benefits to their employees. They do so in order to attract new talent, retain employees, increase competitiveness in the marketplace, and protect the overall well being of their employees. Evaluating overall organizational goals will help determine the structure of your employee benefits package. Common Employee Benefits include:

- Health Insurance (Medical, Dental, Vision, Flexible Spending Accounts)
- Income Protection (Life Insurance, Short and Long Term Disability)
- Retirement Plans
- Other (Gym Memberships, Onsite Child Care, Car Allowances, Expense Accounts)

6.1.4 DIVERSITY MANAGEMENT

In past decades, "diversity" meant avoiding discrimination against women and minorities in hiring. Today, diversity goes far beyond this limited definition; diversity management involves actively appreciating and using the differing perspectives and ideas that individuals bring to the workplace. Diversity is an invaluable contributor to innovation and problem-solving access.

Diversity helps company teams to come up with more creative and effective solutions. Teams whose members have complementary skills are often more successful because members can see one another's blind spots. Members will be more inclined to make different kinds of mistakes, which mean that they will be able to catch and correct those mistakes.

Selecting the right employees and placing them in the right positions within the company is a key HR function and is vital to a company's success. Companies should devote as much care and attention to this "soft" issue as they do to financial planning because errors will have financial impact and adverse effects on a company's strategy.

SOLVED EXERCISE 4 JOB DESCRIPTION

Walt has a problem. He works as a manager in a medium-sized company and considers himself fortunate that the organizational chart allows him a full-time administrative assistant (AA). However, in the two years Walt has been in his job, five people have held this AA job. The most recent AA, who resigned after four weeks, told Walt that she had not known what the job would involve. "I don't do numbers, I'm not an accountant," she said. "If you want someone to add up figures and do calculations all day, you should say so in the job description. Besides, I didn't realize how long and stressful my commute would be—the traffic between here and my house is murder!"

Taken aback, Walt contacted the company's HR department to clarify the job description for the AA position. What he learned was that the description made available to applicants was, indeed, inadequate in a number of ways. Chances are that frequent turnover in this AA position is draining Walt's company of resources that could be used for much more constructive purposes. An accurate and complete job description is a powerful strategic HR tool that costs little to produce and can save a bundle in reduced turnover. While the realistic description may discourage some applicants (for example, those who lack an affinity for calculations might not bother to apply for Walt's AA position), those who follow through with the application process are much more likely to be satisfied with the job once hired.

Result:

In addition to summarizing what the worker will actually be doing all day, here are some additional suggestions for writing an effective job description:

- List the job requirements in bullet form so that job seekers can scan the posting quickly.
- Use common industry terms, which speak to knowledgeable job seekers.
- Avoid organization-specific terms and acronyms, which would confuse job seekers.
- Use meaningful job titles (not the internal job codes of the organization).
- Use key words taken from the list of common search terms (to maximize the chance that a job posting appears on a job seeker's search).
- Include information about the organization, such as a short summary and links to more detailed information.
- Highlight special intangibles and unusual benefits of the job and workplace (e.g., flexitime, travel, etc.).
- Specify the job's location (and nearest large city) and provide links to local community pages (to entice job seekers with quality-of-life information).

6.2 Developing a Staffing Plan

Before you start to think about hiring, you will need at least a basic staffing plan. The plan should sort out how many employees you expect to hire, the type of employee you are looking for, and what they will be expected to do. The plan should also address how the employee expenses will be covered.

A staffing plan should be well coordinated with your business plan, and it should address items of discussion that will likely take place during candidate interviews. The plan does not have to be detailed or lengthy, just something that addresses the key issues at a satisfactory level so that wise management decisions can be made based on its content. Here are the basics of a staffing plan.

- objectives, both near and long term
- characteristics and culture of your employee(s)
- approach to finding new employees
- how you're going to keep good employees
- training and transition
- job descriptions
- organization chart
- funding of employees

The staffing plan has to provide a business vision. In the absence of a vision, it is easy to go off course or go nowhere at all. In addition to helping you understand your plans for growth, a staffing plan is also useful to help communicate to lenders and prospective employees just what kind of organization you are trying to create and maintain.

The organizational structure of a company is what you frequently see as an organizational chart. Make sure you explain how job descriptions work and how the main company functions are divided up. Are your organizational lines drawn clearly? Is the authority properly distributed? Do you have jobs that include responsibility without authority? Do your resources seem in line with your organizational needs? Include summaries of their backgrounds and experience, using them like brief resumes. Describe their functions with the company. Resumes should be attached to the back of a plan.

Finally, you have to develop a personnel table to project personnel costs, including direct compensation and indirect costs. The indirect costs include vacation pay, sick pay, insurance benefits, education, and of course payroll taxes and some other costs.

If you are working as a sole proprietor in a home office, you should still include your own compensation as part of your business plan. What you pay yourself should be added into the profit and loss as an expense. However, in this case you do not really need to include payroll burden, because these additional expenses are irrelevant until you include additional employees.

A good personnel plan varies according to your business and business plan needs. You may want a simple list of names, titles, or groups, each of which is assigned a monthly cost.

Having a business organization structure will give potential investors and funding institutions a window into how the business organizes its operations. The structure also lets investors and lenders know what kind of talent is needed, how soon they will be needed, and how the business will find and attract them. [21]

6.3 MANAGERS VERSUS LEADERS

There are distinctions between managers and leaders. Managers are appointed and have legitimate power within the organization. Leaders are those persons who are able to influence others and who possess managerial authority. Leadership, then, is the ability to influence a group toward the achievement of goals. Leadership, the foundation of the management function of leading, is the process of influencing others toward the achievement of organizational goals. The different types of power can engender different levels of subordinate motivation. **Power** is the capacity to affect the behaviour of others. There are different types of power depending upon their sources originally identified by French and Raven.

- Legitimate power stems from a position's placement in the managerial hierarchy and the authority vested in the position.
- Reward power is based on the capacity to control and provide valued rewards to others.
- Coercive power is based on the ability to obtain compliance through fear of punishment.
- Expert power is based on the possession of expertise that is valued by others.
- Information power result from access to and control over the distribution of important information about organizational operations and plans.
- Referent power results from being admired, personally identified with, or liked by others.

[21]A Strong Business Organization Structure Is Paramount to Business Success," The Business Plan, accessed February 2, 2012, www.the-business-plan.com/business-organization-structure.html

6.3.1 MANAGERIAL COMMUNICATION WITH EMPLOYEES

Communication between managers and employees provides the information necessary to get work done effectively and efficiently in organizations. In this and following lecture, basic concepts in managerial communications will be presented including: the interpersonal communication process, methods of communicating, and barriers to effective communications and ways to overcome these barriers, communication flow and communication networks, and contemporary issues and challenges associated with electronic communications and information technology.

Communication is the transfer and understanding of meaning. If no information or ideas have been conveyed or transferred, communication has not taken place. For communication to be successful, the meaning must be imparted and understood. Good communication does not require agreement with the message; just clear understanding of the message. Managerial communication encompasses both interpersonal communication (between two or more people) and organizational communication (all the patterns, networks, and system of communication within an organization). Communication and associated interpersonal processes are important ingredients of organizational effectiveness. Communication is the exchange of messages between people for achieving common meanings. Managers use two types of communication in their work.

- Verbal communication is the use of words to communicate.
  - Written communication includes letters, memoranda, reports, newsletters, policy manuals, etc.
  - Disadvantage includes the fact that the conversations may be time-consuming and difficult to terminate, and that additional time may have to be spent to document what was said.
- Nonverbal communication is communication by means of elements and behaviours that are not coded into words. Nonverbal Communication is communication transmitted without words. The best-known types of nonverbal communication are body language and verbal intonation. Body language refers to gestures, facial expressions, and other body movements that convey meaning.
- Verbal intonation refers to the emphasis someone gives to words or phrases that convey meaning.

Barriers to Effective Interpersonal Communication

- Filtering is the deliberate manipulation of information to make it appear more favourable to the receiver. As information is communicated up through the organizational levels, it is condensed and synthesized, and that doing the condensing filter communication through their personal interests and perceptions of what is important. The more that organizational cultural reward emphasizes style and appearance, the more those managers will be motivated to filter communications in their favour.
- Selective perception means when people selectively interpret what they see or hear, what is based on their interests, background, experience, and attitudes.
- Emotions influence how a receiver interprets a message when it is received. It is best to avoid reacting to a message when the receiver is upset because he/she is not likely to be thinking clearly.
- Information overload happens when the information we have to work with exceeds our processing—such as 600 waiting e-mail messages in the inbox. Receivers tend to select out, ignore, pass over, or forget information when they

have too much information. Alternatively, receivers may put off further processing until the overload situation is over - still ineffective communication.

- Defensiveness - engaging in behaviours such as verbally attacking others, making sarcastic remarks, being overly judgmental, and questioning others' motives—happens when people feel that they are being threatened.
- Language -words mean different things to different people. Age, education, and cultural background can influence language use and definition given to words Jargon is specialized terminology or technical language that members of a group use to communicate among themselves.
- National culture can affect the way a manager chooses to communicate.

7 MARKETING IN SMALL BUSINESS

Small businesses are particularly suited to abiding by the marketing concept because they are more nimble and closer to the customer than are large companies. They made more quickly in response to customer wants and needs. Today's marketers recognize that they must have a complete, comprehensive, and cohesive approach that goes beyond the traditional applications of the marketing concept (Kotler, Keller, 2009). Marketing plays a key role in creating and delivering value to a customer.

7.1 MARKETING ENVIRONMENT

The marketing environment includes all the factors that affect a small business. Small businesses are particularly vulnerable to changes in the external marketing environment because they do not have multiple product and service offerings and/or financial resources to insulate them.

Figure 24 Marketing environment structure

Source: Kotler, Keller, 2009.

The external marketing environment must be understood by the business if it hopes to plan intelligently. This environment, not controllable by management, consists of the following components (Kotler, Keller, 2009):

- **Social factors** - cultural and sub cultural values, attitudes, beliefs, norms, customs, and lifestyles.
- **Demographics -** population growth, age, gender, ethnicity, race, education, and marital status.
- **Economic environment -** income distribution, buying power and willingness to spend, economic conditions, trading blocs, and the availability of natural resources.
- **Political and legal factors -**regulatory environment, regulatory agencies, and self-regulation.
- **Technology -** the nature and rate of technological change.

- **Competition -** existing firms, potential competitors, bargaining power of buyers and suppliers, and substitutes.
- **Ethics -** appropriate corporate and employee behaviour.

The internal marketing environment refers to the company: its existing products and strategies; culture; strengths and weaknesses; internal resources; capabilities with respect to marketing, manufacturing, and distribution; and relationships with stakeholders (e.g., owners, employees, intermediaries, and suppliers). This environment is controllable by management, and it will present both threats and opportunities.

However, this vulnerability is offset to some degree by small businesses being in a strong position to make quick adjustments to their strategies if the need arises. Small businesses are also ideally suited to take advantage of opportunities in a changing external environment because they are more nimble than large corporations that can be bogged down in the lethargy and inertia of their bureaucracies. Firstly, you need to make marketing research to be sure, which marketing tools you could use for your business.

7.2 MARKETING RESEARCH

Marketing research is about gathering the information that is needed to make decisions about a business as an important precursor to the development of a marketing strategy. Marketing research can help the small business identify and refine the segments that offer the greatest opportunities. Part of that process will be to identify segments that meet the requirements of measurability, substantiality, stability, accessibility, action ability, and differential response. Meeting these requirements will increase the chances for successful segmentation.

DEFINITION 10 MARKETING RESEARCH

A research involves the systematic design, collection, recording, analysis, interpretation, and reporting of information pertinent to a particular marketing decision facing a company (Lascu, Clow, 2007, p. 191)

It means that information relevant to the market, the competition, and the marketing environment should be gathered and analyzed in an orderly and objective way. Marketing research for small business offers many benefits like:

- companies can find hidden niches,
- design customer experiences,
- build customer loyalty,
- identify new business opportunities,
- design promotional materials,
- select channels of distribution,
- find out which customers are profitable and which are not,
- determine what areas of the company's website are generating the most revenue, and
- identify market trends that are likely to have the greatest impact on the business.

Answers can be found for the important questions that all small businesses face, such as the following (Lewin, 2006):

- How are market trends affecting my business?
- How does our target market make buying decisions?
- What is our market share and how can we increase it?

- How does customer satisfaction with our products or services measure up to that of the competition?
- How will our existing customers respond to a new product or service?

The specific nature and extent of any marketing research effort will, however, a function of the product, the size and nature of the business, the industry, and the small-business owner or manager. There is no single approach to the research, which is suitable for all the situations.

TYPES OF MARKETING RESEARCH

Small businesses can conduct primary or secondary marketing research or a combination of the two. **Primary marketing research** involves the collection of data for a specific purpose or project. For example, asking existing customers why they purchase from the business and how they heard about it would be considered primary research. Another example would be conducting a study of specific competitors with respect to products and services offered and their price levels. These would be either simple marketing research projects for a small business, business-to-consumer (B2C) or business-to-business (B2B), and would not require the services of a professional research company. Such companies would be able to provide more sophisticated research, but their cost might be too high for the many small businesses. Data gathering techniques in primary marketing research can include observation, surveys, interviews, questionnaires, and focus groups. A focus group is six to ten people carefully selected by a researcher and brought together to discuss various aspects of interest at length (Kotler, Keller, 2009).

Secondary marketing research is based on information that has already been gathered and published. Corporations are viewed as legal entities, meaning that they can enter into legal agreements with individuals and other corporations. They are also subject to numerous local and state regulations. This often results in extensive paperwork that can be costly. Some of the information may be free-public library databases and collections, certain websites, company information, and some trade associations to which the company belongs—or it can be bought. Secondary research would also be appropriate when looking for things such as economic trends, online consumer purchasing habits, and competitor identification.

Table 13 Types of Marketing Research

Primary Marketing Research	Secondary Marketing Research
Data for a specific purpose or for a specific project	Information that has already been gathered and published
Tends to be more expensive	Tends to be lower cost
Customized to meet a company's needs	May not meet a company's needs
Fresh, new data	Data are frequently outdated (e.g., using US 2000 census data in 2011)
Proprietary—no one else has it	Available to competitors
Examples: in-person surveys, customer comments, observation, and SurveyMonkey online survey	Examples: Wall Street Journal, Bloomberg Business Week, US Census 2010, Bureau of Labour Statistics, Fed Stats, MarketingSherpa, ResearchInfo, and eMarketer

Source: McGowen and Kelly, 2013, p.147.

7.2.1 Marketing Research Questions

The need for marketing research before and during a venture will depend on the type of venture. However, typical research questions might include the following, which are divided by subject (Kuratko, 2009):

SALES

- Do you know all you need to know about your competitors' sales performance by type of product and territory?
- Do you know which accounts are profitable and how to recognize a potentially profitable one?
- Is your sales power deployed where it can do the most good, maximizing your investment in selling costs?

DISTRIBUTION

- If you are considering introducing a new product or line of products, do you know all you should about distributors and dealers' attitudes toward it?
- Are your distributors and dealers' salespeople saying the right things about your products or services?
- Has your distribution pattern changed along with the geographic shifts of your markets?

MARKETS

- Do you know all that would be useful about the differences in buying habits and tastes by territory and kind of product?
- Do you have as much information as you need on brand or manufacturer loyalty and repeat purchasing in your product category?
- Can you now plot, from period to period, your market share of sales by products?

ADVERTISING

- Is your advertising reaching the right people?
- Do you know how effective your advertising is in comparison to that of your competitors?
- Is your budget allocated appropriately for greater profit—according to products, territories, and market potentials?

PRODUCTS

- Do you have a reliable quantitative method for testing the market acceptability of new products and product changes?
- Do you have a reliable method for testing the effect on sales of new or changed packaging?
- Do you know whether adding higher or lower quality levels would make new profitable markets for your products?

7.2.2 *THE MARKETING RESEARCH PROCESS*

Most small-business owners do marketing research every day—without being aware of it. They analyze returned items, ask former customers why they switched to another company, and look at a competitor's prices. Formal marketing research simply makes this familiar process orderly by providing the appropriate framework. Effective marketing research follows the following six steps (Cadden and Lueder, 2008, p. 328):

- **Define the problem and the research objectives.** Care must be taken not to define the problem too broadly or too narrowly—and not to identify a symptom as the problem. The research objectives should flow from the problem definition.
- **Develop the research plan.** This is a plan for gathering the needed information, part of which will include cost. In addition, to be determined is the following: whether primary research, secondary research, or some combination of the two will be used. The specific techniques will be identified, and a timetable will be established.
- **Collect the information.** This phase is typically the most expensive and the most error prone.
- **Analyze the information.** Analysis involves extracting meaning from the raw data. It can involve simple tabulations or very sophisticated statistical techniques. The objective is to convert the raw data into actionable information.
- **Present the findings.** The findings are presented to the decision maker(s). In many small businesses, the owner or the manager may conduct the research, so the findings are presented in a format that will make sense for the owner and other members of the decision-making team.
- **Make the decision.** The owner or manager must consider the information and decide how to act on it. One possible result is that the information gathered is not sufficient for making a decision. The problem may be a flawed marketing research process or problems obtaining access to appropriate data. The question becomes whether the situation is important enough to warrant additional research.

7.2.3 *MARKET SEGMENTATION*

Market segmentation is the process of identifying a specific set of characteristics that differentiate one group of consumers from the rest (Kuratko, 2009). Market segmentation requires some marketing research. The purpose of segmenting a market is to focus the marketing and sales efforts of a business on those prospects who are most likely to purchase the company's product(s) or service(s), thereby helping the company (if done properly) earn the greatest return on those marketing and sales expenditures.[22]

Market segmentation maintains two very important things: (1) there are relatively homogeneous subgroups (no subgroup will ever be exactly alike) of the total population that will behave the same way in the marketplace, and (2) these subgroups will behave differently from each other. Market segmentation is particularly important for small businesses because they do not have the resources to serve large aggregate markets or maintain a wide range of different products for varied markets.

Many small business owners have a good intuitive sense of the segments that make sense for the business, and they choose to go with that intuition in devising their marketing

[22] Center for Business Planning, 2011. *Market Segmentation*. Businessplans.org. [online] [Accessed: 19 Jan 2014]. Available at: http://www.businessplans.org/segment.html

strategy. However, that intuition may not be precise or current enough to be of the most help in planning a marketing strategy. Marketing research can be of help here, even to the smallest of businesses.

Table 14 Market Segmentation

Consumer Segmentation Examples	Business Segmentation Examples
Geographic Segmentation Region (e.g., Northeast or Southwest) City or metro size (small, medium, or large) Density (urban, suburban, or rural) Climate (northern or southern)	**Demographic Segmentation** The industry or industries to be served The company sizes to be served (revenue, number of employees, and number of locations)
Demographic Segmentation Age, Family size, Family life cycle (e.g., single or married without kids), Gender Income Occupation, Education Religion Race/ethnicity,Generation,Nationality Social class	**Operating Variables** The customer technologies to be focused on The users that should be served (heavy, light, medium, or nonusers) Whether customers needing many or few services should be served
Psychographic Segmentation Personality Lifestyle Behavioural occasions (regular or special occasion) Values	**Purchasing Approaches: Which to Choose?** Highly centralized versus decentralized purchasing Engineering dominated, financially dominated, and so forth Companies with whom a strong relationship exists or the most desirable companies Companies that prefer leasing, service contracts, systems purchases, or sealed bidding Companies seeking quality, service, and price
Behavioural Segmentation Benefits of the product (e.g., toothpaste with tartar control) User status (nonuser, regular user, or first-time user) Usage rate (light user, medium user, or heavy user) Loyalty status (none, medium, or absolute) Attitude toward the product (e.g., enthusiastic or hostile)	**Situational Factors: Which to Choose?** Companies that need quick and sudden delivery or service Certain application of the product instead of all applications Large or small orders or something in-between
Personal Characteristics: Which to Choose? Companies with similar people and values Risk-taking or risk-aversive customers Companies that show high loyalty to their suppliers	**Other Characteristics** Status in industry (technology or revenue leader) Need for customization (specialized computer systems)

Source: adapted from Kotler and Keller, 2009, p. 214, 227.

DEFINITION 11 MARKET SEGMENTATION

Segmentation is dividing a market into relatively homogeneous subgroups that behave much the same way in the marketplace, is the necessary precursor to selecting a target market or target markets (Lascu, Clow, 2007).

Once multiple segments have been identified, it is necessary to select a target market or target markets. If only a single segment has been identified, it becomes the target market. Nevertheless, each segment has to reach those points:

- **Measurability.** Is it easy to identify and estimate the size of a segment? A small business that moves forward without a clear definition of its market segments is working blind. Intuition can only go so far.
- **Substantiality.** Is the segment large and profitable enough to justify an investment? A small business may not require a huge number of customers to be profitable, but there should be enough people interested in the product or the service being offered to make operating the business worthwhile.
- **Stability.** Stability has to do with consumer preferences. Are they stable over time? Although segments will change over time, a small business needs to be aware of preferences that are continuously changing. Small businesses can be more nimble at adapting their businesses to change, but too much volatility can be damaging to a business's operations.
- **Accessibility.** Can a business communicate with and reach the segment? A small business interested in women who work outside the home will present greater communication challenges than will stay-at-home wives and mothers.
- **Actionability.** Is a small business capable of designing an effective marketing program that can serve the chosen market segment?
- **Differential response.** Market segments, which are easily distinguishable from each other, respond differently to company marketing strategies. For the small business that chooses only one segment, this is not an issue. However, the small manufacturer of ramen noodles in New York City needs to know whether there are different segments for the product and whether the marketing strategy will appeal to those segments in the same positive way.

The selection of a target market or target markets will be based on the segments that have been identified as having the greatest potential for the business. Selecting the target market should be guided by several considerations:

- **Financial condition of the firm.** Limited resources may dictate the selection of only one target market.
- **Whether the competition is ignoring smaller segments.** If yes, this may be a ready-made target market.
- **Is the market new to the firm?** If yes, concentrating on one target market may make the most sense.
- **Specific need or want.** Does the proposed target market have a specific need or want for the product or the service?
- **Ability to buy.** Does the proposed target market have the resources to buy the product or the service?
- **Willingness to buy.** Is the proposed target market willing to buy the product or the service?
- **Will this target market be profitable?** There needs to be enough demand to make money.

Choosing the right target market is a critical part of the marketing strategy of a small business. The target market should be the best match for a company's products and services, thus helping to maximize the efficiency and effectiveness of its marketing efforts.

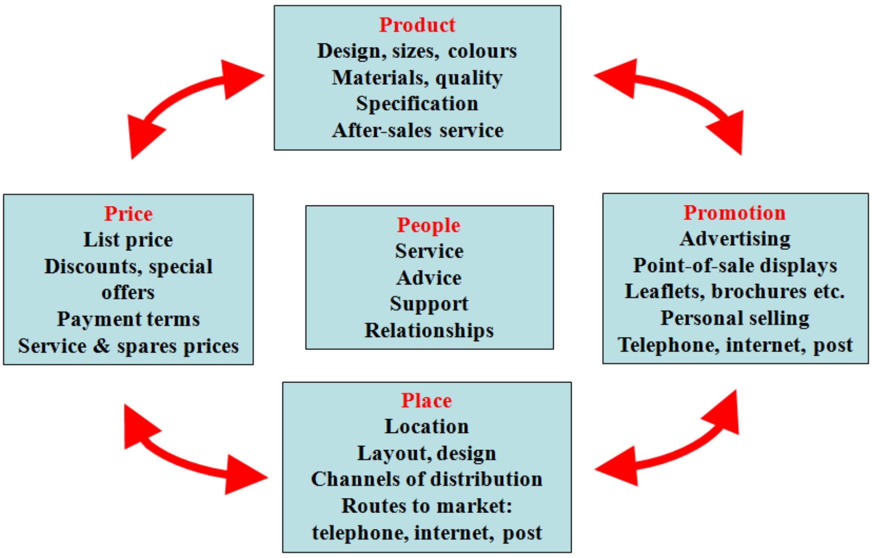
If a small business wants to go with a niche market, the same considerations apply. A niche market is a small, more narrowly defined market that is not being served well or at all by mainstream product or service marketers.

7.3 MARKETING MIX

Whether market segments and target markets are selected based on intuition, marketing research, or a combination of the two, they are the basis for creating an effective marketing mix for any small business.

Marketing mix is easily one of the most well known marketing terms. More commonly known as "the four Ps," the traditional marketing mix refers to the combination of product, price, promotion, and place (distribution). The company controls each component, but they are all affected by factors both internal and external to the company. Additionally, each element of the marketing mix is impacted by decisions made for the other elements. What this means is that an alteration of one element in the marketing mix will likely alter the other elements as well. They are inextricably interrelated. No matter the size of the business or organization, there will always be a marketing mix.

Figure 25 The Marketing Mix



Source: Burns, 2007

The business owner may not think about it in these specific terms, but it is there nonetheless. It is very important in marketing to distinguish between the customer and the consumer. The customer, the person or the business that actually buys a product or a service, will determine whether a business succeeds or fails. The marketing mix should follow the determination of customer needs, wants, and desires. However, there are instances in which a product is created before the target market is selected and before the rest of the marketing mix is designed.

The consumer is the person or the company that uses or consumes a product. For example, the customer of a dry cleaning service is the person who drops off clothes, picks them up, and pays for the service. The consumer is the person who wears the clothes. Another example is a food service that caters business events. The person who orders lunch on behalf of the company is the customer

There are two major types of customer markets: business-to-business (B2B) customer's andindividual consumers or end users (business-to-consumer [B2C]).

- B2B customers are organizations such as corporations; small businesses; government agencies; wholesalers; retailers; and nonprofit organizations, such as hospitals, universities, and museums. In terms of dollar volume, the B2B market is where the action is. More money and products change hands in sales to business buyers than to individual consumers or end users. The B2B market offers many opportunities for the small business. Examples of B2B products include office supplies and furniture, machinery, ingredients for food preparation, telephone and cell phone service, and delivery services such as FedEx or DHL.
- The B2C market consists of people who buy for themselves, their households, friends, coworkers, or other non-business-related purposes. Examples of B2C products include cars, houses, clothing, food, telephone and cell phone service, cable television service, and medical services. Opportunities in this market are plentiful for small businesses.

The problem is that many if not most small businesses probably do not take the time to do what it takes to understand their customers.

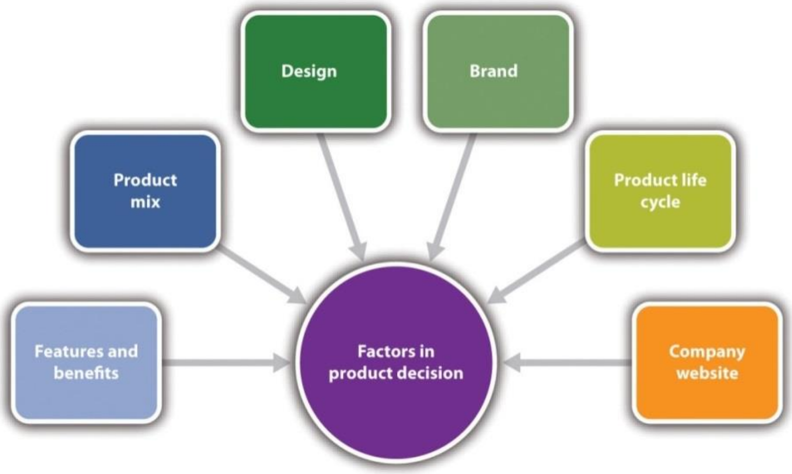
PRODUCT

Product refers to tangible, physical products as well as to intangible services. Examples of product decisions include design and styling, sizes, variety, packaging, warranties and guarantees, ingredients, quality, safety, brand name and image, brand logo, and support services. In the case of a services business, product decisions also include the design and delivery of the service, with delivery including such things as congeniality, promptness, and efficiency. Without the product, nothing else happens. Product also includes a company's website.

The key element in the marketing mix is the product. Without it, price, promotion, and place are moot. The same is true for marketing strategy. The product must lead fulfilling a company's vision and mission and achieving its marketing objectives. Multiple decisions and considerations factor into product or service development:

- features and benefits,
- product mix,
- design,
- brand,
- the product life cycle,
- and the company website.

Figure 26 Product mix



Cadden and Lueder, 2012, s.357

- ***Product Features and Benefits***

A product has multiple layers: core, augmented, and symbolic. These three layers can help a small business owner understand the product features and benefits that will best deliver value to current and prospective customers. These layers also provide the bases for differentiating and positioning the product.

- **The core layer** is the details of a product, its physical anatomy, and its basic features. It is also the basic benefit or problem solution, which B2C or B2B customers are looking for. Someone buying an airline ticket, for example, is buying transportation. Someone buying an ice cream cone is buying a delicious and fun treat. The core layer is also, where considerations of quality begin. Quality "refers to overall product quality, reliability, and the extent to which [the product or the service] meets consumers' needs," and the perception of quality has the greatest impact on customer satisfaction. (Lascu, Clow, 2007). Decisions about design, manufacturing, preparation, ingredients, service delivery, component parts, and process materials all reflect a business's philosophy about quality.
- **The augmented layer** is where additional value is added via things such as packaging, promotion, warranties, guarantees, brand name, design, financing opportunities where appropriate, prompt and on-time service, and additional services that may enhance a product. Consider the ice cream cone that is purchased in an old-fashioned ice cream parlor will likely of greater value to many customers than the ice cream cone purchased at Modern cafeteria. It is this layer where many marketing mistakes are made because opportunities are missed.
- **The symbolic layer** captures the meaning of a product to a consumer—its emotional and psychological connections. The old-fashioned ice cream parlor will engender nostalgia and create powerful emotional ties.

The most serious marketing errors are made when the symbolic product layer is either ignored or not understood. The power of symbolism should never be underestimated.

Every small business should look at its products within the context of the product layers. It is the creativity and imagination of the small business owner with the product layers that can set a business apart. They provide an excellent basis for dissecting an existing product to see where opportunities may have been missed, features could be added or changed, and features or enhancements could be explained more effectively in promotional activities. The product layers should also be used to develop new products that the business plans to introduce.

- ***Product Mix***

All small businesses have a product mix, the selection of products or services that is offered to the marketplace. With respect to the product mix for small companies, a company will usually start out with a limited product mix. No matter the approach, the product mix needs to be created so that it is responsive to the needs, wants, and desires of the small business's target market.

- ***Product Design***

Product design involves aesthetic properties such as colour, shape, texture, and entire form, but it also includes a consideration of function, ergonomics, technology, and usability as well as touch, taste, smell, sight, and sound. The pulling together of these things, as appropriate to the specific product or service being designed, should result in a design that matches customer expectations. "Design represents a basic, intrinsic value in all products and services." (Lascu, Clow, 2007; Kotler, Keller, 2009)

Design is particularly important in making and marketing retail services, apparel, packaged goods, and durable equipment. The designer must figure out how much to invest in form, feature development, performance, conformance, durability, reliability, reparability, and style. To the company, a well-designed product is one that is easy to manufacture and distribute. To the customer, a well-designed product is one that is pleasant to look at and easy to open, install, use, repair, and dispose of. The designer must consider all these factors.

Design issues also apply to services. Some of the design issues for services that are delivered in a store (e.g., dry cleaning, repair, and restaurant) are the same as for any retail store: the design of the physical space, the appearance of the personnel, the helpfulness of the personnel, the ease of ordering, and the quality of service delivery. For services that are performed at a customer's home or at a business site, the design issues include timeliness; the appearance and helpfulness of personnel; the quality of installation, service, and repair; and the ease of ordering the service.

- ***Packaging Design***

The design of the product or the service package is another decision component of the product. Packaging can be defined as "*all the activities of designing and producing the container for a product*." (Kotler, Keller, 2009, p.239) Thus, the package communicates both emotional and functional benefits to the buyer, and it can be a powerful means of product differentiation. A well-designed package can build brand equity and drive sales. Although the manufacturers and retailers may see difficult-to-open packaging as necessary, it does not do much for a positive customer experience.

- ***Brand***

A brand is defined by the American Marketing Association as "*a name, term, sign, symbol, or design, or a combination of them, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors…A brand may identify one item, a family of items, or all items of that seller. If used for the firm as a whole, the preferred term is trade name.*"[23] A brand is a promise to the consumer that certain expectations will be met, a promise that—if broken—may result in the loss of that customer. A company's brand is probably its most important asset.

[23] " American Marketing Association, 2011. *Brand. Dictionary.* [online] Marketingpower.com. [Accessed: 1 Dec 2013] Available at: http://marketingpower.com/_layouts/Dictionary.aspx?dLetter=B.

Building a brand is an ongoing process for a small business because it wants a memorable identity. It is important for the business to monitor constantly its brand to ensure that it represents the core values and needs of its existing and potential customers. The brand needs to reach people on an emotional level because customers ultimately make decisions on an emotional level, not a logical level. For this reason, a small business should think in terms of tapping into as many senses as possible with its brand. "*Almost our entire understanding of the world is experienced through our senses. Our senses are our link to memory and can tap right into emotion.*" (Lindstrom, 2005, p.10) Scenting the air of a store with a fresh fragrance could be a powerful contributor to the store's brand.

Whether a small business wants to keep its brand (but may be monitoring it) or is looking to rebrand (changing the brand). There are four fundamental qualities of great brands, which should be kept in mind (Barwise and Sean Meehan, 2010):

- They offer and communicate a clear, relevant customer promise, such as fun, speedy delivery, or superior taste.
- They build trust by delivering on that promise. Keeping a customer informed when something goes wrong can help build and retain trust.
- They drive the market by continually improving the promise. A small business should always be looking to make things better for its customers. Think in terms of the total customer experience.
- They seek further advantage by innovating beyond the familiar. If a small business focuses on the customer experience, there are undoubtedly ways to improve the brand by adding the unexpected.

- ***Product Life Cycle***

Small-business owners should understand the product life cycle because there are specific implications for marketing strategy (Burns, 2007).

- The product development (incubation) stage is when a product is being prepared for sale. There are costs but no sales. The product introduction stage is when a product is available to buy for the first time. Sales will generally be low but increasing, marketing expenses will be high, and profits will be typically low or non-existent. The focus of the marketing strategy will be to create awareness, establish a market, and create demand for the product.
- The product growth stage is when sales grow rapidly as the target market adopts a product and competition enters the marketplace once it observes the success. Marketing strategy should focus on differentiation and building a brand preference. There is substantial profit improvement. Rapid growth must be managed carefully so that the company does not succeed into failure.
- The product maturity stage is characterized by slow growth because most of the buyers interested in a product have bought it. Sales may increase but slowly due to intense price competition. Profits stabilize or decline. The marketing strategy must focus on getting people to switch brands by using special promotions and incentives.
- The product decline stage is when sales decline and profits erode. A product has become obsolete because of an innovation (or the tastes of the target market have changed. The marketing strategy works to reinforce the brand image of the product. The product may be dropped from the product line or rejuvenated if possible and practical.

Many small business owners may not see the life cycle as applying to their products or services. Thinking this way would be a mistake. The lifecycle provides guidance for watching how a product or a service progresses in the marketplace so that the necessary marketing strategy steps can be taken.

- ***The New Product Development Process***

If the development of a new product is being considered, the following steps are suggested as guidance (Lascu, Clow, 2007):

  - Generate new product ideas. Search for ideas for new products.
  - Screen new product ideas. Make sure the product fits the target market and the overall mission of the business.
  - Develop and evaluate new product concepts. Develop product concepts and determine how consumers will view and use the product.
  - Perform a product business analysis. Calculate projected business costs, return on investment, cash flow, and the long-term fixed and variable costs. Long-term fixed costs are production costs that do not vary with the number of units produced (e.g., annual rent). Long-term variable costs are production costs that vary with the number of units produced (e.g., selling more hot dogs will require more hot dogs, ketchup, mustard, and relish).
  - Design and develop the product. Develop a product prototype. A product prototype is an exact match to the product description developed in the concept development and evaluation stages. It is a sample.
  - Test market the product. Introduce the product to a market to find out how the product will be received when it is introduced for real. The test market should be as close as possible in terms of characteristics (e.g., demographics) as the target market. For a small business, an appropriate test market might be a few select customers.
  - Launch the product or the service. The product is introduced to the full marketplace.

- ***The Company Website***

A company's website is part of its product or service. The conventional wisdom is that all businesses should have a website. The reality is that there are many small businesses, which do very well without a web presence. The small local deli, accounting or insurance services, a legal firm, a liquor store, or a dental office may not see the need for a website. At the same time, customers are increasingly expecting a web presence, so any small business that does not have a website runs the risk of losing sales because of it. The time may also be approaching when not having a website will be perceived as odd, with questions raised as to the seriousness of the business. Every small business without a website should determine whether this matters to them or not. The goal is to have an interesting and speedy site.

7.3.1 PRICE

Price is what it will cost for someone to buy the product. Although the exchange of money is what we traditionally consider as price, time and convenience should be considered. Examples of pricing decisions include pricing strategy selection (e.g., channel pricing and customer segment pricing), retail versus wholesale pricing, credit terms, discounts, and the means of making online payments. Channel pricing occurs when different prices are charged depending on where the customer purchases the product (Cadden and Lueder, 2018, p.385)

PRICING OBJECTIVES

Pricing objectives (what the company wants to accomplish with its pricing strategy) should be related to a company's objectives and should follow the decision about where a company wants to position its products or services. Different small businesses in the same industry may have different pricing objectives (Kotler, Keller, 2009):

- **Sales-based objectives**. Increasing sales volume and market share relative to the competition may involve penetration pricing, where a business prices a new product below that of the competition to quickly penetrate the market at the competitor's expense, acquire a large market share, and then gradually raise the price. This objective might be appropriate for a small business that is introducing a new product or service to a very competitive marketplace.
- **Profit-maximization objectives**. Quickly recovering the costs of product development while providing customer value may involve price skimming, where a new product is priced higher than that of the competition to maximize profit. This objective would work for a small business with customers who are more concerned with quality, uniqueness, and status rather than price. However, a product's image and quality must warrant the high price.
- **Status-quo-based objectives**. Used to minimize the impact of competitors, government, or channel members and to avoid a sales decline, these objectives are reactive rather than proactive, so they should be adopted for the short term only. Small businesses must be able to meet the needs of their target market.

PRICING STRATEGY

Once the pricing objectives are set, a small business must determine a pricing strategy. The small business owner can consider a variety of approaches. How goods and services are priced tells consumers a lot about what to expect from a small business.

- ***Discount Pricing***

Discount pricing is used with customers who buy in large quantities, customers who buy during off-peak times (seasonal), promotions used to increase traffic, and loss leaders (products that are discounted to get customers in the door in the hope that they will also buy more profitable products). Discount pricing can be used in the online environment in ways similar to brick-and-mortar stores. If the discounting is short term, inventory can be reduced, and revenues are increased temporarily. An important disadvantage, however, is that customer's often-associate low price with low quality, particularly if a brand name is unfamiliar. A discount pricing strategy could lead to a product or a service being perceived as low quality. In addition, price reductions can be easily matched by the competition, eliminating any but the earliest advantage

- ***Cost-Based Pricing***

Cost-based pricing is a very simple approach. A company figures out how much it costs to make a product or deliver a service and then sets the price by adding a profit to the cost. Cost-based pricing is very easy to use. It is flexible (allowing different profit percentages to be added to different product lines), allows for easy price adjustments if costs go up or down, and is simple to calculate. On the downside, cost-based pricing ignores product demand, what the competition is doing with pricing, and positioning, and it provides no incentive for cost efficiencies.

- ***Prestige Pricing***

Prestige pricing (or premium pricing) taps into the belief that a high price means high quality. Although this relationship exists in many instances, it is not true in all cases. Nonetheless, prestige pricing is "a strategy based on the premise that consumers will feel that products below a particular price will have inferior quality and will not convey a desired status and image." Prestige pricing can be very effective at improving brand identity in a particular market. However, it is not typically used when there is direct competition because such competition tends to have a downward effect on pricing. Unique products usually have the best chance of succeeding with prestige pricing.

- ***Even-Odd Pricing***

Also known as the "nine and zero effect," even-odd pricing can be used to communicate quality or value. It assumes that consumers are not perfectly rational, which is true. Emotion plays a much larger role in consumer behaviour than rationality. Odd-numbered prices give consumers the impression that they are getting a great value. It is a psychological effect with no basis in logic.

- ***Geographic Pricing***

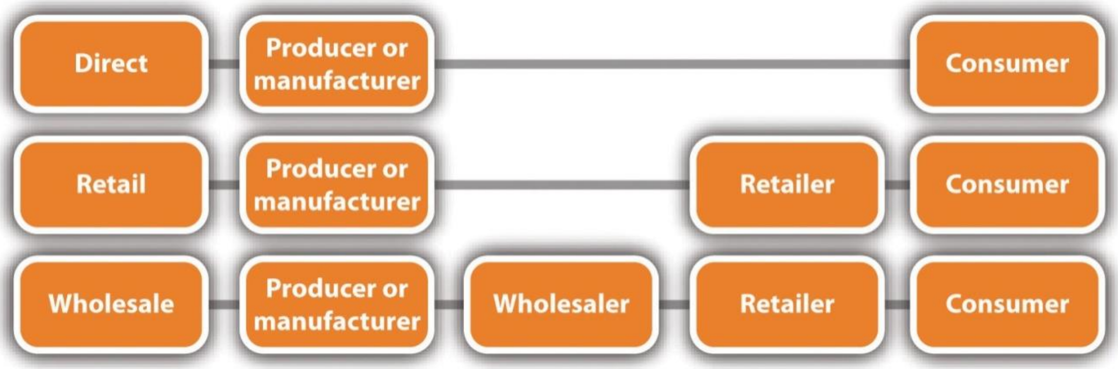
Some small companies will use a geographic pricing strategy. This pricing strategy takes the geographic location of a customer into consideration, the rationale being that distribution can increase product delivery costs and thus the cost of the product. Taxes, the cost of advertising, competitors who benefit from government subsidies, consumer demand, differences in costs of living, and the general cost of doing business are other factors that enter into the decision to use geographic pricing. This strategy might also be appropriate when selling in different states.

7.3.2 Place

Place is another word for distribution. The objective is to have products and services available where customers want them when they want them. Examples of decisions made for place include inventory, transportation arrangements, channel decisions (e.g., making the product available to customers in retail stores only), order processing, warehousing, and whether the product will be available on a very limited (few retailers or wholesalers) or extensive (many retailers or wholesalers) basis. A company's website is also part of the distribution domain.

A small business may choose the direct, retail, wholesale, service, or hybrid channels. In general, business-to-business (B2B) distribution channels parallel those of business-to-consumer (B2C) businesses.

Figure 27 Channels



Source: Cadden and Lueder, 2008, p.392

The direct channel provides close contact with the customer and full control of all aspects related to the marketing of a company's products. Many B2B sellers also use the direct channel. Service businesses use the direct channel because there is no way to do otherwise. Services are performed and consumed at the same time; there is no role for intermediaries. The Internet has increased the opportunities for small businesses to use the direct channel as the only means of distribution or as an additional sales channel.

Many small businesses may choose to produce or manufacture products and distribute them to retailers for sale. This is considered an indirect channel because the retailer is an **intermediary** between the producer or manufacturer and the final consumer. If a small business that makes one-of-a-kind, handcrafted picture frames sells its frames to a picture-framing business that in turn sells the frames to its customers, this would be an example of using the retail channel. Although selling through retailers may expand the distribution coverage to a small business's target market, the business must give up some control over pricing and promotion. In addition, the business should expect to get a wholesale price from the retailer that is significantly lower than what it would get if it sold directly to the final consumer (Collins, 2005).

Wholesalers are also **intermediaries**. A small business that chooses to use wholesalers is also using an **indirect channel** of distribution. Using a wholesaler makes sense when a business makes a product that it wants to sell in many stores that would not be easily or conveniently reachable through the direct channel or the retail channel. Although any small business that uses wholesalers will see a reduction in profit, there are several advantages to wholesaling. For example, wholesalers are able to sell and promote to more customers at a reduced cost, they can deliver more quickly to buyers because wholesalers are closer to them, and wholesalers can inventory products, thereby reducing inventory costs and risks to their suppliers and customers. Small businesses that produce only one or a few products commonly use the wholesale channel of distribution. Retail outlets may not be placing orders from the small business because it is not known. The wholesaler can put the product in front of them. (Madura, 2010)

Multichannel Distribution. A small business may choose multichannel distribution system (or hybrid channel). This channel option uses two or more channels of distribution to reach one or more customer segments, offering customers multiple purchase and communication options. The multichannel approach offers three important advantages (Kotler, Keller, 2009):

- **Increased market coverage.** More customers are able to shop for a company's product in more places, and customers who buy in more than one channel are often more profitable than one-channel customers.
- **Lower channel cost.** Selling by phone or online is cheaper than selling via personal visits to small customers.
- **More customized selling.** A technical sales force could be added to sell equipment that is more complex.

PHYSICAL DISTRIBUTION (LOGISTICS)

Physical distribution (logistics) involves "all the activities involved in the physical flow and storage of materials, semi finished goods, and finished goods to customers in a manner that is efficient and cost effective." Lascu, Clow, 2007, 307). Logistics can be performed by the producer or the manufacturer, intermediaries, or the customer. Deciding on the right logistics solution may be the differentiator that puts a company ahead of its competition. Logistics are relevant to both online and on ground companies. Retailers that offer a wide assortment of products will spend more on logistics because transportation and storage costs will increase as the number of carried products increases. Logistics involve the following four primary functions:

1. **Transportation.** The transportation choices for a small business will determine whether products will arrive at their destination in good condition and on time. Transportation costs will increase product price. The choices include truck, rail, air, water, and pipeline. The selection of the best mode or combination of transportation modes depends on a variety of factors, including cost, speed, and appropriateness for the type of good, dependability, and accessibility.
2. **Warehousing.** Producers and manufacturers must store goods before they are sold because production and consumption rarely match. Some inventory may be kept at or near the point of production or manufacture, but the rest is located in warehouses. Some warehouses also provide assembly, packaging, and promotional display construction services…all for a fee, of course.
3. **Inventory control.** Inventory control is about ensuring that goods are where customers want them when they want them. In other words, it is about avoiding the "out of stock" situation that irritates customers. Small-business owners must understand how much inventory will be needed to address their customers' needs on a timely basis and at the appropriate cost (think pricing strategy). Small businesses should think of inventory as a wasting asset: it does not improve with time and, in fact, becomes less valuable with every day that passes taking up space and incurring heat, light, power, handling, and interest charges. The goal is to keep inventory as low as possible.
4. **Order processing.** Every small business should want to shorten the elapsed time between an order's receipt, delivery, and payment. Although there are typically multiple steps involved, the reality is that the longer the cycle, the lower the customer's satisfaction, the higher the company's costs, and the lower the company's profits. Streamlining the process should be a priority.

There are several things that small businesses can do to increase the efficiency and the effectiveness of their logistics. For example, a business can select a logistics company that is industry specific (e.g., wine or clothing) because that company will understand the shipping needs of the products or use small business logistics services.

7.3.3 PROMOTION

Having the best product in the world is not worth much if people do not know about it. This is the role of *promotion* getting the word out. Examples of promotional activities include advertising (including on the Internet), sales promotion (e.g., coupons, sweepstakes, and 2-for-1 sales), personal sales, public relations, trade shows, webinars, videos on company websites and YouTube, publicity, social media such as Facebook and Twitter, and the company website itself. Word-of-mouth communication, where people talk to each other about their experiences with goods and services, is the most powerful promotion of all because the people who talk about products and services do not have any commercial interest.

Promotion, the fourth P in the marketing mix, is now more commonly referred to as marketing communications. Marketing communications can be defined as "the means by which firms attempt to inform, persuade, and remind customers—directly or indirectly—about the products and brands they sell. In a sense, marketing communications represent the 'voice' of the company and its brands and are a means by which it can establish a dialogue and build relationships with consumers." (Kottler, Keller, 2009, p.407). Small-business owners should be familiar and comfortable with all three terms because at least one of them will be the basis of conversations with vendors, employees, and other businesses. Prior to selecting and designing any communications, however, objectives must be established for the marketing communications program.

Every small business must decide what it wants to accomplish with its marketing communication plan. Although many marketing communication plans may be oriented toward a single objective, it is possible for a program to accomplish more than one objective at a time. The problem is that this may be confusing to potential customers.

Orientation to the local product sourcing in the retailers' promotion policy when communicating to their customers becomes topical even in the Czech Republic (Pícha et al, 2013 p.1062)

MARKETING COMMUNICATIONS MIX

The marketing communications mix for a small business, either pure-play or brick-and-click, will consist of some combination of the following major modes of communication: advertising, sales promotion, events and experiences, public relations (PR) and publicity, direct marketing, interactive marketing, word-of-mouth communication, and personal selling. (Kotler, Keller, 2009, p. 470) Each mode of communication has its own advantages and disadvantages, which should all be considered carefully before any final selections should be made.

Figure 28 The Marketing Communications Mix

Source: Kotler and Keller, 2009, p. 473.

- Advertising

Advertising is "any paid form of nonperson presentation and promotion of ideas, goods, or services by an identified sponsor." (Kotler, Keller, 2009, p. 472) Advertising is around us all the time—for example, ads are on television and radio, in newspapers and magazines, in train stations and on trains, on the sides and inside of buses, in public restrooms, in taxis, on websites, and on billboards. Ads can also be found in other places, and the locations are limited only by the creativity of the company placing the ads. Small businesses must choose advertising media (e.g., radio, television, newspapers, billboards, the Internet, and magazines) based on its product, target audience, and budget. Advertising on the Internet is also a consideration for the marketing communications mix of any business with a web presence. Advertising offers several advantages to the small business. For example, advertising is able to reach a diverse and geographically dispersed audience; it allows the seller to repeat a message many times; and it provides the opportunity for dramatizing the company and its products through the artful use of print, colour, and sound. Whether the advantages of advertising outweigh the costs and disadvantages is something that must be decided by each small business.

- Sales Promotion

Given the expense of advertising and the fact that consumers are exposed to so many advertising messages every day, many companies correctly believe that advertising alone is not enough to get people to try a product a product or a service. Enter lower-cost sales promotion techniques. Sales promotion refers to the variety of short-term incentives to encourage trial or purchase of a product or a service. Examples of commonly used sales promotions include contests, sweepstakes, coupons, premiums and gifts, product samples, rebates, low-interest financing, price discounting, point-of-sale displays, and frequent user or loyalty programs.

- Events and Experiences

Events and experiences are "company-sponsored activities and programs designed to create daily or special brand interactions." There are several advantages to events and experiences: (1) A well-chosen event or experience can be very effective because the consumer gets personally involved. (2) Experiences are more actively involving for consumers because they are real time. (3) Events are not hard sell, and most consumers will appreciate the softer sell situation. By having special events, a small business will stand out from the rest, and they will create desirable publicity for the company (Schmitt, 1999, p.22)

- Public Relations and Publicity

Public relations (PR) and publicity are designed to promote a company's image or its individual products. A small business can also use PR to clarify information in response to negative publicity. Traditional PR tools include press releases and press kits that are sent to the media to generate positive press on behalf of the business. A press kit, the most widely used PR tool, pulls together company and product information to make a good, solid first impression. A press kit can be particularly useful for small businesses, although the smallest of businesses may not see the need. Increasingly, companies are using the Internet: interactive social media, such as blogs, Twitter, and Facebook, home-page announcements for specific occasions (e.g., messages of sympathy for the victims of a disaster) and e-mail.

Most small businesses are not likely to have PR departments. Instead, there will be one person whose job includes among many other things PR and publicity. The key is for PR and marketing to work closely together so that "every piece of communication produced by the company speaks with one voice." Getting publicity for a small business is usually free. Stories about events and experiences might be of interest to the media. One great idea is to have a group of people outside the business with positive picketing, holding signs such as "Low prices" or "Beware of friendly employees." This was actually done by a small business, and it resulted in the business being on the front page of the local paper (Lascu, Clow, 2007).

- Direct Marketing

Direct marketing is the "promotion of a product from the producer directly to the consumer or business user without the use of any type of channel members." Common direct marketing platforms include catalogues; direct mailing; telemarketing; television shopping; electronic shopping; fax mail; voice mail; blogs; websites;[30] e-mail; direct response radio, television, and Internet; social media, such as Facebook and Twitter; and mobile devices. Because channel members are bypassed, direct marketing normally allows for greater profitability; perhaps more importantly, however, it can develop stronger brand loyalty with customers.

- Interactive Marketing

Interactive marketing refers to "online activities and programs designed to engage customers or prospects and directly or indirectly raise awareness, improve image, or elicit sales of products and services." Everything is personalized and individualized from the website content to the products being promoted. Common interactive marketing tools include e-mail, websites, online shopping, videos, webinars and webcasts, blogs, and social media such as Facebook and Twitter. Because e-mail, websites, online shopping, webinars and webcasts have been mentioned previously, the focus here will be on videos, blogs, and social media. Social media "generally refers to websites featuring user-generated content or material created by visitors rather than the website publishers. In turn, these sites encourage visitors to read and respond to that material." Social media is changing the way that people communicate and behave. Social media outlets such as Facebook, LinkedIn, and Twitter are, among other things, driving purchases—and they should be seen "like a virtual cocktail party where all attendees can discuss [a company's] products, services, experiences, and new ideas." (Thomas, 1999, p.99). Many small businesses in the B2B sector are already using social media for business as a resource, to engage in initiatives, or both. Despite the surrounding social media, and the fact that many small businesses are already connected, small businesses must still consider the use of social media just as carefully as the other modes of marketing communications.

- Personal Selling

A small business owner needs to connect with customers before a sale can take place. Sometimes personal selling is the best way to do that. Personal selling, "the process of communicating with a potential buyer (or buyers) face-to-face with the purpose of selling a product or service," is essential in the marketing communications mix of a small business. History has shown that the most successful entrepreneurs have been skilled salespeople who were able to represent and promote their companies and products in the marketplace. It makes sense that successful small business owners should have the same sales skills. Although personal selling plays an important role in the sale of consumer products, it is even more important in the sale of industrial and business products. More than four times as many personal selling activities are directed toward industrial and business customers than toward consumers (Ivancevich et al., 2007)

Like all other forms of marketing communications, personal selling offers both advantages and disadvantages. On the plus side, personal selling is flexible and dynamic, providing companies with the best opportunity to tailor a message to satisfy customers' needs. Personal selling's interactive nature also makes it the most effective promotional method for building relationships with customers, particularly in the B2B market, and it is the most practical promotional method for reaching customers who are not easily reached through other methods. Personal selling can help a small business build strong, loyal relationships with customers and consumers.

On the minus side, the biggest disadvantage may be the negative perceptions that many people have of salespeople: pushy, annoying, slippery, and willing to do anything for the sale whether legal or not. The reality, of course, is that most salespeople (unfortunately, not all) do not fit this stereotype. The successful salesperson is the person who focuses his or her efforts on satisfying customers over the long term as opposed to his or her own selfish interests. Also on the negative side is the high cost of personal selling. Personal sales contacts are very expensive, with the costs incurred (compensation plus sales support) whether the sale is made or not. Then there are the costs of training the sales staff on product knowledge, industry information, and perhaps selling skills. Depending on the size of the company, small businesses will have varying numbers of salespeople, so some of the costs will vary as well.

7.4 MARKETING STRATEGY CONCEPT

Small-business marketing and big business marketing are not the same. The basic marketing principles that guide both are the same, but there are important differences with respect to scope, budget, risk factors, and areas of opportunity. The difference between marketing strategy and marketing management is an important one.

Marketing strategy involves selecting one or more target markets, deciding how to differentiate and position the product or the service, and creating and maintaining a marketing mix that will improve successfully with the selected target market(s)—all within the context of marketing objectives. Differentiation involves a company's efforts to set its product or service apart from the competition. Positioning "entails placing the brand [whether store, product, or service] in the consumer's mind in relation to other competing products, based on product traits and benefits that are relevant to the consumer Cadden and Lueder, 2012, 336.

Small businesses cannot compete with the marketing budgets of big companies. As a result, small businesses do not have the luxury of large staffs and the staying power that comes with high profits. There is little room for error. Failed strategies can lead to ruin.

The scope of small business marketing does not extend across the same level of multiple products and services that characterize most big businesses. Combined with having few if any products in the pipeline, this significantly reduces the insulation that small businesses have against difficulties in the marketplace or strategic failures. "Small business marketing strategies have to be more targeted, cost-effective and more elaborately planned [s]o as to minimize the losses in case the strategy fails."

Opportunity areas for small businesses are also very different from those of big businesses. The small business can take advantage of niche markets and local needs and wants. They are much better able to emphasize personal, one-to-one interactions and can market real time in ways that cannot be matched by big businesses. Given the special marketing vulnerabilities of small businesses, the importance of understanding the components of a marketing strategy should be clear. A marketing strategy involves selecting one or more target markets, deciding how to differentiate and position the product or the service, and creating and maintaining a marketing mix that will prove successful with the selected target market(s) all within the context of marketing objectives. Marketing objectives are what a company wants to accomplish with its marketing strategy: "Strategy is not a wish list; set of goals, mission statement, or litany of objectives…A marketing strategy is a clear explanation of how you're going to get there, not where or what there is. An effective marketing strategy is a concise explanation of your stated plan of execution to reach your objectives…Marketing without strategy is the noise before failure."

7.4.1 MARKETING OBJECTIVES

Marketing objectives are what a company wants to accomplish with its marketing. They lay the groundwork for formulating the marketing strategy. Although formulated in a variety of ways, their achievement should lead to sales. The creation of marketing objectives is one of the most critical steps a business will take. The company needs to know, as precisely as possible, what it wants to achieve before allocating any resources to the marketing effort.

Marketing objectives should be SMART: specific, measurable, achievable, realistic, and time-based (i.e., have a stated period for achievement). It has been recommended that small businesses limit the number of objectives to a maximum of three or four. If you have fewer than two objectives, you are not growing your business, as you should be in order to keep up with the market. Having more than four objectives will divide your attention, and this may result in a lacklustre showing on each objective and no big successes. If a small business has multiple marketing objectives, they will have to be evaluated to ensure that they do not conflict with each other. The company should also determine if it has the resources necessary to accomplish all its objectives.

For small businesses that already have, or are looking to have, a web presence and sell their products or services online, e-marketing objectives must be included with all other marketing objectives. The ultimate objective, however, will be "the comprehensive integration of e-marketing and traditional marketing to create seamless strategies and tactics." (Strauss and Frost, 2009, p.6)

7.4.2 MARKETING PLAN

Many small businesses do not have a marketing plan, choosing instead to market their products and services on an intuitive, sometimes seat-of-the-pants basis. As long as there is regular and effective communication with the rest of the people in the organization, a formal written plan may not be necessary. However, as the business grows and regular and effective communication becomes more difficult, a written marketing plan should be seriously considered. For the small businesses that do have a marketing plan, few actually use it.

There are many reasons why so many small businesses do not have marketing plans. Among the reasons are the following:

- They do not have enough knowledge of marketing.
- They take a scattergun approach to marketing.
- They do not know how to go about developing a marketing plan.
- They do not have enough money to do marketing properly.
- They do not have enough time to do marketing properly.
- They do not have good people or resources to help them with marketing.

DEFINITION 12 MARKETING PLAN

A marketing plan "is a written document that summarizes what the marketer has learned about the marketplace and indicates how the firm plans to reach its marketing objectives. It contains tactical guidelines for the marketing programs and financial allocations over the planning period." (Kotler, Keller, 2009, p.56)

A marketing plan provides a specific marketing direction for a small business and is a very valuable tool if it is done correctly. Because the ultimate purpose of the plan is to generate efficient, profitable action, the marketing plan should consist of usable, practical instructions that are designed to ensure that resources are properly applied. A good marketing plan will provide the reader with a good general idea of its main contents even after only a quick skim in fifteen minutes or less. No matter the length, the plan should be practical, to the point, with useful graphics as appropriate and worded clearly with no flowery or legalistic language.

The plan should cover one year, which is often the best way to think about marketing for the small company. This is not to say that you should not also think about the long term. It just means that things change more rapidly in the short term. People leave, markets evolve, and customers come and go. A marketing plan is a very important part of the small business roadmap to success. There are many good reasons for developing a marketing plan, including the following:

- It forces you to identify the target market. A company's best customers, and hopefully the ideal customer, should be in the target market.
- You get a higher return on investment (ROI). Every dollar will work harder when it is focused.
- It forces you to think about both short- and long-term marketing strategies. Focusing only on the short term can be devastating to the future of the company.
- It provides a basis on which to evaluate a company against its industry or market in terms of strengths, weaknesses, opportunities, and threats.
- You can eliminate waste by building efficiency. Limited resources can be allocated to create the greatest return.
- It will be easier to see where past decisions have helped or hindered the growth of a business. The plan will provide a guide for measuring progress and outcomes.
- It will help you to minimize risk, mistakes, and failures.

- It helps you to establish a timeline, keeping people accountable for the growth and success of operation.
- It gives clarity to who does what, when, and with what marketing tools.
- It lays out a company's game plan. If people leave, if new people arrive, if memories falter, if events bring pressure to alter the givens, the information in the written marketing plan is a reminder of what you agree.

Because many small businesses seem to operate successfully without a marketing plan, depending on how you want to define successfully, the absence of marketing plan does not mean automatic failure. However, there are some distinct disadvantages to not having a marketing plan. The following are some examples:

- Not having a marketing plan, whether it be a stand-alone document or a section in the business plan, will put you at a significant disadvantage when trying to get any type of business loan.
- Not having a marketing plan can push a business into a meandering mode that could result in slowed growth, missed opportunities, and ignored threats.
- The target market may not be defined correctly.
- Not having a marketing plan may force you to focus on the short term with little or no attention to the long term. This can be devastating to the future of a company.
- Potential efficiencies will not be realized.
- Risk will likely increase.

In short, not having a marketing plan means that you will not realize the advantages of having one. Even if you are an owner-only business, a marketing plan can provide a discipline and a structure for growing the business if that is desired. On the other hand, if an owner is perfectly satisfied with where and how things are, a marketing plan will most likely not be helpful. Just remember that change is constant. Without a marketing plan, a business may not be ready for change.

7.4.3 THE MARKETING STRATEGY

With its focus being on achieving the marketing objectives, marketing strategy involves segmenting the market and selecting a target or targets, making differentiation and positioning decisions, and designing the marketing mix. The design of the product (one of the four Ps) will include design of the company website.

Differentiation refers to a company's efforts to set its product or service apart from the competition, and positioning is placing the brand (whether store, product, or service) in the consumer's mind in relation to other competing products based on product traits and benefits that are relevant to the consumer. It has been said "in some cases strategy just happens because a market and a product find each other and grow organically. However, small businesses that understand the power of an overarching marketing strategy, they filtered and infused in every tactical process, will usually enjoy greater success.

Figure 29 Initial Marketing strategies

Source: Mutiso, P., Mutiso, P. and V. Rarr,. 2012. 4 Types Of Marketing Strategies To Use As An Entrepreneur. *[online] [Accessed: 19 Jan 2014]. Available at: http://www.mybusinesstricks.com/2012/09/4-types-of-marketing-strategies-to-use.html#.Une7YOJ_vDw*

- Market Leader Strategies

Under this strategy, there are three ways, in which you could use it to establish yourself as a market leader. The first way is to expand your total market. This is done by applying strategies that will increase the numbers of consumers using your product or services. **To lead** you must find new uses of existing products or targeting a new market. In identifying new markets, you might have to source consumers in locations where your product is not known.

Defending the market share you are in control of is the second strategy. The most effective ways of defending your current market is by capitalizing on improving the quality of your products to be able to retain consumers. Market segmentation helps in defending your market share. You need to segment products to be able to tap and retain consumers who would go to your competitor if you engaged in a single segment business.

The third strategy is to **expand your market share**. To expand your market share you need to counter aggressively completion.

A business can deal with completion by doing what your competitor does not. An example of ways of expanding market share is to advertise products using appropriate promotion mix the suits your business.

- Market Challenger Marketing Strategy

The market challenger marketing strategy means that you research and identify minor unmet needs that you believe your business can cater for competitively. There is little or no competition here, and it makes it easy to establish yourself in the market. Challengers use the weaknesses of their competitors as their selling point.

- Market Niche Marketing Strategy

Having a market niche means that your market is differentiated into fine tuned segments. The niches make it easier to address the need of consumers in each of the market niches. This is a fundamental type of marketing strategy as you are able to address the differing preferences of diverse consumers as well as moving with current trends in the market. Diversifying the market will enable you to reach out to a wider market.

- Market Follower Marketing Strategy

The market follower depend waits for his competitors to identify markets and carry out research consumer preferences. As a follower, you need to be keen your competitor's weaknesses and improve on them. This marketing strategy saves you on cost arising from having to carry out research because you only have to work on your competitors weaknesses to better your products.

The above-mentioned examples of marketing strategies and tactics are very important for promoting small businesses and large-scale businesses. Other kinds of approaches to use as entrepreneur are the digital and social marketing strategies. The main aim of business is to make profits; proper advertising is required for the objectives of the business to be realized.

EXAMPLE 9 FOR COOKS ONLY

When Phil Hartrack was a young man, he already knew what he wanted to be - a salesperson. His mother was delighted. "Salespeople make great money," she explained to him. "And with your appetite, you’re going to need all of the money you can make. You’ve got the biggest appetite in the family."

After graduating from college, Phil took a job with a consumer-goods firm. For the next ten years, he was one of its leading salespeople every year. At the end of this time, however, Phil admitted to himself that although he enjoyed selling, what he really wanted to do was sell books. "I want to own my own bookstore," he told his wife. "I know it sounds silly because I have had no experience in bookstore selling, but I've always loved books, and I'm a terrific salesperson." After researching the market, Phil and his wife had to face a very important fact: The competition in this business is extremely aggressive. Most small bookstores do not last more than three years, and the majors such as Walden and Doubleday dominate the industry.

Phil refused to admit defeat. "There has to be a market niche somewhere in this field that the majors are not addressing. I'm going to find that niche and go after it," he told his banker. Six months ago, Phil concluded that he had found this niche. "Cookbooks are the wave of the future," he explained to his wife. "The average person today buys twice as many cookbooks as ten years ago. It is the fastest-growing segment of the book market. Moreover, with your cooking skills and my appetite, we are a natural for this market. We love food, and we have sales skills."

Taking all of their savings, Phil and his wife opened their bookstore in a popular subur-ban mall. It is called For Cooks Only and it sells cookbooks only. By the end of the first month, the Hartracks realized they had made the right choice. Their wide selection of cookbooks and their familiarity with many of the books helped them build a loyal clien-tele. They even installed a photocopying machine. If someone wants a recipe but does not want to buy the book, a photocopy of it is made for the individual. This service has re-sulted in many people coming by to get a recipe and then returning within a couple of weeks to buy the book.

Although Phil is quite happy over the business's success, he realizes that his limited market niche could dry up in a short period. He feels that the best way to prevent this from happening is by conducting marketing research, seeing if he can add any additional books or services to the line, and developing the strongest possible clientele loyalty. The first place to begin, in his opinion, is by examining the current purchasing habits of customers and then using this as a foundation for deciding where to go from here.

Questions

1. From the customer's viewpoint, what type of good is a cookbook? Defend your answer.
2. Why is Phil's store doing so well? Include in your answer his philosophy of marketing
3. In his marketing research efforts, what type of information would you suggest Phil collect? How can he go about doing this? Be complete in your answer.[24]

[24] Based on Kuratko, 2009, chapter 8.

8 BUSINESS MODELS AND STRATEGIES

Strategic management is a process through which managers formulate and implement strategies geared to optimizing goal achievement, given available environmental and internal conditions. Strategic management is that set of managerial decisions and actions that determines the long-run performance of an organization. It entails all of the basic management functions like planning, organizing, leading, and controlling (see chapter 5).

When an organization has a long-term purpose, articulated in clear goals and objectives, and these goals and objectives can be rolled up into a coherent plan of action, then we would say that the organization has a strategy. It has a *good* or even *great* strategy when this plan also takes advantage of unique resources and capabilities to exploit a big and growing external opportunity.

The word strategy is derived from the Greek word strategos, which roughly translates into the art of the general, namely a military leader. Generals are responsible for marshalling required resources and organizing the troops and the basic plan of attack. Much in the same way, executives as owners of businesses are expected to have a general idea of the desired outcomes, acquire resources, hire and train personnel, and generate plans to achieve those outcomes. In this sense, all businesses, large and small, have strategies, whether they are clearly written in formal business plans or they reside in the mind of the owner of the business (Cadden and Lueder, 2008, p.230)

Strategy then, is the central, integrated, externally oriented concept of how an organization will achieve its objectives (Hambrick, Fredrickson, 2001, p. 2).

DEFINITION 13 A STRATEGY DEFINITION

A strategy is a pattern of objectives, purposes or goals and the major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or to be (Arrow, 1971,p. 28)

The determination of the long-run goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals (Chandler,1962,p. 13)

What business strategy is all about, in a word, is competitive advantage (Ohmae, 1982, p.6).

PURPOSES OF STRATEGIC MANAGEMENT

Strategic management is important to organizations because it helps organizations identify and develop a competitive advantage, a significant edge over the competition in dealing with competitive forces; provides a sense of direction so that organization members know where to expend their efforts; helps highlight the need for innovation and provides an organized approach for encouraging new ideas related to strategies. Strategies are large-scale action plans for interacting with the environment in order to achieve long-term goals. Most well run organizations attempt to develop and follow strategies.

- One reason strategic management is important is that it is involved in many of the decisions that managers make.
- Another reason is that studies of the effectiveness of strategic planning and management have found that, in general, companies with formal strategic management systems had higher financial returns than those companies with no such systems.

- Strategic management has moved beyond for-profit organizations to include all types of organizations, including not-for-profit.

Figure 30 Strategy and its relationships

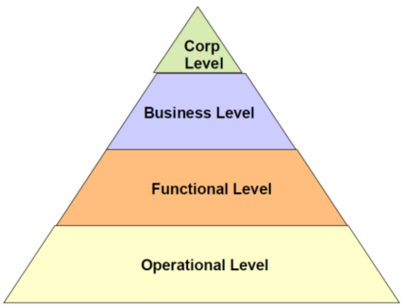
Source: Cadden and Lueder, 2012, p.230

Therefore, Strategy formulation is concerned with developing right strategies and policies by finding: Matching with corporation's Vision, Mission and Long-term objectives.

8.1 Levels of strategies

Strategy formulation is not just a task for top executives or small business owners. Middle and lower level managers too must be involved in the strategic planning process to the extent possible. It is important to note that all levels / all persons responsible for strategic planning at the various levels. Although most entrepreneurs do some form of planning for their ventures, it often tends to be informal and unsystematic. 1 The actual need for systematic planning will vary with the nature, size, and structure of the business. In other words, a small two-person operation may successfully use informal planning because little complexity is involved. But an emerging venture that is rapidly expanding with constantly increasing personnel size and market oper-ations will need to formalize its planning because a great deal of complexity exists.

Figure 31 Strategy pyramid



Source: own

Top-level management / business owner and the board of directors develop corporate-level strategy. The corporate-level strategy seeks to determine what businesses a corporation should be in or wants to be in. Two popular approaches for answering the question of what business (es) should we be in are the grand strategies framework and the corporate portfolio matrix. These strategies address:

- What business the organization will be coordinated to strengthen the organization's competitive position.
- How the strategies of those businesses will be coordinated to strengthen the organization's competitive position.
- How resources will be allocated among businesses.

Process generally involves a selection of a Grand Strategy and using portfolio strategy approaches to determine the type of business. GS is the general plan of major action by which a firm intends to achieve its long-term goals. It provides basic direction for the strategic action of a firm.

Strategy falls into four general categories:

(1) Growth / expansion – Internal (exploited through intensification or Diversification) and External – through Mergers, Take over, joint ventures (JV).
(2) Stability Strategy: growing in a methodical but slow manner, firm follow 'Safety – oriented, Status quo – type strategy without effecting any major changes in its present operations.
(3) Retrenchment Strategy: when the firm's performance is disappointed or when its survival is at stake, it is forced to effect across the board cuts in Personnel & Expenditure.
(4) Combination Strategy: Large diversified org. generally used as a mixture of stability, expansion or retrenchment strategy either simultaneously or sequentially.

Business-level strategy concentrates on the best means of competing within a particular business while also supporting the corporate-level strategy.

- The distinction between corporate-level and business-level strategy applies only to organizations with separate divisions that compete in different industries.
- A strategic business unit (SBU) is a distinct business, with its own set of competitors that can be managed reasonably independently of other businesses within the organization.

Business strategies focus on improving the competitive position of a company's or business unit's products or services within the specific industry or market segments that the company serves.

Business Strategy can be:

(1) Competitive strategy
(2) Cooperative strategy or both

1. Competitive Strategy (e.g. Porter´s generic strategies):

Battling against all competitors for competitive advantage raises two questions:

- Should the firm compete based on low cost or should the business differentiate it products or services?
- Should the firm compete head to head with major competitors for profitable segment of the market?

2. Cooperative Strategy:

When the business units or firm is working with one or more competitors to gain advantages against other competitors called cooperative strategy or strategic alliance. Strategic alliance is nothing but mutual benefits and broadly, it is JV.

Functional-level strategy focuses on action plans for managing a particular functional area within a business in a way that supports the business-level strategy.

- Functional areas include operations, marketing, finance, human resources management, accounting, research and development, and engineering.
- Functional strategies are usually developed by functional managers and are typically reviewed by business unit heads.

Coordinating strategies across these three levels is critical in maximizing strategic impact. According to David Aaker, in any case while selecting appropriate strategies at corporate business & functional level, the following strategy selection criteria should be kept in mind:

- Strategies are responsive to the External environment.
- Strategies are offering sustainable competitive advantages.
- They are consistent with other strategies in the organization.
- They provide adequate flexibility for the business & the organization.
- They conform to the organization’s mission and long-term objectives.
- They are organizationally feasible in terms of Cost effective, Creative and Constructive (C3).

8.2 STRATEGIC MANAGEMENT PROCESS

8.2.1 VALUE, VISION, STRATEGY AND TACTICS RELATIONSHIP

Clearly specifying your strategy should be seen as an end in itself. Requiring a company to specify its strategy forces that company to think about its core issues, such as the following:

- Who are your customers?
- How are you going to provide value to those customers?
- Who are your current and future competitors?
- What are your resources?
- How are you going to use these resources?

Figure 32 Strategic chain

Source: Burns, 2007

Let´s define those terms in the text below.

DEFINITION 14 VISION ATTRIBUTES

Vision is a shared mental image of a desired future state, which provides a sense of meaning and purpose of your business. A vision is:

- Inspirational
- Aspirational
- Motivating

Nevertheless, must be realistic, credible and attractive and so often includes core values of the company.

DEFINITION 15 MISION ATTRIBUTES

The (company) aims to use its (competitive advantage) to achieve/maintain (aspirations) in providing (product scope) which offers (benefits) to satisfy the (needs) of (customer scope). In doing this the company will at all times strive to uphold (values).

8.2.2 COMPONENTS OF THE PROCESS

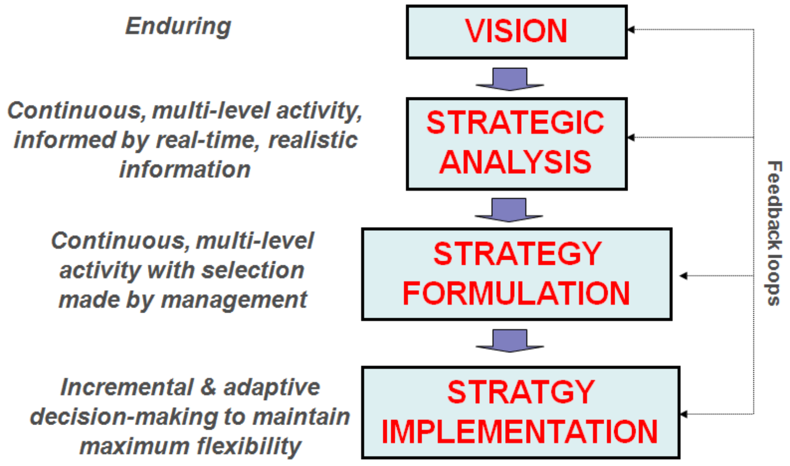
The strategic management process is made up of several components.
Strategy formulation is the part of the strategic management process that includes:

- Identifying the mission and strategic goals.
- Conducting competitive analysis
- Developing specific strategies

Strategy implementation is the part of the strategic management process that focuses on:

- Carrying strategic plans.
- Maintaining control over how those plans are carried out.

Figure 33 Strategic planning process



Source: Burns, 2007

The first step is identifying the organization's current mission, objectives, and strategies. Every organization needs a mission, which defines the purpose of the organization. What is the organization's reason for being in business? It is also important to identify the organization's current objectives and strategies, as well.

Step 2 is analyzing the external environment. It is important to analyze the environment because, to a large degree, it defines management's strategic options. A successful strategy is one that aligns well with the environment. This step is complete when managers have an accurate grasp of what is taking place in the external environment and are aware of important trends that might affect the organization.

The third step is identifying opportunities and threats. After analyzing the external environment, managers need to assess what opportunities to exploit and what threats to avoid.

Opportunities are positive external environmental factors. Threats are negative external environmental factors.

Step 4 is analyzing the organization's resources. In this internal analysis, managers are looking at the organization's specific assets, skills, and work activities. Managers look for core competencies, which are an organization's major value-creating skills, capabilities, and resources that determine its competitive advantage. This step forces managers to realize that every organization, no matter how large or powerful, is constrained in some way by its resources and skills.

Step 5 is identifying strengths and weaknesses. The analysis in step 4 should lead to a clear assessment of the organization's internal resources. Strengths are those activities the firm does well or the unique resources it controls. Weaknesses are those activities the firm does not do well or the resources it needs but does not possess. One area that is often overlooked in this step is an analysis of the organization's culture and its strengths and weaknesses. Remember that culture is the organization's personality. The strength of the culture is a result of how much employees understand and support the shared values. A strong culture should make it easy for managers to convey to employees the organization's distinctive competencies. However, the strong culture will make it more difficult to change, if needed. Strategic choices will also be influenced by the culture's tolerance of risk and innovation. The culture can also promote or hinder an organization's strategic actions.

- The merging of steps 3 and 5 results in a SWOT analysis, which is an analysis of an organization's strengths, weaknesses, opportunities, and threats. It brings together the internal and external analyses in order to identify a strategic niche the organization might exploit.
- In light of the SWOT analysis, managers need to re-evaluate the organization's current mission and objectives.

Step 6 is formulating strategies. Strategies need to be established for the corporate, business, and functional levels of the organization. In formulating strategies, managers hope to give the organization a competitive advantage.

The next step is implementing strategies. The strategies must now be put into action. Strategies are only as good as their implementation.

The eighth (and final) step in the strategic management process is evaluating results. Managers must evaluate the results to determine how effective their strategies have been and what corrections are necessary.

8.3 STRATEGY FORMULATION

Before an effective strategy to gain a competitive advantage can be formulated, the organization's competitive situation needs to be carefully analyzed.

BASIC INFORMATION FOR STRATEGY PREPARATION

The process of strategy formulation starts with, and critically depends on, the appraisal of the external and internal environment of the organization. So what are the inputs into strategizing? At the most basic level, you will need to gather information and conduct analysis about the internal characteristics of the organization and the external market conditions. This means an internal appraisal and an external appraisal. On the internal side, you will want to gain a sense of the organization's strengths and weaknesses; on the external side, you will want to develop some sense of the organization's opportunities and threats. Together, these four inputs into strategizing are often called SWOT analysis, which stands for strengths, weaknesses, opportunities, and threats (see the chapter 4). It does not matter if you start this appraisal process internally or externally, but you will quickly see that the two need to mesh eventually. At the very least, the strategy should leverage strengths to take advantage of opportunities and mitigate threats, while the downside consequences of weaknesses are minimized or managed.

An assessment of strengths and weaknesses occurs as a part of organizational analysis; that is, it is an audit of the company's internal workings, which are relatively easier to control than outside factors. Conversely, examining opportunities and threats is a part of environmental analysis—the company must look outside of the organization to determine opportunities and threats, over which it has lesser control.

Andrews's original conception of the strategy model that preceded the SWOT asked four basic questions about a company and its environment: (1) what can we do? (2) What do we want to do? (3) What might we do? In addition (4), what do others expect us to do?

8.3.1 FORMULATING CORPORATE-LEVEL STRATEGY

A grand strategy (master strategy) provides the basic strategic direction at the corporate level of the organization. Four grand strategies have been identified:

1. **Growth strategies** are grand strategies that involve organizational expansion along some major dimension.

   a. ***Concentration*** focuses on effecting the growth of a single product or service or a small number of closely related products or services.
      - Market development is gaining a larger share of a current market or expanding into new ones.
      - Product development is improving a basic product or service or expanding into closely related products or services.
      - Horizontal integration is adding one or more business that is similar, usually by purchasing such business.

   b. ***Vertical integration*** involves effecting growth through the production of inputs previously provided by suppliers or through the replacement of a customer role (Such as that of a distributor) by disposing of one's own outputs.
      - Backward integration occurs when a business grows by becoming its own supplier
      - Forward integration occurs when organizational growth encompasses a role previously fulfilled by a customer.

   c. **Diversification** entails effecting growth through the development of new areas that are clearly distinct from current businesses.
      - ***Conglomerate diversification*** takes place when an organization diversifies into areas that are unrelated to its current business.
      - ***Concentric diversification*** occurs when an organization diversifies into a related, but distinct, business.

These growth strategies can be implemented through a number of means:

- Internal growth occurs as the organization expands by building on its own internal resources.
- An acquisition is the purchase of all or part of one organization by another.
- A merger is the combining of two or more companies into one organization.
- A joint venture occurs when two or more organizations provide resources to support a given project or product offering.

2. A **stability strategy** is a second type of grand strategy that involves maintaining the status quo or growing in a methodical, but slow, manner.

- Small, privately owned businesses are most likely to adopt this strategy.
- Some of the reasons for adopting a stability strategy are that it
- Avoids the risks or hassles of aggressive growth.
- Provides the opportunity to recover after a period of accelerated growth.
- Lets the company hold on to current market share.
- May occur through default.

3. **Defensive strategies**, the third class of grand strategies, are sometimes called retrenchment strategies. They tend to focus on the desire or need to reduce organizational operations usually through cost reductions, such as cutting back on non-essential expenditures and instituting hiring freezes, and/or asset reductions such as selling land, equipment, or the business itself.

- Harvest entails minimizing investments while attempting to maximize short-run profits and cash flow, with the long-run intention of existing with the market.
- A turnaround is designed to reverse a negative trend and restore the organization to appropriate levels of profitability.
- A divestiture involves an organization's selling or divesting of a business or part of a business.
- A bankruptcy is a means whereby an organization that is unable to pay its debts can seek court protection from creditors and from certain contract obligations while it attempts to regain financial stability.
- Liquidation entails selling or dissolving an entire organization.

4. A **portfolio strategy** approach is a method of analyzing an organization's mix of businesses in terms of both individual and collective contributions to strategic goals. Two portfolio approaches are used most frequently. Each uses a two-dimensional matrix, and each may apply either to the existing or to potential strategic business units (SBUs).

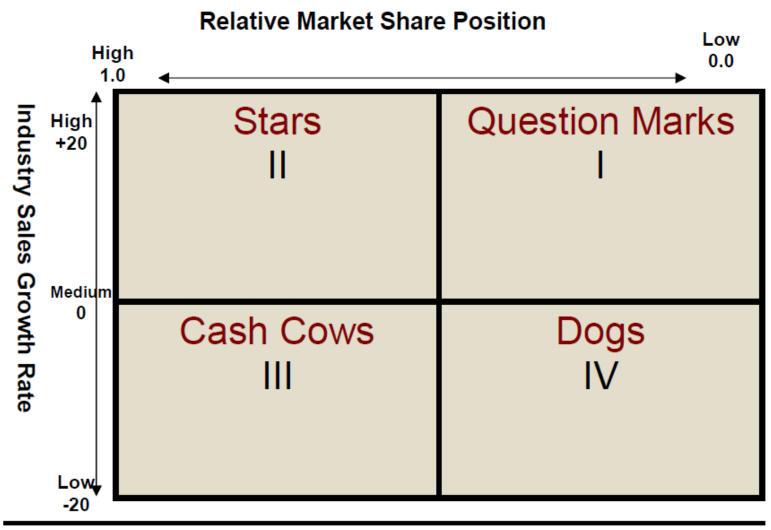
8.3.2 THE PORTFOLIO CONCEPT

The portfolio concept is analogous to an individual's selecting a portfolio of stocks to achieve balance in terms of risk, long-term growth, etc.

The Boston Consulting Groups (BCG) growth-share matrix compares various businesses in an organization's portfolio based on relative market share and market growth rate. The corporate portfolio matrix approach has been a popular approach to determining corporate-level strategy. A business portfolio is the collection of SBU that makes up a corporation. The optimal business portfolio is one that fits perfectly to the company's strengths and helps to exploit the most attractive industries or markets. The BCG growth share matrix is directly derived from the experience curve and based on the pattern of cash flow. The aim of the analysis is:

- Analyze its current business portfolio and decide which SBUs' should receive more or less investment,
- Develop growth strategies for adding new products and businesses to the portfolio, and
- Decide which businesses or products should no longer be retained.

Figure 34 BCG matrix



Source: own

The matrix defines four business groups. SBUs plotted on the BCG matrix can be categorized:

STARS (HIGH GROWTH, HIGH MARKET SHARE)

- Stars are in the upper left quadrant of the matrix.
- They grow rapidly
- They use large amounts of cash
- Are leaders in the business so they should also generate large amounts of cash?
- There is generally a balance on net cash flow.

Over time, all growth slows. Therefore, stars eventually become sources of income if they hold their market share. If they fail to hold market share, they become dogs.

CASH COWS (LOW GROWTH, HIGH MARKET SHARE)

- Sources of income are in the lower left quadrant of the matrix.
- Such products are profitable and cash generation is high,
- Because of the low growth, investments needed should be low.
- Keep profits high
- They form the foundation of an organization.

Sources of income pay the dividends, pay the interest on debt and cover the corporate overhead.

DOGS (LOW GROWTH, LOW MARKET SHARE)

- Dogs are in the lower right quadrant.
- These products need to be avoided. You should try to minimize the number of dogs in a company.
- Beware of expensive ‘turn around plans’.
- As soon as they stop delivering cash, they should be phased out or otherwise liquidated

They are essentially worthless and are generally cash traps.

QUESTION MARKS (HIGH GROWTH, LOW MARKET SHARE)

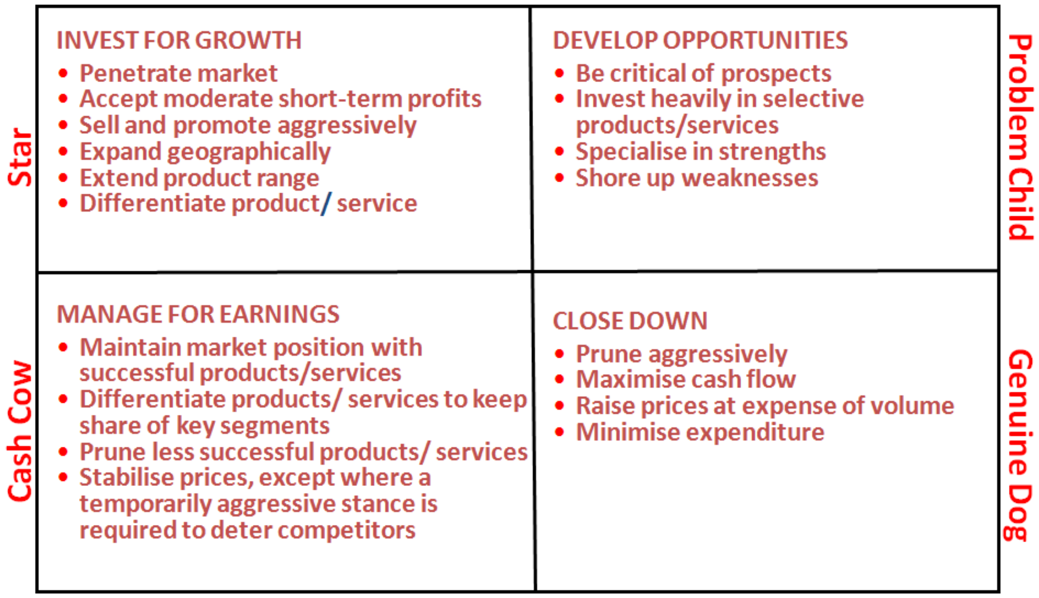
- They are in the upper right quadrant.
- These products have the worst cash characteristics of all, because high demands and low returns due to low market share
- If nothing is, done to change the market share, question marks will simply absorb great amounts of cash and later, as the growth stops, turn into dogs.
- Either invests heavily or sells off; or invests nothing and generates whatever cash it can. You should either increase market share or deliver cash.

Question marks are the real gambles. Their cash needs are great because of their growth. Yet, their cash generation is very low because their market share is low.

STRATEGIES SUGGESTED BY THE SBU’S POSITION ON THE MATRIX

1. Use funds from sources of income to duns stars and possibly question marks.
2. Divest dogs and less desirable question mark.
3. The product/market evolution matrix (sometimes called the life-cycle portfolio matrix) is a 15-cell matrix in which business is plotted according to the business unit’s business strengths or competitive position, and the industry’s stage in the evolutionary product/market life cycle.
    - While the BCG matrix measures market growth rate the product/market evolution matrix shows the industry’s stage in the evolutionary life cycle.
    - The maturity and saturation stage is particularly important because it may last for an extended period and is a stage that presents special challenges to preserve market share while facing the prospect of the decline stage.
    - In assessing these portfolio matrixes, remember that each model offers a somewhat different perspective. Portfolio matrices do not provide advice about specific business within the organization-such specifics are derived at the business level.

Figure 35 BCG matrix strategies



Source: Burns, 2007

The BCG matrix (and the portfolio concept) has lost much of its merit because:

- Not every organization has found that increased market share leads to lower costs.
- The portfolio concept assumes that an organization's businesses can be divided into reasonable number of independent units.
- Contrary to predictions, many so-called dogs have shown consistently higher levels of profitability than their growing competitors with dominant market shares have.
- Given the rate at which the economy has been growing and the fact that a market can have only one leader, well over half of all businesses by definition fall into the dog category.
- Strategic implications of the BCG matrix are: "milk" the sources of income; invest resources in the stars; liquidate or sell the dogs; and sell off or invest in the question marks.

8.3.3 FORMULATING BUSINESS-LEVEL STRATEGY

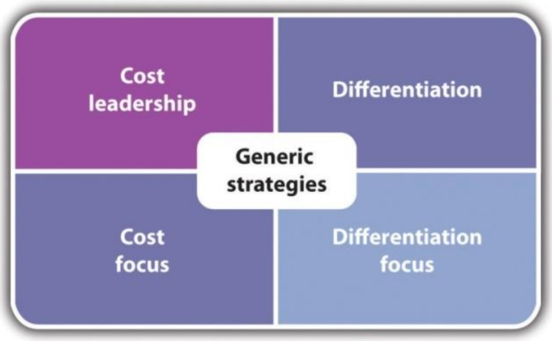
Business-level strategies provide advice about specific strategies for various businesses. Michael E. Porter has developed three business-level strategies that are generic, i.e., widely applicable to a variety of situations.

1. **A cost leadership** strategy involves emphasizing organizational efficiency so that the overall costs of providing products and services are lower than of competitors.
    - The business should have a cost advantage that is not easily to be imitated.
    - Managers should consider making those product or service innovations that are most important to customers.
2. **A differentiation** strategy involves attempting to develop products and services that are viewed as unique in the industry.
    - Differentiation may occur in brand image, technology, customer service, features, quality, and election.
    - Costs are not as important as product or service uniqueness.

3. **A focus strategy** entails specializing by establishing a position of overall cost leadership, differentiation, or both, but only within a particular portion, or segment, or an entire market.

These four generic strategies can be applied to small businesses. We will examine each strategy and then discuss what is required to implement them successfully.

Figure 36 Strategies based on Porter



Source: Cadden and Lueder, 2008

LOW-COST ADVANTAGE

A cost leadership strategy requires that a firm be in the position of being the lowest cost producer in its competitive environment. By being the lowest cost producer, a firm has several strategic options open to it. It can sell its product or service at a lower price than its competitors can. If price is a major driver of customer value, then the firm with the lowest price should sell more. The low-cost producer also has the option of selling its products or services at prices that are comparable to its competitors. However, this would mean that the firm would have a much higher margin than its competitors would.

Obviously, following a cost leadership strategy dictates that the business be good at curtailing costs. It might appear that cost leadership strategies are most suitable for large firms, which can exploit economies of scale. This is not necessarily true. Smaller firms can compete based on cost leadership. They can position themselves in low-cost areas, and they can exploit their lower overhead costs. Family businesses can use family members as employees, or they can use a web presence to market and sell their goods and services.

DIFFERENTIATION

A differentiation strategy involves providing products or services that meet customer value in some unique way. This uniqueness may be derived in several ways. A firm may try to build a particular brand image that differentiates itself from its competitors. Other firms will try to differentiate themselves because of the services that they provide. Differentiation also can be achieved by offering a unique design or features in the product or the service.

Adopting a differentiation strategy requires significantly different capabilities than those that were outlined for cost leadership. Firms that employ a differentiation strategy must have a complete understanding of what constitutes customer value. Further, they must be able to respond rapidly to changing customer needs. Often, a differentiation strategy involves offering these products and services at a premium price. A differentiation strategy may accept lower sales volumes because a firm is charging higher prices and obtaining higher profit margins. A danger in this approach is that customers may no longer place a premium value on the unique features or quality of the product or the service. This leaves the firm that offers a differentiation strategy open to competition from those that adopt a cost leadership strategy.

FOCUS—LOW COST OR DIFFERENTIATION

Porter identifies the third strategy—focus. He said that focus strategies could be segmented into a cost focus and a differentiation focus.

In a focus strategy, a firm concentrates on one or more segments of the overall market. Focus can also be described as a niche strategy. Focus strategy entails deciding to some extent that we do not want to have everyone as a customer. There are several ways that a firm can adopt a focus perspective:

- **Product line.** A firm limits its product line to specific items of only one or more product types. California Cart Builder produces only catering trucks and mobile kitchens.
- **Customer.** A firm concentrates on serving the needs of a particular type of customer. Weight Watchers concentrates on customers who wish to control their weight or lose weight.
- **Geographic area.** Many small firms, out of necessity, will limit themselves to a particular geographic region. Microbrewers generally serve a limited geographic region.
- **Particular distribution channel.** Firms may wish to limit themselves with respect to the means by which they sell their products and services.

The selection of a generic strategy by a firm should not be seen as something to be done on a whim. Once a strategy is selected, all aspects of the business must be tied to implementing that strategy.

Table 15 Summary of Generic Strategies

Generic Strategy	Required Activities	Issues
Cost leadership	Economies of scale Reduce overhead costs Lower cost of supplies Capital investment in technology to reduce cost Labour cost reduction through supervision, outsourcing, and work design Low-cost distribution Reduce cost of manufacturing or providing service Tight financial control Operate in lower cost environments Production-based incentives	Product or service becomes a commodity with no brand loyalty Changing technology cuts your cost advantage New entrants can produce at even lower costs (e.g., China) Focus on cost reduction means that you miss changing customer tastes
Differentiation	Unique or highly improved products or services Brand image Creative approach to marketing Reputation for quality and product or service innovation Ability to attract creative personnel Effective coordination among R&D, marketing, and operations	Qualitative difference between you and low-cost producer may not be enough to sustain sales Differentiating factor may no longer be attractive to customers Imitation narrows perceived differences

Generic Strategy	Required Activities	Issues
Focus—low cost	Reduce overhead costs Lower cost of supplies Labour cost reduction through supervision, outsourcing, and work design Low-cost distribution Tight financial control Operate in lower cost environments Production-based incentives	Cost advantage of focused firms is lost with respect to broader competitors Differentiation advantage with a focused market is lost Competitors find even smaller markets to focus on
Focus—differentiation	Unique or highly improved products or services Creative approach to marketing Reputation for quality and product/service innovation Ability to attract creative personnel Effective coordination among R&D, marketing, and operations	Cost advantage of focused firms is lost with respect to broader competitors Differentiation advantage with a focused market is lost Competitors find even smaller markets to focus on

Source: Porter, 1980, p. 21.

8.3.4 FORMULATING FUNCTIONAL-LEVEL STRATEGY

Strategies at the functional level are important in supporting a business-level strategy. Functional areas develop the distinctive competencies that lead to potential competitive advantages.

8.4 STRATEGY IMPLEMENTATION

Strategies at the functional level are important in supporting a business-level strategy. Functional areas develop the distinctive competencies that lead to potential competitive advantages. Strategy implementation includes the various management activities that are necessary to put the strategy in motion, institute strategic controls that monitor progress, and ultimately achieve organizational goals. Managers need to synchronize major factors within an organization needed to put a chosen strategy into action.

- Technology is the knowledge, tool, equipment, and work technique used by an organization in delivering its product or service.
- Human resources are the individuals who are members of the organization.
- Reward systems include bonuses, awards, or promotions provided by others, as well as rewards related to internal experiences, such as feeling of achievement and challenge.
- Decision processes include the means of resolving questions and problems that occur in organizations.
- Organization structure is the formal pattern of interactions and coordination designed by management to link the tasks of individuals and groups in achieving organizational goals.

Managers need to be able to monitor progress through strategic control. Strategic control involves monitoring critical environmental factors that could affect the viability of strategic plans, assessing the effects of organizational strategic actions, and ensuring that strategic plans are implemented as intended. Strategic control systems include information systems that provide feedback on the implementation and effectiveness of strategic plans.

CASE STUDY 4 STRATEGY THINKING

Solomon and Friedman recounted a prime example of true strategic thinking (Cadden and Lueder, 2012, s.232). Wilson Harrell took a small, closely held, cleaning spray company known as Formula 409 to the point of having national distribution. In 1967, the position that Formula 409 held was threatened by the possible entry of Procter & Gamble into the same spray cleaning market. Procter & Gamble was a huge consumer products producer, noted for its marketing practical understanding. Procter & Gamble began a program of extensive market research to promote its comparable product they called Cinch. Clearly, **the larger firm had a much greater advantage**.

Harrell knew that Procter & Gamble would perform test market research. He decided ***to do the unexpected***. Rather than directly confront this much larger competitor, he began a program where *he reduced advertising expenditures* in Denver and stopped promoting his Formula 409.

The outcome was that Procter & Gamble had spectacular results, and the company was extremely excited with the potential for Cinch. Procter & Gamble immediately begin a national sales campaign. However, before the company could begin, Harrell introduced a **promotion of his own**.

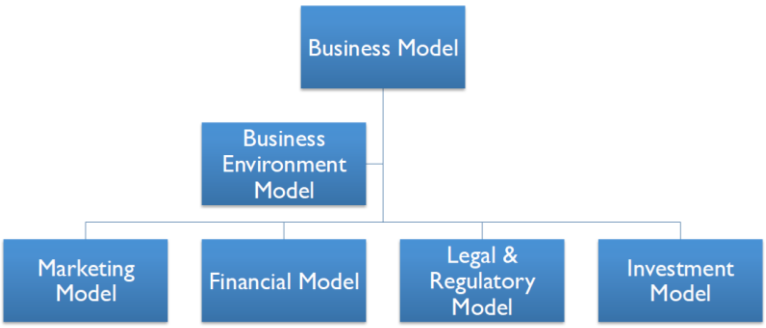
He took the Formula 409 sixteen-ounce bottle and attached it to a half-gallon size bottle. He then sold both at a significant discount. This quantity of spray cleaner would last the average consumer six to nine months. The market for Procter & Gamble's Cinch was significantly reduced. Procter & Gamble was confused and confounded by its poor showing after the phenomenal showing in Denver. Confused and uncertain, the company chose to withdraw Cinch from the market. Wilson Harrell's display of brilliant strategic thinking had bested them.

He leveraged his small company's creative thinking and flexibility against the tremendous resources of an international giant. Through superior strategic thinking, Harrell was able to best Procter & Gamble.

8.5 BUSINESS MODELS

A business model describes the rationale of how an organization creates, delivers, and captures value to the customer. Osterwalder and Pigneur (2009; p.15-35). The creative version of the model consists from nine bricks putted into one canvas.

Figure 37 Business model and its relatives



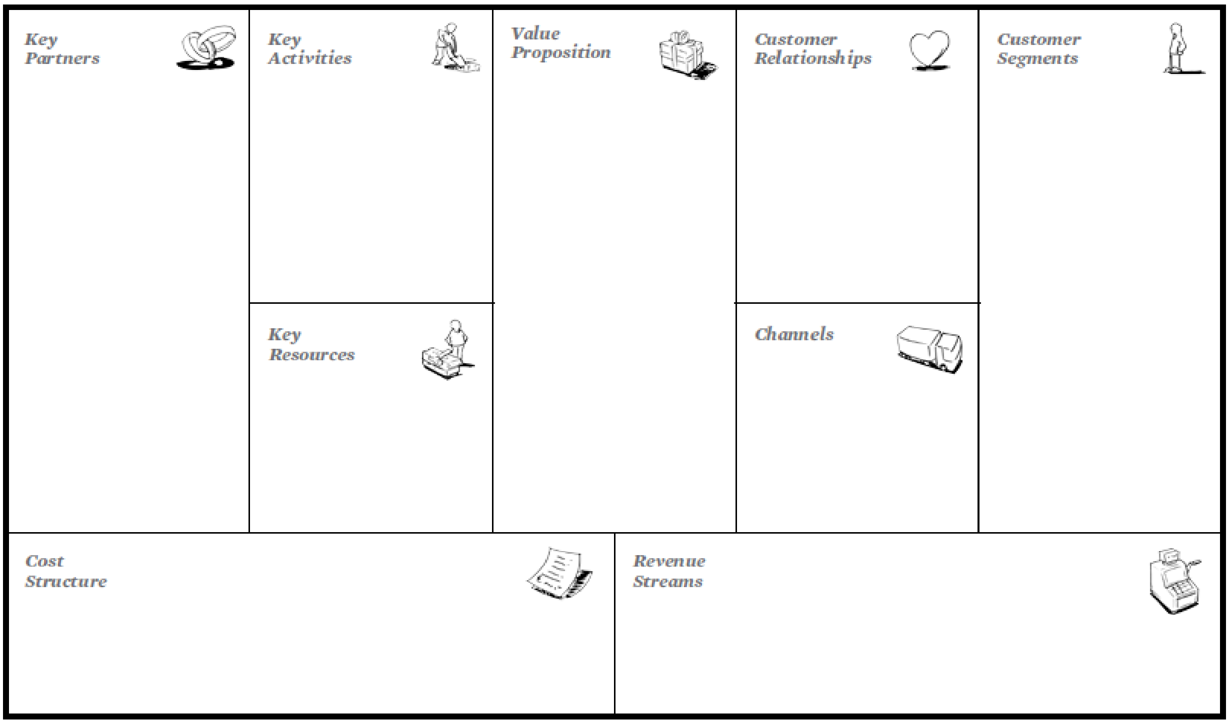
Source: own

A repeatable and scalable business model is the foundation for an effective business plan. Once you find one, then think about spending time and effort on the business plan.

8.5.1 ELEMENTS OF A BUSINESS MODEL

This tool resembles a painter's canvas - preformatted with the nine blocks, which allows you to paint pictures of new or existing business models according your previous analysis.

Figure 38 Canvas model



Source: Osterwalder and Pigneur, 2009, p.44

The model is divided into two parts; logical part and emotional part (see enclosure no. 4 and 5)

1. **EMOTIONAL PART – value for your business**

CUSTOMER SEGMENTS (CS)

The Customer Segments Building Block defines the different groups of people or organizations an enterprise aims to reach and serve Customers comprise the heart of any business model. Without (profitable) customers, no company can survive for long. In order to better satisfy customers, a company may group them into distinct segments with common needs, common behaviours, or other attributes. A business model may define one or several large or small Customer Segments. An organization must make a conscious decision about which segments to serve and which segments to ignore. Once this decision is made, a business model can be carefully designed around a strong understanding of specific customer needs (segments – see chapter 7.2).

- Who is the customer?
- Is our offering relevant to this customer?

Customer groups represent separate segments if:

- Their needs require and justify a distinct offer
- They are reached through different Distribution Channels

- They require different types of relationships
- They have substantially different profitability
- They are willing to pay for different aspects of the offer

Finally, choose the market:

- **Mass Market** - Business models focused on mass markets don't distinguish between different Customer Segments
- **Niche Market** Business models targeting niche markets cater to specific, specialized Customer Segments. The Value Propositions, Distribution Channels, and Customer Relationships are all tailored to the specific requirements of a niche market. Such business models are often found in supplier-buyer relationships.
- **Segmented**- distinguish between market segments with slightly different needs and problems (one service for different type of customers – books for scholars, kids, academicians)
- **Diversified**- An organization with a diversified customer business model serves two unrelated Customer Segments with very different needs and problems. For example, in 2006 Amazon.com decided to diversify its retail business by selling "cloud computing" services: online storage space and on-demand server usage. Thus it started catering to a very different Customer Segment — Web companies — with a very different Value Proposition. The strategic rationale behind this diversification can be found in Amazon.com's powerful IT infrastructure, which can be shared by its retail sales operations and the new cloud computing service unit.
- **Multi-Sided Market-** Some organizations serve two or more interdependent Customer Segments. A credit card company, for example, needs a large base of credit card holders and a large base of merchants who accept those credit cards. Similarly, an enterprise offering free newspapers needs a large reader base to attract advertisers. On the other hand, it also needs advertisers to finance production and distribution.

VALUE PROPOSITION (VP)

- What are the unique benefits?

The Value Propositions Building Block describes the bundle of products and services that create value for a specific Customer Segment. It solves a customer problem or satisfies a customer need. Each Value Proposition consists of a selected bundle of products and/or services that caters to the requirements of a specific Customer Segment. In this sense, the Value Proposition is an aggregation, or bundle, of benefits that a company offers customers. Some Value Propositions may be innovative and represent a new or disruptive offer. Others may be similar to existing market offers, but with added features and attributes.

Values may be quantitative (e.g. price, speed of service) or qualitative (e.g. design, customer experience). The Value attributes are:

- Newness

Some Value Propositions satisfy an entirely new set of needs that customers previously did not perceive because there was no similar offering. This is often, but not always, technology related.

- Performance

Improving product or service performance has traditionally been a common way to create value. However, improved performance has its limits.

- Customization

Tailoring products and services to the specific needs of individual customers or Customer Segments creates value. In recent years, the concepts of mass customization and customer co-creation have gained importance. This approach allows for customized products and services, while still taking advantage of economies of scale.

- “Getting the job done”

Value can be created simply by helping a customer get certain jobs done. Rolls-Royce understands this very well: its airline customers rely entirely on Rolls- Royce to manufacture and service their jet engines. This arrangement allows customers to focus on running their airlines. In return, the airlines pay Rolls- Royce a fee for every hour an engine runs.

- Design

Design is an important but difficult element to measure. A product may stand out because of superior design.

- Brand/status

Customers may find value in the simple act of using and displaying a specific brand. Wearing a Rolex watch signifies wealth, for example.

- Price

Offering similar value at a lower price is a common way to satisfy the needs of price-sensitive Customer Segments.

- Cost reduction

Helping customers reduce costs is an important way to create value. Salesforce.com, for example, sells a hosted Customer Relationship management (CRM) application. This relieves buyers from the expense and trouble of having to buy, install, and manage CRM software themselves.

- Risk reduction

Customers value reducing the risks, when they purchasing products or services. For a used car buyer, a one-year service guarantee reduces the risk of post-purchase breakdowns and repairs.

- Accessibility

Making products and services available to customers who previously lacked access to them is another way to create value. This can result from business model innovation, new technologies, or a combination of both.

- Convenience/usability

Making things more convenient or easier to use can create substantial value.

CHANNELS (CH)

The Channels Building Block describes how a company communicates with and reaches its Customer Segments to deliver a Value Proposition. Communication, distribution, and sales Channels comprise a company's interface with customers. Channels are customer touch points that play an important role in the customer experience. Channels serve several functions, including:

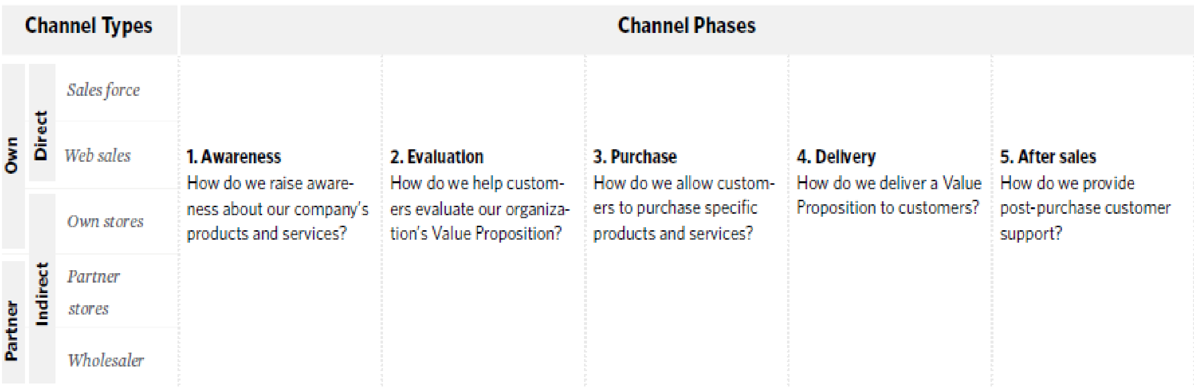
- *Raising awareness among customers about a company's products and services*
- *Helping customers evaluate a company's Value Proposition*
- *Allowing customers to purchase specific products and services*
- *Delivering a Value Proposition to customers*
- *Providing post-purchase customer support*

Finding the right mix of Channels to satisfy how customers want to be reached is crucial in bringing a Value Proposition to market.

An organization can choose between reaching its customers through its own Channels, through partner Channels, or through a mix of both. Owned Channels can be direct, such as an in-house sales force or a Web site, or they can be indirect, such as retail stores owned or operated by the organization.

Partner Channels are indirect and span whole range of options, such as wholesale distribution, retail, or partner-owned Web sites. Partner Channels lead to lower margins, but they allow an organization to expand its reach and benefit from partner strengths. Owned Channels and particularly direct ones have higher margins, but can be costly to put in place and to operate. The trick is to find the right balance between the different types of Channels to integrate them in a way to create a great customer experience, and to maximize revenues.

Figure 39 Channels types and phases



Source: Osterwalder and Pigneur, 2009, p.27

CUSTOMER RELATIONSHIPS (CR)

The Customer Relationships Building Block describes the types of relationships a company establishes with specific Customer Segments. Relationships can range from personal to automate. Customer relationships may be driven by the following motivations:

- Customer acquisition
- Customer retention
- Boosting sales (up selling)

We can distinguish between several categories of Customer Relationships, which may co-exist in a company's relationship with a particular Customer Segment:

- Personal assistance

This relationship is based on human interaction. The customer can communicate with a real customer representative to get help during the sales process or after the purchase is complete. This may be happen onsite at the point of sale, through call centres, by e-mail, or through other means.

- Dedicated personal assistance

This relationship involves dedicating a customer representative specifically to an individual client. It represents the deepest and most intimate type of relationship and normally develops over a long period. Similar relationships can be found in other businesses in the form of key account managers who maintain personal relationships with important customers.

- Self-service

In this type of relationship, a company maintains no direct relationship with customers. It provides all the necessary means for customers to help themselves.

- Automated services

This type of relationship mixes a more sophisticated form of customer self-service with automated processes. Automated services can recognize individual customers and their characteristics, and offer information related to orders or transactions.

- Communities

Increasingly, companies are utilizing user communities to become more involved with customers/prospects and to facilitate connections between community members. Many companies maintain online communities that allow users to exchange knowledge and solve each other's problems. Communities can also help companies better understand their customers.

- Co-creation

More companies are going beyond the traditional customer-vendor relationship to co-create value with customers. Some companies engage customers to assist with the design of new and innovative products.

REVENUE STREAMS (RS)

The Revenue Streams Building Block represents the cash a company generates from each Customer Segment (costs must be subtracted from revenues to create earnings). Each Revenue Stream may have different pricing mechanisms, such as fixed list prices, bargaining, auctioning, market dependent, volume dependent, or yield management. A business model can involve two different types of Revenue Streams:

- Transaction revenues resulting from one-time customer payments
- Recurring revenues resulting from ongoing payments to either deliver a Value Proposition to customers or provide post-purchase customer support

There are several ways to generate Revenue Streams:

- Asset sale

The most widely understood Revenue Stream derives from selling ownership rights to a physical product. Amazon.com sells books, music, consumer electronics, and more online. Fiat sells automobiles, which buyers are free to drive, resell, or even destroy.

- Usage fee

This Revenue Stream is generated by the use of a particular service. The more a service is used, the more the customer pays. A telecom operator may charge customers for the number of minutes spent on the phone. Hotel charges customers for the number of nights rooms are used.

- Subscription fees

This Revenue Stream is generated by selling continuous access to a service. A gym sells its members monthly or yearly subscriptions in exchange for access to its exercise facilities.

- Lending/Renting/Leasing

This Revenue Stream is created by temporarily granting someone the exclusive right to use a particular asset for a fixed period in return for a fee. For the lender this provides the advantage of recurring revenues. Renters or lessees, on the other hand, enjoy the benefits of incurring expenses for only a limited time rather than bearing the full costs.

- Licensing

This Revenue Stream is generated by giving customers permission to use protected intellectual property in exchange for licensing fees. Licensing allows rights holders to generate revenues from their property without having to manufacture a product or commercialize a service. Licensing is common in the media industry, where content owners retain copyright while selling usage licenses to third parties. Similarly, in technology sectors patent holders grant other companies the right to use a patented technology in return for a license fee.

- Brokerage fees

This Revenue Stream derives from intermediation services performed on behalf of two or more parties. Credit card providers, for example, earn revenues by taking a percentage of the value of each sales transaction executed between credit card merchants and customers. Brokers and real estate agents earn a commission each time they successfully match a buyer and seller.

- Advertising

This Revenue Stream results from fees for advertising a particular product, service, or brand. Traditionally, the media industry and event organizers relied heavily on revenues from advertising. In recent years, other sectors, including software and services, have started relying more heavily on advertising revenues.

Figure 40 Pricing mechanisms

Fixed "Menu" Pricing Predefined prices are based on static variables		**Dynamic Pricing** Prices change based on market conditions	
List price	Fixed prices for individual products, services, or other Value Propositions	*Negotiation (bargaining)*	Price negotiated between two or more partners depending on negotiation power and/or negotiation skills
Product feature dependent	Price depends on the number or quality of Value Proposition features	*Yield management*	Price depends on inventory and time of purchase (normally used for perishable resources such as hotel rooms or airline seats)
Customer segment dependent	Price depends on the type and characteristic of a Customer Segment	*Real-time-market*	Price is established dynamically based on supply and demand
Volume dependent	Price as a function of the quantity purchased	*Auctions*	Price determined by outcome of competitive bidding

Source: Osterwalder and Pigneur, 2009, p.33

Each Revenue Stream might have different pricing mechanisms. The type of pricing mechanism chosen can make a big difference in terms of revenues generated.

2. LOGICAL PART – efficiency of your business proposition

KEY RESOURCES (KR)

Every business model requires Key Resources. The Key Resources Building Block describes the most important assets required to make a business model work. These resources allow an enterprise to create and offer a Value Proposition, reach markets, maintain relationships with Customer Segments, and earn revenues. Different Key Resources are needed depending on the type of business model. Key resources can be physical, financial, intellectual, or human. Key resources can be owned or leased by the company or acquired from key partners. Key Resources can be categorized as follows:

- Physical

This category includes physical assets such as manufacturing facilities, buildings, vehicles, machines, systems, point-of-sales systems, and distribution networks. Retailers rely heavily on physical resources, which are often capital-intensive. The former has an enormous global network of stores and related logistics infrastructure. The latter has an extensive IT, warehouse, and logistics infrastructure.

- Intellectual

Intellectual resources such as brands, proprietary knowledge, patents and copyrights, partnerships, and customer databases are increasingly important components of a strong business model. Intellectual resources are difficult to develop but when successfully created may offer substantial value.

- Human

Every enterprise requires human resources, but people are particularly prominent in certain business models. For example, human resources are crucial in knowledge-intensive and creative industries.

- Financial

Some business models call for financial resources and/or financial guarantees, such as cash, lines of credit, or a stock option pool for hiring key employees.

KEY ACTIVITIES (KA)

The Key Activities Building Block describes the most important things a company must do to make its business model work. Like Key Resources, they are required to create and offer a Value Proposition, reach markets, maintain Customer Relationships, and earn revenues. In addition, like Key Resources, Key Activities differ depending on business model type. Key Activities can be categorized as follows:

- Production

These activities relate to designing, making, and delivering a product in substantial quantities and/or of superior quality. Production activity dominates the business models of manufacturing firms.

- Problem solving

Key Activities of this type relate to coming up with new solutions to individual customer problems. The operations of consultancies, hospitals, and other service organizations are typically dominated by problem solving activities. Their business models call for activities such as knowledge management and continuous training.

- Platform/network

Business models designed with a platform as a Key Resource are dominated by platform or network related Key Activities. Networks, matchmaking platforms, software, and even brands can function as a platform. Key Activities in this category relate to platform management, service provisioning, and platform promotion.

KEY PARTNERSHIP (KP)

The Key Partnerships Building Block describes the network of suppliers and partners that make the business model work. Companies forge partnerships for many reasons, and partnerships are becoming a cornerstone of many business models. Companies create alliances to optimize their business models, reduce risk, or acquire resources. We can distinguish between four different types of partnerships:

- Strategic alliances between non-competitors
- Competition: strategic alliances between competitors
- Joint ventures to develop new businesses
- Buyer-supplier relationships to assure reliable supplies

It can be useful to distinguish between three motivations for creating partnerships:

- Optimization and economy of scale

The most basic form of partnership or buyer-supplier relationship is designed to optimize the allocation of resources and activities. It is illogical for a company town all resources or perform every activity by itself. Optimization and economy of scale partnerships are usually formed to reduce costs, and often involve outsourcing or sharing infrastructure.

- Reduction of risk and uncertainty

Partnerships can help reduce risk in a competitive environment characterized by uncertainty. It is not unusual to form a strategic alliance in one area for competitors, while they are competing in another. Blu-ray, for example, is an optical disc format jointly developed by a group of the world's leading consumer electronics, personal computer, and media manufacturers.

- Acquisition of particular resources and activities

Few companies own all the resources or perform all the activities described by their business models. Rather, they extend their own capabilities by relying on other firms to furnish particular resources or perform certain activities. Such partnerships can be motivated by needs to acquire knowledge, licenses, or access to customers.

COST STRUCTURE (CS)

The Cost Structure describes all costs incurred to operate a business model. This building block describes the most important costs incurred while operating under a particular business model. Creating and delivering value, maintaining Customer Relationships, and generating revenue all incur costs. Such costs can be calculated relatively easily after defining Key Resources, Key Activities, and Key Partnerships. Some business models, though, are more cost-driven than others are. Naturally enough, costs should be minimized in every business model. However, low Cost Structures are more important to some business models than to others. Therefore, it can be useful to distinguish between two broad classes of business model Cost Structures like cost-driven and value-driven (many business models fall in between these two extremes):

- Cost-driven

Cost-driven business models focus on minimizing costs wherever possible. This approach aims at creating and maintaining the leanest possible Cost Structure, using low price Value Propositions, maximum automation, and extensive outsourcing.

- Value-driven

Some companies are less concerned with the cost implications of a particular business model design, and instead focus on value creation. Premium Value Propositions and a high degree of personalized service usually characterize value-driven business models.

Cost Structures can have the following characteristics:

1. ***Fixed costs.*** Costs that remain the same despite the volume of goods or services produced. Examples include salaries, rents, and physical manufacturing facilities. A high proportion of fixed costs characterize some businesses, such as manufacturing companies.

2. ***Variable costs***. Costs that vary proportionally with the volume of goods or services produced. A high proportion of variable costs characterize some businesses, such as music festivals.

ECONOMIES OF SCALE

Cost advantages that a business enjoys as its output expands. Larger companies, for instance, benefit from lower bulk purchase rates. This and other factors cause average cost per unit to fall as output rises.

ECONOMIES OF SCOPE

Cost advantages that a business enjoys due to a larger scope of operations. In a large enterprise, for example, the same marketing activities or Distribution Channels may support multiple products.

8.5.2 BUSINESS MODEL PATTERNS

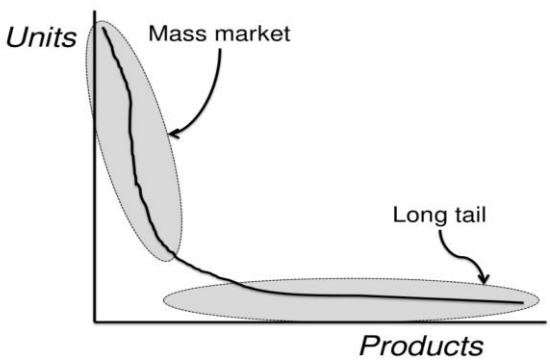
Finally, we could distinguish four main patterns for final business model canvas (see enclosure no. 4)

LONG TAIL

Traditional business models sell many units of small number of hit products, but long tail sells many smaller units of greater number of products or you sell a large number of niche products, each of which sells infrequently

• E.g. Netflix, eBay, Lego

Figure 41 Long tail



Source: own

MULTI-SIDED PLATFORMS

You choose this type when:

- you bring together two or more distinct but inter-dependent groups of customers
- value to one group of customers only if the other groups of customers are present
- Creates value by facilitating interactions between the different groups
- Grows in value to the extent that it attracts more users (network effect)
- e.g. Visa, Google, eBay, Microsoft Windows

- you can answer those questions:
    - Can we attract sufficient numbers of customers for each side of the platform?
    - Which side is more price sensitive
    - Can that side be enticed by a subsidized offer
    - Will the other side of the platform generate sufficient revenues to cover the subsidies?

Figure 42 Platform examples

	Customers	Who Pays
Network Television	viewers, advertisers	advertisers
Payment Cards	cardholders, merchants	in large part, merchants
Yellow Pages	phone shoppers, merchants	merchants
Computer Operating Systems	hardware makers, software applications developers, computer users	computer users
Video Game Consoles	players, game makers	both sides
Web Auctions	buyers, sellers	sellers

Source: Osterwalder and Pigneur, 2009

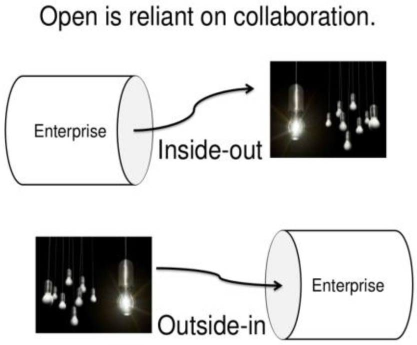
FREE

- At least one Customer Segment continuously benefits from a free-of charge (or low cost) offer
- Non-paying customers are financed by another part of the business model or by another Customer Segment
- e.g. Flicker, Skype, Google, Gillette
- three free models to consider:
    1. free offer, which is based on multi-sided platforms
    2. freemium, where free basic services exists and premium services are optional
    3. bait and hook, where free/inexpensive initial offer lures customers into repeating purchases

OPEN BUSINESS MODELS

Create and capture value by systematically collaborating with outside partners to create innovations.

Figure 43 Open Business Model



Source: Osterwalder and Pigneur, 2009

- "Outside in" exploits external ideas from within the firm
- "Inside out" provides external parties with ideas or assets lying idle within the firm e.g. P&G, GlaxoSmithKline, Open Source

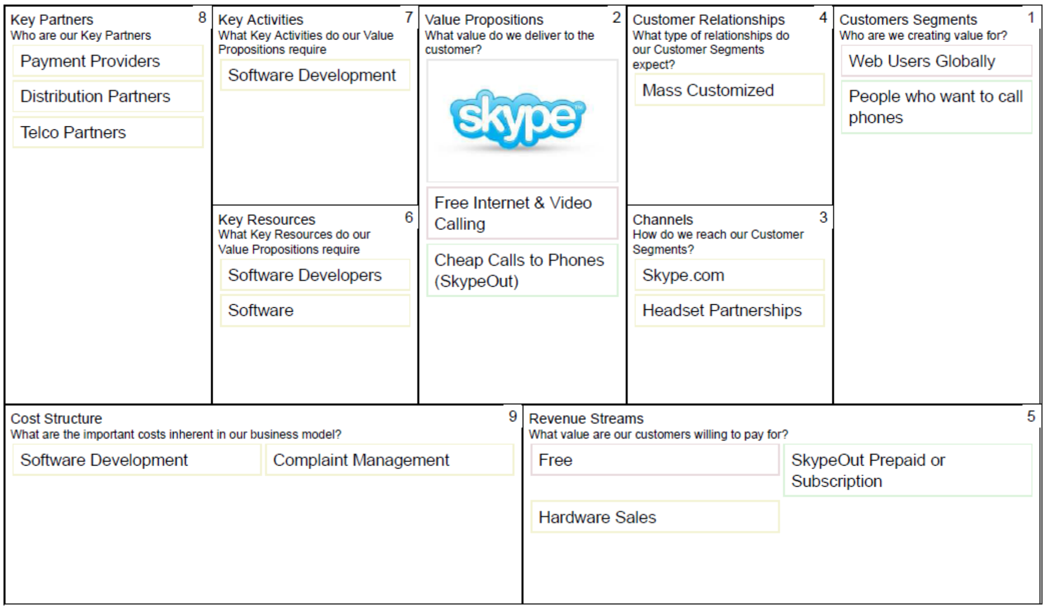
Figure 44 Principles of innovations

Closed	Open
The smart people in our field work for us.	We need to work with smart people both inside and outside our company.
To profit from R&D, we must discover it, & ship it ourselves.	External R&D can create significant value: internal R&D is needed to claim some portion of that.
If we conduct most of the best research in the industry we will win.	We don't have to originate the research to benefit from it.
If we create most of the best ideas in the industry, we will win.	If we make the best use of internal and external ideas, we will win.
We should control our innovation process, so that competitors don't profit from our ideas.	We should profit from others' use of our innovations, and we should buy others' (IP) whenever it advances our own research.

Source: Osterwalder and Pigneur, 2009, p.111

SOLVED EXERCISE 5 EVALUATE CANVAS OF SKYPE

Which business model does Skype use? Compare the information from Canvas with previous information and real knowledge about Skype on skype.com.



Answer:
The **model used is "Free", multi sided platform now, previously freemium**

8.6 STRATEGIES FOR COOPERATION

Traditionally, small businesses have had to face challenges for their survival with their limited resources and with little support from governments. This unfavourable scenario gets worse in uncertain economic periods like the current crisis because they do not have access to capital markets and their sources of external financing for innovations (see chapter 12). One popular alternative for small firms is the adoption of cooperative approaches with other organizations.

The framework also includes the factors influencing business collaboration (Casals, 2011, p.120):

- Internal factors: This category includes variables related with the profile of the SME. Variables like the size (number of employees), age, sector, languages, business activity, location, management style or profile of the employees are just some internal factors that should be considered when analysing SME collaboration because they have an important influence when interacting with other partners.
- External factors: This group includes factors external to the SME. They are characteristics of the market and the environment that could affect the collaboration process in some moment. Size and trend of the market, number of competitors, type of industry, governmental regulations and the presence of private/public funding organizations.

8.6.1 TYPES OF COOPERATION

According to Šúbertová and Gajdová (2010, p.322) they are existing four main types of cooperation:

- Franchising
- Co-operative
- Cluster
- Union, association or alliances

FRANCHISING

According to the International Franchise Association, "Franchising is a method of distributing products or services. At least two levels of people are involved in a franchise system: 1) the franchisor, who lends his trademark or trade name and a business system; and 2) the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor's name and system." [25]

There are two primary forms of franchising:

- **Product/trade name franchising**

Franchisor owns the right to the name or trademark and sells that right to a franchisee.

- **Business format franchising**

Franchisor and franchisee have an ongoing relationship, and the franchisor often provides a full range of services, including site selection, training, product supply, marketing plans and even assistance in obtaining financing.

In fact, it is necessary to provide the partner´s organisation with some kind of operational manual, handbook, or the „franchise bible“ that should comprise following items:

- File of marketing information about the market, its trends, entrepreneurial environment
- Elements of the marketing mix
- Operational handbook
- Legal terms and supervision operations.

COOPERATIVE

Cooperatives focuses on the individual who wishes to start or expand a business including small and medium enterprise (SME) to better their socio-economic life and individuals who can be considered entrepreneurial lead this. Clearly, cooperative societies from their antecedents have not contributed only to the development of small-scale business but they are in themselves small-scale businesses. In comparison with cluster, within the cooperation, the co-operative has individual status in the fact that although it is also the regional activity there is no need attendance of research institutions, universities or local authorities.

CLUSTER

SMEs-clustering has been of considerable interest over the last decade and is associated with regional development. Chung and Tibben (2006, p. 390) constructed a working

[25] Franchising.com. 2014. *The Basics of Franchising*. [online] Available at: http://www.franchising.com/guides/what_is_franchising_the_basics.html#sthash.x4DxSKQa.dpuf [Accessed: 25 Jan 2014].

definition of SME Cluster as follows: “SME clusters are interconnected (inter-networked) firms based on common business goals, and are composed of SMEs in related industries and connected in particular fields that compete but also co-operate, and are preferably located in some degree of proximity.”

Companies can find ”the common language“ in different areas. Among the most frequent one could mention marketing and common business policy, research and innovation, human resources or lobbying (Šúbertová, Gajdová, 2010, p. 320)

ALLIANCES (ASSOCIATIONS)

Small to Medium sized Enterprises (SMEs) are increasingly entering into **strategic alliances** to achieve market growth and gaining access to new markets. A strategic alliance is a relationship between firms to create more value than they can on their own. The firms unite to pursue agreed upon goals, while remaining independent.

Figure 45 Summary of cooperative strategies

Nature of cooperation	Initial investment (costs of founding the cooperation)	Permanent costs	Independent negotiator	Possibilities and advantages of this cooperation form for small enterprise
Cluster	Single fee (e.g. registration by notary)	Cost of the administration (general expenses)	Negotiator required	Limited because of the size of companies
Franchising	Purchase of know – how	Trademark rental	Not required	Limited – depends on the provider
Co-operative	Membership fee	Membership fee, administration cists (general expenses)	There is no-one (elected bodies)	Depend on the statute (mostly from the membership fee)
Union, association	Membership fee	Membership fee	There is no-one (elected bodies)	Depend on the statute and the number of members

Source:Šúbertová, Gajdová, 2010, p.322

8.7 EXIT STRATEGIES

This very personal decision and the hardest decision to make - is when and how to exit the business. The strategy should be developed early in the business, and it should be reviewed and changed periodically because conditions change. Unfortunately, many small business owners have no exit strategy. This will make an already very emotional decision and process even more difficult. The term failure can have several meanings. Small-business failure is often measured by the cessation of a firm’s operation, but several things can bring this about:

- An owner can die or simply choose to discontinue operations.
- The owner may recognize that the business is not generating sufficient return to warrant the effort that is being put into it. This is sometimes referred to as the failure of opportunity cost.
- A firm that is losing money may be terminated to avoid losses to its creditors.
- There can be losses to creditors that bring about cessations of the firm’s operations.

- The firm can experience bankruptcy. Bankruptcy is probably what most people think of when they hear the term business failure. However, the evidence indicates that bankruptcies constitute only a minor reason for failure.

Table 16 Reasons for Small Business Failure

Managerial Inadequacy	Financial Inadequacy	External Factors
Failure in planning (initial start-up plan and subsequent plans) Inexperience with managing business operation Ineffective staffing Poor communication skills Failure to seek or respond to criticism Failure to learn from past failures Ignoring customers' needs Ignoring competition Failure to diversify customer base Failure to innovate Ineffective marketing strategies	Cash-flow problems Insufficient initial capitalization Inadequate financial records Not using accountants' insights Inadequate capital acquisition strategies Failure to deal with financial issues brought about by growth	Downturn in economy Rising unemployment Rising interest rates Product or service no longer desired by customers Unmatchable foreign competition Fraud Disaster

Source: Cadden and Lueder, 2012, p. 44

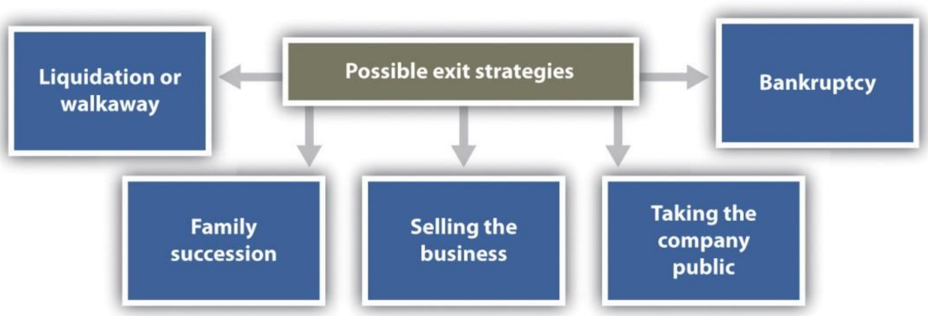
A small business owner can consider many exit strategies:

- Liquidation or walk away,
- family succession,
- selling the business,
- bankruptcy and taking the company public.

Selecting an exit strategy is important because the way in which an owner exits can affect the following[26]:

- The value that the owner and/or shareholders (if any) can realize from a business.
- Whether a cash deal, deferred payments, or staged payments are received.
- The future success of the business and its products or services (unless one is closing the business).
- Whether the owner wants to retain any involvement in or control of the business.
- Tax liabilities.

Figure 46 Possible Exit Strategies



Source: Cadden and Lueder, 2012

[26] *Exit Strategies*. [online] [Accessed: 19 Jan 2014].Available at: http://2012books.lardbucket.org/books/modern-management-of-small-businesses/s18-04-exit-strategies.html

The owner must first decide what he or she wants to walk away with money, management control, or intellectual property. If interested only in money, selling the business on the open market or to another business may be the best choice.

LIQUIDATION OR WALKAWAY

There are times when a small business owner may decide that enough is enough, so he or she simply calls it quits, closes the business doors, and stops for the day. This closing of the business involves liquidation, the selling of all assets. If all debts are paid, it can also be referred to as a **walkaway**.

To make any money with the liquidation exit strategy, a business must have valuable assets to sell—for example, land or expensive equipment. The name of the business may have some value, so it could be purchased by someone for cents per euro and restarted with different owners. There is also a possibility that there may be a substantial amount of goodwill or even badwill if a business has been around for a long time. Goodwill is an intangible asset that reflects the value of intangible assets, such as a strong brand name, good customer relationships, good employee relationships, patents, intellectual property, size and quality of the customer list, and market penetration. However, if a business is simply closed, the value of the goodwill will drop, and the selling price will be lower than it would have been closed. For the small business owner who wants to close under these circumstances, there will be nothing much to sell but tangible assets because the business will have very little, if any, market value.

In all instances of liquidation, the proceeds from the sale of assets must first be used to repay creditors. The remaining money is divided among the shareholders (if any), the partners (if any), and the owner.[27] In an ideal walkaway situation, the following occurs (Katz, Green, 2003):

- All bills are paid off (or scheduled).
- All taxes are paid, and the various levels of government are informed of the closure.
- Contracts, leases, and the like are fulfilled or formally terminated.
- Employees are let go to find other jobs.
- Assets or inventory is depleted.
- No lawsuits are consuming money and time.
- Customers are placed so that they get needed goods or services.
- If needed, insurance is continued to cover unexpected claims after the firm closes.

The walkaway is the cleanest and best way to exit, but it is not always possible for all businesses that decide to close their doors. There will be those instances in which the owner closes the business and takes off, leaving a mess behind.

FAMILY SUCCESSION

Many small business owners dream of passing the business to a family member. Keeping the business in the family allows the owner's legacy to live on, which is clearly an attractive option. However, given that very few family firms survive beyond the first generation and even fewer survive into the third generation, [1]succession is the most critical issue facing family firms.

[27] Robbins, S, 2005. *Business - Exit Strategies for Your Business*. [online] [Accessed: 6 Jan 2012] Available at: http://www.entrepreneur.com/article/78512

The owner will be burdened with problems that will likely lead to business failure. Succession in family firms is a multistage, complex process that should begin even before the heirs enter the business, and effects extend beyond the point in time when they are named as successors. Further, because succession is usually followed by changes in the organization, particularly the change in the top position, it is thought to be an indicator of the future of the business. The better prepared and committed the successor is, the greater the likelihood of a successful succession process and business.

The ideal is for the family business to have engaged in formal succession planning: planning for the family business to be transferred to a family member or members. The failure to plan for succession is seen as a fundamental human resource problem as well as the primary cause for the poor survival rate of family businesses. Unfortunately, a very small percentage of family businesses plan appropriately for succession, and those that do frequently have mental, not written, plans (Handler, 1994).

BANKRUPTCY

Bankruptcy is an extreme form of business termination that uses a legal method for closing a business and paying off creditors when the business is failing and the debts are substantially greater than the assets. Because bankruptcy is a complicated legal process, it is important to get an attorney involved as soon as possible. There may be options other than bankruptcy, and consulting with an attorney will help. The owner must understand how bankruptcy works and which the options that are available, are. It is also good to know that not all bankruptcies are voluntary; creditors can petition the court for a business to declare bankruptcy.

Alternatives to Bankruptcy

Instead of going the bankruptcy route, a small business owner could do the following things[28]:

- Negotiate debt. This involves trying to reorganize a business's finances outside a legal proceeding. The owner can work with the creditors to renegotiate the terms of payment and the amount owed to each creditor. If a business is profitable but the debt situation is due to an unusual circumstance, such as a lawsuit or a temporary industry slowdown, this could be a successful solution.
- Improve operations. If the owner is in a position to fix the cash problem by fixing the underlying problems in the business, it may not be necessary to declare bankruptcy. An owner should look at cash-flow controls; eliminate unprofitable products, services, and divisions; and restructure into a leaner and meaner organization.
- Turn around and restructure the business. This alternative combines debt negotiation and operational improvement, perhaps the best choice. By doing both things at the same time, an owner will be in an even stronger position to improve the balance sheet, cash flow, and profitability and avoid insolvency.

TAKING A COMPANY PUBLIC

An initial public offering (IPO) is a stock offering in which the owner or owners of equity in a formerly private company have their private holdings transferred into issues tradable in public markets. From the initial owners' perspective, an IPO is often seen as

[28]Small-business-bankruptcy.com. 2012. *Small Business Bankruptcy Options for Your Troubled Firm*. [online] [Accessed: 6 Feb 2013]. Available at: http://www.small-business-bankruptcy.com

liquidation, but it is also a money event for a company. For this reason, an IPO makes sense only if a small business can benefit from a substantial infusion of cash.

Why are the numbers so small? The IPO process is costly, labour intensive, and usually requires an up-front investment of more than €100,000. Detailed reports are required on a business's financials, staffing, marketing, operations, management, and so forth. For some small businesses, although not many, an IPO might make sense and may even be necessary. For most, however, an IPO is clearly not a viable exit strategy.[29]

SELLING THE BUSINESS

Another possible exit strategy is selling the business. Although the sale of a business is sometimes described as the end of entrepreneurship or as failure or defeat, selling the business can also be a relief and the beginning of the next phase of the owner's personal and professional life. The owner should address the following questions:

- **Can the business be sold?** There are many things that make a business attractive to buyers: a solid history of profitability, a large and loyal base of customers, a good reputation, a competitive advantage (e.g., intellectual property rights, patents, long-term contracts with clients, and exclusive distributorships), and opportunities for growth, a desirable location, a skilled workforce, and a loyal workforce. If a business does not have at least some of these things or others of equal value, it will not likely generate much interest in the market.
- **Is the owner ready to sell or does the owner need to sell?** Selling a business, when it is a choice, requires emotional and financial readiness. The owner must think about what life will be like after the business is sold. What will be a source of income? How will time be spent? Has the owner "sold out" or could more have been done with the business? Does the owner love what he or she is doing? Many small business owners suffer real remorse after handing their businesses over to a new owner. Selling the business because the owner is forced to will engender very different emotional and financial challenges.
- **What is the business worth?** The owner may have no idea. For example, the owner of a small professional services firm felt the firm was worth more than €1 million. After a lengthy search, however, the owner received less than one-half that amount from the buyer. On the other side of the coin, the owner of an information technology (IT) company planned to sell the company to an employee for €200,000. However, after advertising the business for sale nationwide, the owner sold it for one dollar shy of €1 million.

It is recommended that an owner start planning for a sale at least three to four years in advance. Sometimes, even five years is not long enough. It is very easy to become overly attached to a business, so it will be difficult to see how the business really looks to an outsider. Selling a business is an art and a science. If the asking price is too high, this may signal to potential buyers that the owner is not interested in selling. Because there are several methods used to value a business, it is a good idea to hire a professional.[30]

---

[29] Clarke, A., 2006. *Exit Strategies for Small Business Owners*. [online] [Accessed: 19 Jan 2012]. Available at: http://www.experts.com/Articles/Exit-Strategies-for-Small-Business-Owners-By-Andrew-Clarke.

[30] Taylor, B., 2010. How to Sell Your Business, *The New York Times*. [online] [Accessed: 6 Jan 2013]. Available at: http://www.nytimes.com/2010/01/07/business/smallbusiness/07guide.html.

Figure 47 Four Ways to Sell a Small Business

Source: Cadden and Lueder, 2008

- Acquisition

Businesses buy other businesses for all kinds of reasons—for example, as a quick path to expansion or diversification, to get rid of the competition. Acquisition is one of the most common exit strategies for a small business. One key to success is to target the potential acquirer(s) in advance, position the business accordingly, and convince the acquirer that the small business is worth the asking price. Another way to become the target of an acquisition is to be successful in the marketplace. In an acquisition, the owner negotiates the price—a good thing because public markets value a business relative to its industry, which limits the value of a business. In an acquisition, however, there is no limit on the perceived value of a company. Why? The person making the acquisition decision is rarely the owner of the acquiring company, so there is no problem with the checkbook. It is someone else's money.

- Friendly Buyout

A friendly buyout occurs when ownership is transferred to family members, customers, employees, current managers, children, or friends. It is still considered selling the business, but the terms and nature of the transaction are usually very different. No matter who the "friendly" buyer may be, figure on starting to plan early—and engage a professional before, during, and after the sale.

- Selling to Employees

Selling the business to employees and/or managers is another option to consider. The owner can accomplish this process by setting up an employee stock option plan (ESOP), a stock equity plan that lets employees buy ownership in the business. However, because the owner is giving control of the business to the employees, a transition plan is critical to make sure that they are ready to carry on the business after the owner leaves. It is a good idea to hire an ESOP specialist. Keep in mind, though, that only corporations are eligible to form an ESOP. An ESOP is expensive to set up and maintain, so this might not be the best choice. For a worker-owned cooperative to work, the business owner(s) must be totally committed to the sale of the business to the employees. It is a good option if the business is small (fewer than twenty-five employees), profitable, relatively debt free, already has a culture of participatory management, and the owners are willing to stay on throughout the transition.

- Selling on the Open Market

Selling a business on the open market is the most popular exit strategy for small businesses. Most savvy business buyers use the Internet to research available businesses for sale, so post the sale notice on the two largest websites: BizBuySell.com, self-described as the "Internet's Largest Business for Sale Marketplace," and BizQuest.com, self-described as the "Original Business for Sale Website."

9 FINANCING SMALL BUSINESSES

However, even after the initial business plan is created, these financial statements provide critical information that will be required for the successful operation of the business. They not only are necessary for tax purposes but also provide critical insights for managing the firm and addressing issues such as the following:

- Are we profitable?
- Are we operating efficiently?
- Are we too heavily in debt or could we acquire more debt?
- Do we have enough cash to continue operations?
- What is this business worth?

There are three key financial statements: the balance sheet, the income statement, and the cash-flow statement. Every business owner or manager needs to be able to interpret correctly these statements if he or she expects to continue successful operations. It should be pointed out that all three financial statements follow general formats. The degree of detail or in some cases terminology may differ slightly from one business to another.

9.1 THE BALANCE SHEET STATEMENT

One should think of the balance sheet statement as a photograph, taken at a particular point in time, which images the financial position of a firm. The balance sheet is dominated by what is known as the accounting equation. Put simply, the accounting equation separates what is owned from who owns it.

Formally, the accounting equation states the following:

$$\boxed{\boldsymbol{assets = liabilities + owner's\ equity}} \quad \textbf{(9–1)}$$

9.1.1 ASSETS EVALUATION

Assets (A) are economic resources that are expected to produce a benefit in the future They consist of liabilities, which are the amount of money owed to outside claims (i.e., money owed to people outside the business) and owner's equity, also known as stockholders' equity—represents the claims on the business by those who own the business. As specified in the accounting equation, the dollar value of assets must equal the value of the business's liabilities plus the owner's equity (Harrison, Charles Lungren, 2010).

1. **Current assets** (CA) are assets that will be held for less than one year. These are listed in a specific order. The order is based on the degree of liquidity of each asset. Naturally, cash is the most liquid of all assets. All firms should have cash readily available. The exact amount of the desirable amount of cash to be held at hand will be determined by the sales level of the anticipated cash receipts and the cash needs of the business. They include:
   - **Cash(Ca),**
   - **Marketable securities (MaS)** which are stocks and bonds that a business may hold in the hope that they would provide a greater return to the business rather than just letting cash "sit" in a bank account. Most of these securities can be easily turned into cash—should the need arise.
   - **Accounts receivables (AcR)** represent the amount of money due to a business from prior credit sales. Not all firms operate on a strictly cash sales basis. Many firms will offer customers the opportunity to purchase on a credit basis. As an

example, a furniture store sells a bedroom set worth €6,000 to a newlywed couple. The couple puts down €2,500 to fix the sale and then signs a contract to pay the remaining €3,500 within the next year. That €3,500 would be listed as accounts receivable for the furniture firm.

- **Prepaid expense (PrE)** is an accrual accounting term that represents a payment that is made in advance of their actual occurrence. Insurance would be an example of a prepaid expense because a company is paying premiums to cover damages that might occur in the near future. If a year's worth of rent were paid at one time, it too would be viewed as a prepaid expense
- **Inventory (In)** is the tangible goods held by a business for the production of goods and services. Inventory can fall into three categories: raw materials, work-in-process (WIP), and finished goods. Raw materials inventory represents items or commodities purchased by a firm to create products and services. WIP inventory represents "partially completed goods, part or subassemblies that are no longer part of the raw materials inventory and not yet finished goods." The valuation of WIP should include the cost of direct material, direct labour, and overhead put into the WIP inventory. Finished inventory represents products that are ready for sale. Generally Accepted Accounting Principles (GAAP) requires that a business value its inventory on either the cost price or the market price—whichever is lowest. This inherent conservative approach to valuation is due to the desire to prevent the overestimation of inventory during inflationary periods.

Total current assets are the summation of the aforementioned items and are defined as follows:

$$\boxed{\boldsymbol{Total\ current\ assets\ =\ Ca+\ MaS\ +\ AcR\ +\ PrE\ +\ In}}\ (9\text{–}\mathbf{2})$$

2. **Long-term assets** are those assets that will not be turned into cash within the next year. Long-term assets may include a category known as investments. These items management holds for investment purposes, and they do not intend to "cash in" within the upcoming year. They might consist of other companies' stock, notes, or bonds. In some cases, they may represent specialized forms—money put away for pension funds.
   - The next major category of long-term assets is **fixed assets (FA)**. Fixed assets include plant (PL), equipment (Eq), and land (L). Generally, these are valued at their original cost. The value of these assets will decline over time. As an example, you purchase a new car for €25,000. If you were to sell the same car one, two, or five years later, its value would be less than the original purchase price. This recognition is known as depreciation, which is a noncash expense that specifically recognizes that assets decline in value over time. [31]In the example of the car, assume you purchased this car for company use. You intend to use it for five years, and at the end of the five years, you plan to scrap the car and expect that its salvage value will be zero.

[31] Accumulated depreciation is a running total of all depreciation on assets. Depreciation is also found on the income statement. Its presence in that financial statement enables a business to reduce its taxable income. There are many methods by which you can compute the depreciation value on fixed assets. These methods can be split into two broad categories: straight-line depreciation and accelerated depreciation. Straight-line depreciation is fairly easy to illustrate.

Table 17 Depreciation Calculations

	Year 0	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Depreciation	€0	€5,000	€5,000	€5,000	€5,000	€5,000
Accumulated depreciation	€0	€5,000	€10,000	€15,000	€20,000	€25,000
Net asset value	€25,000	€20,000	€15,000	€10,000	€5,000	€0

Because the useful lifetime of the vehicle was five years, the original value of the vehicle was divided by five; therefore, the annual depreciation would equal €5,000 (€25,000/5 = €5,000 per year). The accumulated depreciation simply sums up the prior years' depreciation for that particular asset.

Accelerated depreciation methods attempt to recapture a major portion of the depreciation earlier in the life of an asset. Accelerated depreciation yields tax-saving benefits earlier in the life of any particular fixed asset.

- The last category of long-term assets is **intangible assets** (InA); assets that provide economic value to a business but do not have a tangible, physical presence. Intangible assets include items such as patents, franchises, copyrights, and goodwill. Thus the value of long-term assets can be calculated as follows:

$$\boxed{\boldsymbol{long-term\ assets\ =\ investments\ +\ FA\ -\ accumulated\ depreciation\ +\ InA}} \quad \textbf{(9–2)}$$

The last element on the asset side of the balance sheet is the total assets. This is the summation of current assets and long-term assets.

9.1.2 LIABILITIES AND OWNER´S EQUITY STRUCTURE

On the other side of the balance sheet, we have liabilities plus **owner's equity.** The elements of liabilities consist of current liabilities and long-term liabilities. These represent what a business owes to others.

1. **Current liabilities (CuL)** are debts and obligations that are to be paid within a year. These include notes payable, accounts payable, other items payable (e.g., taxes, wages, and rents), dividends payable, and the current portion of long-term debt.
   - **Notes payable (NP)** represents money that is owned and which must be repaid within a year. It is inclusive because it may include lines of credit from banks that have been used, short-term bank loans, mortgage obligations, or payments on specific assets that are due within a year.
   - **Accounts payable** (AP) are short-term obligations that a business owes to suppliers, vendors, and other creditors. It may consist of all the supplies and materials that were purchased on credit.
   - **Other items payable** (OIP) can include items such as the payroll and tax withholdings owed to employees or the government but which have not as of yet been paid.
   - **Dividends payable** (DP) is a term that is appropriate for businesses structured as corporations. This category represents the amount that a business plans to pay its shareholders.
   - **The current portion of long-term debt (LTD)** represents how much of the long-term debt must be repaid within the upcoming fiscal year. This would include the portion of the principal that is due in this fiscal year.

In equation form,

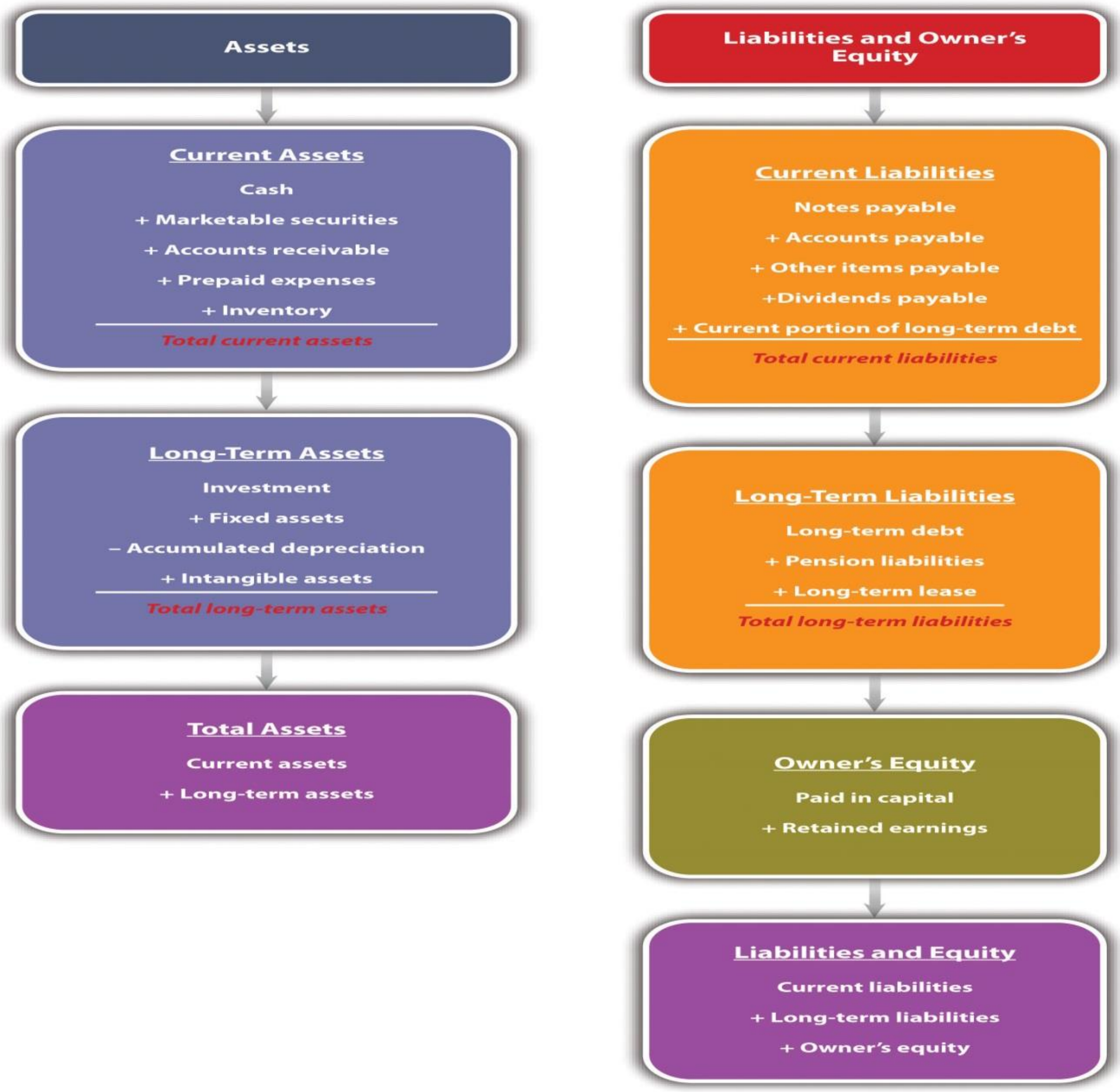
$$\boxed{current\ liabilities = NP + AP + OIP + DP + LTD}\ (9\text{–}3)$$

2. The other portion of liabilities is represented by long-term liabilities. These are debts payable over a period greater than one year and include long-term debt (LTDe), pension fund liability (PFL), and long-term lease obligations (LTLO). In equation form,

$$\boxed{long - term\ liabilities = LTDe + PFL + LTLO}\ \mathbf{(9\text{–}4)}$$

Total liabilities are the sum of current liabilities and long-term liabilities.

Table 18 Balance sheet structure



Source: Cadden and Lueder, 2008

The other major component of the right side of the balance sheet is owner's (or stockholders') equity. Owner's equity represents the value of the shareholders' ownership in a business. It is sometimes referred to as net worth. It may be composed of items such as paid in capital and retained earnings. Paid in capital is the amount of money provided by investors through the issuance of common or preferred stock. Retained earnings are the cumulative net income which has been reinvested in a business and which has not been paid out to shareholders as dividends.

9.2 THE INCOME STATEMENT

Whereas the balance sheet looks at a firm at a particular point (date) in time, the income statement examines the overall profitability of a firm over a particular length or period. Normally, there are several times that may be used as fiscal year, fiscal quarter, or monthly. The income statement is also known as a *profit and loss statement*. It identifies all sources of revenues generated by a business and all the expenses incurred. The income statement provides the best insight into whether a business is profitable.

The income statement begins by identifying the sales or income for the designated period. Sales would be all the revenues derived from all the products and services sold during that time. The term *income* represents all revenues and additional incomes produced by a business during the designated period.

The next item in the income statement is the **cost of goods sold** (COGS), which is composed of all costs associated with the direct production of goods and services that were sold during the period. It would include the costs of the raw materials used to produce the goods and those costs associated with production, such as direct labour. With these two values, the first measure of profit as gross profit can be calculated:

$$\boxed{\boldsymbol{gross\ profit\ =\ income - COGS}} \quad \textbf{(9–5)}$$

The next element in the income statement is **operating expenses** as expenses that are incurred during the normal operation of a business. Operating expenses can be broken down into four broad categories: selling expenses, general and administrative expenses, depreciation, and other overhead expenses. Selling expenses would include all salaries and commissions paid to the business's sales staff. It would also include the cost of promotions, advertising expenses, and other sales expenditures. Promotion costs might consist of costs associated with samples or giveaways. Advertising expenses would include all expenditures for print, radio, television, or Internet ads. Other sales expenditures would include money spent on meals, travel, meetings, or presentations by the sales staff.

General and administrative expenses are those associated with the operation of a business beyond COGS and direct-selling expenses. Expenditures in this category would include salaries of office personnel, rent, and utilities. Depreciation was covered in the previous subsection. The balance sheet has a component designated accumulated depreciation. This is the summation of several years' worth of depreciation on assets. In the income statement, depreciation is the value for a particular period. The last component of operating expenses would be other overhead costs a generic category that may include items such as office supplies, insurance, or a variety of services a business might use. Having identified all the components of operating expenses, one is now in a position to compute a second measure of profitability—operating profit, which is sometimes referred to as earnings before interest and taxes (EBIT):

$$\boxed{\boldsymbol{operating\ profit\ (EBIT) =\ gross\ profit\ -\ operating\ expenses}} \, (9-\boldsymbol{6})$$

The next section of the income statement is designated other revenues and expenses. This segment would include other nonoperational revenues (such as interest on cash or investments) and interest payments on loans and other debt instruments. When the other revenues and expenses are subtracted from the operating profit, one is left with earnings before taxes (EBT):

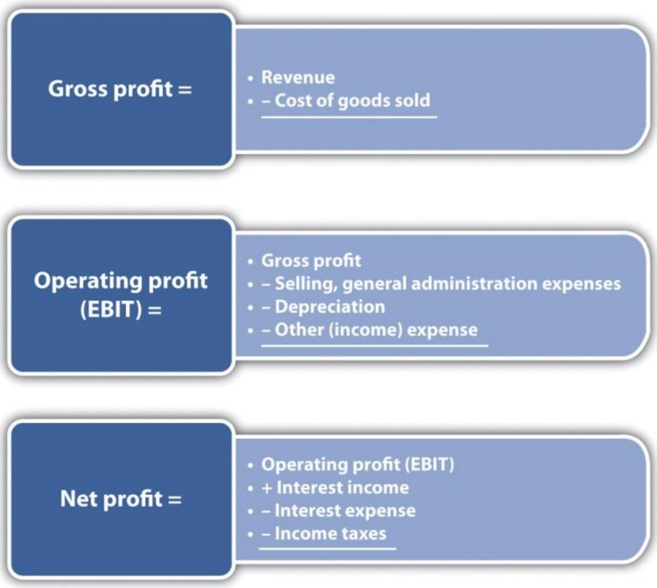
$$\boxed{\boldsymbol{EBT\ =\ operating\ profit\ -\ other\ revenues\ and\ expenses}} \quad \textbf{(9–7)}$$

Taxes are then computed on the EBT and then subtracted. This includes all state, and local tax payments that a business is obligated to pay. This brings us to our last measure of profitability as a net profit:

$$\boxed{net\ profit\ =\ EBT - taxes}\ (9-8)$$

If a business does not pay out dividends, the net profit becomes an addition to retained earnings. The income statement is the item that most individuals look at to determine the success of business operations.

Figure 48 The Income Statement



Source: Cadden and Lueder, 2008

9.3 The Cash-Flow Statement

The third component of financial statements is the cash-flow statement. There are two types of cash-flow statements—one examines cash flows for a given period (historic), and the other is a projection of future cash flows. The historic cash-flow statement is similar to the income statement in that it looks at cash inflows and cash outflows for a business during a specified period. Like the income statement, these periods can be the fiscal year, the fiscal quarter, or a month. The cash-flow projections statement attempts to identify cash flows into a firm and cash flows from a firm for some future period. This projection is extremely important because it may identify future sub periods in which a firm is producing a negative cash flow—where cash outflows exceed cash inflows.

From the standpoint of a small business owner, cash-flow statements provide insight into where cash flows are coming and going. The cash-flow projections statement may be the most important component of all the financial statements. Its importance stems from the fact that the flow of cash into a firm may not be synchronized with its cash outflows. Should there be a significant mismatch with cash outflows being significantly higher than cash inflows, a business may be in great difficulty with respect to meeting its current obligations, such as payroll, paying suppliers, and meeting short-term creditors. As we will see, cash-flow projection statements require several forecasts. These are discussed later in this section.

At some point, many businesses will experience negative cash flow. In fact, a negative cash flow is quite common in start-up operations and high-growth businesses where there is a pressing need for capital expenditures, research and development expenditures, and other significant cash outflows. One can also see the recurring presence of negative cash flows in businesses with seasonal sales. Short-term borrowing can cover negative cash flows. However, this type of borrowing brings up two important issues. First, any type of borrowing raises the overall debt level of a business, which might have an impact on the interest rate on the debt. Second, either when a negative cash flow exists because of an unforeseen exigency or because a business owner has failed to properly conduct a cash-flow projection analysis, a lender might look at a business in a jaundiced manner, which could have long-term consequences for a business.

In looking at the income statement, one could find a positive net income (profit) and then examine the cash-flow statement and discover that a business has a significant negative cash flow. The cash-flow statement specifically maps out where cash is flowing into a firm and where it flows out. A properly developed cash-flow statement will show if a business will be generating enough cash to continue operations, whether it has sufficient cash for new investments, and whether it can pay its obligations. As previously stated, many of the uninitiated will look singularly at profits, while those who have greater expertise in business will always believe that cash is king.

As a way of visualization, the cash-flow statement bears some similarity to the bank statement you may receive at the end of the month. A bank statement shows the beginning cash balance, deposits (cash inflows), and checks you have written (cash outflows) for that month. I hope that you have a positive cash flow as if cash inflows are greater than cash outflows and you have not bounced any checks. Unlike the bank statement, the cash-flow statement is broken into three major categories: operations, financing, and investing. Cash flow from operations examines the cash inflows from all revenues, and interest and dividend payments from investments held by a business. It then identifies the cash outflows for paying suppliers, employees, taxes, and other expenses. Cash flow from investing examines the impact of selling or acquiring current and fixed assets. Cash flow from financing examines the impact on the cash position from the changes in the number of shares and changes in the short and long-term debt position of a firm.

Cash inflows from operating activities consist of the following:

- Cash derived from the sale of goods or services.
- Cash derived from accounts receivable.
- Any cash derived from interest or dividends.
- Any other cash derived that is not identified with financing or investments.

The cash outflows from operating activities consist of the following:

- Cash outlays for goods purchased in the creation of goods and services.
- Cash outlays for payment to suppliers.
- Cash outlays to employees.
- Cash paid for taxes or interest paid to creditors.

Financing focuses on the cash flows associated with debt or equity. Some of the cash inflows associated with financing activities consist of the following:

- Cash from the sale of a company’s stock.
- Cash received from borrowing (debt).

Cash outflows associated with financing consist of the following:

- Cash outlays to repay principal on long- and short-term debt.
- Cash outlays to repurchase preferred stocks.
- Cash outlays to pay for dividends on either common or preferred stock.

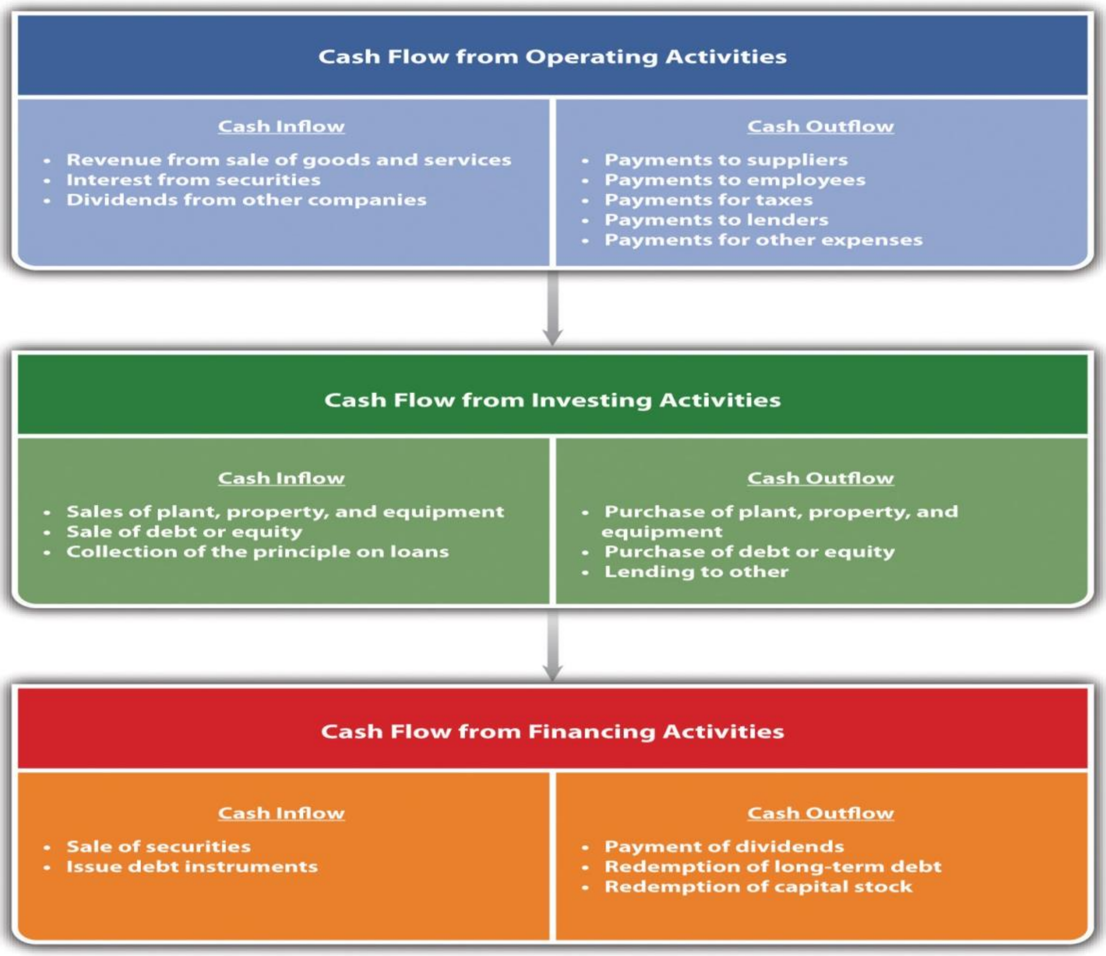
The third category is investing. The sources of cash flow from investing activities consist of the following:

- Cash received from the sale of assets.
- Cash received from the sale of equity investments.
- Cash received from collections on a debt instrument.

Cash outflows associated with investing activities consist of the following:

- Cash outlays to acquire a debt instrument of another business.
- Cash payments to buy equity interest in other businesses.
- Cash outlays to purchase a productive asset.

Figure 49 Cash Flow Breakdown



Source: Cadden and Lueder, 2008.

9.4 FINANCIAL RATIOS

One way of putting financial data into a comparative context is known as financial ratio analysis. From a financial accounting standpoint, ratio analysis enables external constituencies to evaluate the performance of a firm with respect to other firms in that particular industry. This is sometimes referred to as comparative ratio analysis. From a managerial accounting standpoint, ratio analysis can assist a management team to identify areas that might be of concern. The management team can track the performance on these ratios across time to determine whether the indicators are improving or declining. This is referred to as trend ratio analysis. There are literally scores of financial ratios that can be calculated to evaluate a firm's performance.

Because many small businesses are not publicly held and have no publicly traded stock, market ratios play no role in analyzing a small firm's performance. This section will review some of the most commonly used ratios in each category. Financial ratios can be grouped into five categories:

1. liquidity ratios,
2. financial leverage ratios,
3. profitability ratios,
4. asset management or efficiency ratios, and
5. market value ratios.

LIQUIDITY RATIOS

Liquidity ratios provide insight into a firm's ability to meet its short-term debt obligations. It draws information from a business's current assets and current liabilities that are found on the balance sheet. The most commonly used liquidity ratio is the current ratio given by the formula

$$\boxed{\boldsymbol{current\ ratio = current\ assets\ /\ current\ liabilities}}\ \textbf{(9–9)}$$

The normal rule of thumb is that the current ratio should be greater than one if a firm is to remain solvent. The greater this ratio is above one, the greater its ability to meet short-term obligations. As with all ratios, any value needs to be placed in context. This is often done by looking at standard ratio values for the same industry.

Another ratio used to evaluate a business's ability to meet in short-term debt obligations is the quick ratio; also known as the acid test. It is a more stringent version of the current ratio that recognizes that inventory is the least liquid of all current assets. A firm might find it impossible to transfer immediately the euro value of inventory into cash to meet short-term obligations. Thus the quick ratio, in effect, values the inventory dollar value at zero. The quick ratio is given by the following formula:

$$\boxed{\boldsymbol{quick\ test = current\ assets\ -\ inventory\ /\ current\ liabilities}}\ (9-\mathbf{10}3)$$

FINANCIAL LEVERAGE RATIOS

Provide information on a firm's ability to meet its total and long-term debt obligations. It draws on information from both the balance sheet and the income statement. The first of these ratios- the debt ratio- illustrates the extent to which a business's assets are financed with debt. The formula for the debt ratio is as follows:

$$\boxed{\boldsymbol{debt\ ratio = total\ debt\ /\ total\ assets}}\ (9-4)$$

A variation on the debt ratio is the ratio of debt to the total owner's equity (the debt-to-equity ratio). As with the other ratios, one cannot target a specific, desirable value for the debt-to-equity ratio. Median values will vary significantly across different industries. The automobile industry, which is rather capital intensive, has debt-to-equity ratios above two. Other industries, such as personal computers, may have debt-to-equity ratios under 0.5. The formula for the debt-to-equity ratio is as follows:

$$\boxed{\boldsymbol{debt-to-equity\ ratio = total\ debt\ /\ total\ owner's\ equity}}\ (9-5)$$

One can refine this ratio by examining only the long-term portion of total debt to the owner's equity. Comparing these two debt-to-equity ratios gives insight into the extent to which a firm is using long-term debt versus short-term debt. The formula for the long-term debt-to-owner's equity ratio is as follows:

$$\boxed{\boldsymbol{debt - to - owner's\ equity\ ratio = long - term\ debt\ /\ total\ owner's\ equity}}\ (9\text{–}6)$$

The interest coverage ratio examines the ability of a firm to cover or meet the interest payments that are due in a designated period. The formula for the interest coverage ratio is as follows:

$$\boxed{\boldsymbol{interest\ coverage\ ratio = EBIT/total\ interest\ charges}}\ (9\text{–}7\mathbf{4})$$

PROFITABILITY RATIOS

The next grouping of ratios is the profitability ratios. Essentially, these ratios look at the amount of profit that is being generated by each dollar of sales (revenue). Remember, from the review of the income statement, we can identify three different measures of profit: gross profit, operating profit, and net profit. Each measure of profit can be examined with respect to the net sales of a business, and each can give us a different insight into the overall efficiency of a firm in generating profit.

The first profitability ratio examines how much gross profit is generated by each euro of revenue and is given by the following formula:

$$\boxed{\boldsymbol{gross\ profit\ margin\ =\ gross\ profit\ /\ revenue}}\mathbf{(9\text{–}15)}$$

The next examines operating profit per euro of sales and it is calculated in the following manner:

$$\boxed{\boldsymbol{operating\ profit\ margin\ =\ operating\ profit\ revenue}}(9\text{–}8)$$

Lastly, the net profit margin is the one that is mostly used to evaluate the overall profitability of a business. It is determined as follows:

$$\boxed{net\ profit\ margin\ =\ net\ profit\ /\ revenue}\ (9\text{–}\mathbf{17})$$

The last category of financial ratios is the asset management or efficiency ratios. These ratios are designed to show how well a business is using its assets. These ratios are extremely important for management to determine its own efficiency. There are many different activity or efficiency ratios. Here we will examine just a few. The sales-to-inventory ratio computes the number of dollars of sales generated by each dollar of inventory. Firms that are able to generate greater sales volume for a given level of inventory are perceived as being more efficient. This ratio is determined as follows:

$$\boxed{sales\ to\ inventory\ =\frac{sales}{inventory}}\ (9\text{–}\mathbf{18})$$

Other efficiency ratios look at how well a business is managing its inventory. Some look at the number of days of inventory on hand; others look at the number of times inventory is turned over during the year. Both can be used to measure the overall efficiency of the inventory policy of a firm. For simplicity's sake, these ratios will not be reviewed in this text.

The sales-to-fixed-asset ratio is another efficiency measure that looks at the number of dollars of sales generated by a business's fixed assets. Again, one is looking for a larger value than the industry average because this would indicate that a business is more efficient in using its fixed assets. This ratio is determined as follows:

$$\boxed{sales\ to\ fixed\ assets\ =\ \frac{sales}{fixed\ assets}}(9\text{–}\mathbf{19})$$

Another commonly used efficiency ratio is the days-in-receivables ratio. This ratio shows the average number of days it takes to collect accounts receivables. The desired trend for this ratio is a reduction, indicating that its customers are paying a firm more quickly. This ratio is determined as follows:

$$\boxed{days\ in\ receivables\ =\ accounts\ receivable \Big/ \left(\frac{sales}{365}\right)} \quad (9\text{–}\mathbf{20})$$

The 365 in the denominator represents the number of days in a year.

Financial ratios serve an extremely useful purpose for small business owners who are attempting to identify trends in their own operations and see how well their business's stand up against its competitors. As such, owners should periodically review their financial ratios to get a better understanding of the current position of their firms.

9.5 Financial plan

For most small businesses, the major source of external financing comes from banks. However, there exist many other possibilities how to set up external financial plan.

Perhaps the major source of equity financing for most small start-up businesses comes from personal savings. The term bootstrapping refers to using personal, family, or friends' money to start a business. The use of one's own money (or that of family and friends) is a strong indicator that a business owner has a strong commitment to and belief in the success of the business. If a business is financed totally from one's personal savings that means the owner or the operator has total control of the business.[32]

9.5.1 Stages of Funding

Many individuals start small businesses with the express purpose of finding independence and control over their own economic and business lives. This desire for independence may make many small business owners averse to the idea of equity financing because that might mean ceding business control to equity partners (Sapienza et al, 2003).

Figure 50 Sources of Funding

Source: Cadden and Lueder, 2008

Equity financing raises money by selling a certain share of the ownership of the business. It involves no explicit obligation or expectation, on the part of the investors, to be repaid their investment. The value of equity financing lies in the partial ownership of the

[32] Financing," Small Business Notes, accessed December 2, 2011,www.smallbusinessnotes.com/business-finances/financing.

business. Another issue that makes some small business owners averse to acquiring additional equity partners is the simple fact that the acquisition of these partners means less profit to the business owner. This factor in the control issue must be considered when the small business owner is looking to raise additional capital through venture capitalist and angel investors Venture capitalists are looking for substantial returns on their initial investment—five, ten, sometimes even twenty-five times their original investment. They will be looking for firms that can rapidly generate significant profits or significant growth in sales. Angel investors may be more attracted to their interest in the small business concept than in reaping significant returns. This is not to say that they are not interested in recouping their original investment with some type of significant return. It is much more likely that angel investors, as compared to venture capitalists, will play a much more active role in the decision-making process of the small business.

Debt financing represents a legal obligation to repay the original debt plus interest. Most debt financing involves a fixed payment schedule to repay both principal and interest. A failure to meet the schedule has serious consequences, which might include the bankruptcy of the business. Those who provide debt financing expect that the principal will be repaid with interest, but they are not formal investors in the business. There are numerous sources for debt financing. Some small businesses begin with financing by borrowing from friends and family. Some firms may choose to finance business operations by using either personal or corporate credit cards. This approach to financing can be extraordinarily expensive given the interest rates charged on credit cards and the possibility that the credit card companies may change (by a significant amount) the credit limit associated with the credit card.

Another source of capital is the generation of **internal funding**. This simply means that a business flow it is retained earnings back into the business. This is a viable source of capital when a business is highly profitable.

The last source of capital is **trade credit**. Trade credit involves purchasing supplies or equipment through financing made available by vendors. This approach may allow someone to acquire inventory of materials and supplies without having the full price at the time of purchase.

STEPS IN FINANCIAL PLANNING

- Step 1: Summarize the financial aspects of your business plan.

Table 19 Start-up plan

Requirements	**amount**		**amount**
Start-up Expenses		Start-up Assets	
Expense 1	€	Cash Assets	€
Expense 2	€	Other Current Assets	€
Expense 3	€	Long-term Assets	€
Expense 4	€	Total Assets	€
Expense 5	€		
Expense 6	€	Total Requirements	€
Total Start-up Expenses	€		

- Step 2: Explain where your funding will come from, in what form (as investments and/or loans), and how this funding will cover the start-up requirements outlined in the Start-up table.

Table 20 Start-up Funding Start-up Expenses to Fund

Start-up Assets to Fund	Amount in €		
Total Funding Required	amount€		
Assets	Amount in €	**Liabilities and Capital**	Amount in €
Non-cash Assets from Start-up	€		
Cash Requirements from Start-up	€	**Liabilities**	**amount**
Additional Cash Raised	€	Current Borrowing	€
Cash Balance on Starting Date	€	Long-term Liabilities	€
Total Assets	**€**	Accounts Payable (Outstanding Bills)	€
		Other Current Liabilities (interest-free)	€
		Total Liabilities	***€***
		Capital	**amount**
		Planned Investment	€
		Owner	€
		Investor	€
		Additional Investment Requirement	€
		Total Planned Investment	€
		Loss at Start-up (Start-up Expenses)	€
		Total Capital	**€**
		Total Capital and Liabilities	**€**
		Total Funding	**€**

- Step 3: Explain the important points of your Profit and Loss projections, such as percentage increase in sales and profits, your gross margins, and key budget items

Table 21 Sales Forecast

Sales	**Year 1**	**Year 2**	**Year 3**
Total Sales	*€*	*€*	*€*
Direct Cost of Sales	*Year 1*	*Year 2*	*Year 3*
Subtotal Direct Cost of Sales	**€**	**€**	**€**
	Year 1	Year 2	Year 3
Sales	€	€	€
Direct Cost of Sales	***€***	***€***	***€***
Other Costs of Sales	***€***	***€***	***€***
Total Cost of Sales	**€**	**€**	**€**
Gross Margin	€	€	€
Gross Margin %	%	%	%
Expenses			
Expense 1	€	€	€
Expense 2	€	€	€
Depreciation	€	€	€
Rent	€	€	€
Utilities	€	€	€
Insurance	€	€	€
Payroll Taxes	€	€	€
Other	€	€	€
Total Operating Expenses	**€**	**€**	**€**
Profit Before Interest and Taxes	€	€	€
EBITDA	€	€	€
Interest Expense	€	€	€
Taxes Incurred	€	€	€
Net Profit	**€**	**€**	**€**
Net Profit/Sales	%	%	%

CASE STUDY 5 CAPITAL STRUCTURE ISSUES IN PRACTICE

Let us envision a small family-based manufacturing firm that until now has been able to grow through the generation of internal funds and the equity that has been invested by the original owners. Presently, the firm has no long-term debt. It has a revolving line of credit, but in the last few years, it has not had to tap into this line of credit largely. The income statement for the year 2010 and the projected income statement for 2011 are given in Table as Income Statement for 2010 and Projections for 2011". In preparing the projected income statement for 2011, the firm assumed that sales would grow by 7.5 percent due to a rapidly rising market. In fact, the sales force indicated that sales could grow at a much higher rate if the firm can significantly increase its productive capacity. The projected income statement estimates the cost of goods sold to be 65 percent of the firm's revenue. This estimate is predicated on the past five years' worth of data. The return on assets (ROA) and the return on equity (ROE) for 2010 and the projected values for 2011 are provided in the bottom of the table.

Income Statement for 2010 and Projections for 2011			Abbreviated Balance Sheet		
	2010	**2011**		**2010**	**2011**
Revenue	€475,000	€510,625	Total assets	€750,000	€765,000
Cost of goods sold	€308,750	€331,906	Long-term debt	€—	€—
Gross profit	€166,250	€178,719	Owners' equity	€750,000	€765,000
General sales and administrative	€95,000	€102,125	Total debt and equity	€750,000	€765,000
EBIT	€71,250	€76,594	**ROA and ROE Values for 2010 and Projections for 2011**		
Interest	€—	€—		**2010 (%)**	**2011 (%)**
Taxes	€21,375	€22,978	Return on assets	6.65	7.01
Net profit	€49,875	€53,616	Return on equity	6.65	7.01

After preparing these projections, the owners were approached by a company that manufactures computer-controlled machinery. The owners were presented with a series of machines that will not significantly raise the productive capacity of their business while also reducing the unit cost of production. The owners examined in detail the productive increase in improved efficiency that this computer-controlled machinery would provide. They estimated that demand in the market would increase if they had this new equipment, and sales could increase by 25 percent in 2011, rather than 7.5 percent as they had originally estimated. Further, the efficiencies brought about by the computer-controlled equipment would significantly reduce their operating costs. A rough estimate indicated that with this new equipment the cost of goods sold would decrease from 65 percent of revenue to 55 percent of revenue. These were remarkably attractive figures. The only reservation that the owners had was the cost of this new equipment. The sales price was €200,000, but the business did not have this amount of cash available. To raise this amount of money, they would either have to bring in a new equity partner who would supply the entire amount, borrow the €200,000 as a long-term loan, or have some combination of equity partnership and debt. They first approached a distant relative who has successfully invested in several businesses. This individual was willing to invest €50,000, €100,000, €150,000, or the entire €200,000 for taking an equity position in the firm. The owners also went to the bank where they had line of credit and asked about their lending options. The bank was impressed with the improved productivity and efficiency of the proposed new machinery. The bank was also willing to lend the business €50,000, €100,000, €150,000, or the entire €200,000 to purchase the computer-controlled equipment. The bank, however, stipulated that the lending rate would depend on the amount that was borrowed. If the firm borrowed €50,000, the interest rate would be 7.5 percent; if the amount borrowed were €100,000, the interest rate would increase to 10 percent; if €150,000 were the amount of the loan, the interest rate would be 12.5 percent; and if the firm borrowed the entire €200,000, the bank would charge an interest rate of 15 percent.

To analyze correctly this investment opportunity, the owners could employ several financial tools and methods, such as net present value (NPV). This approach examines a lifetime stream of additional earnings and cost savings for an investment. The cash flow that might exist is then discounted by the cost of borrowing that money. If the NPV is positive, then the firm should undertake the investment; if it is negative, the firm should not undertake the investment. This approach is too complex—for the needs of this text—to be examined in any detail. For the purpose of illustration, it will be assumed that the owners began by looking at the impact of alternative investment schemes on the projected results for 2011. Obviously, any in-depth analysis of this investment would have to entail multiyear projections.

They examined five scenarios:

- Their relative provides the entire €200,000 for an equity position in the business.
- They borrow €50,000 from the bank at an interest rate of 7.5 percent, and their relative provides the remaining €150,000 for a smaller equity position in the business.
- They borrow €100,000 from the bank at an interest rate of 10 percent, and their relative provides the remaining €100,000 for a smaller equity position in the business.
- They borrow €150,000 from the bank at an interest rate of 12.5 percent, and their relative provides the remaining €50,000 for an even smaller equity position in the business.
- They borrow the entire €200,000 from the bank at an interest rate of 15 percent.

All five scenarios begin with the assumption that the new equipment would improve productive capacity and allow sales to increase, in 2011, by 25 percent, rather than the 7.5 percent that had been previously forecasted. Likewise, all five scenarios have the same cost of goods sold, which in this case is 55 percent of the revenues rather than the anticipated 65 percent if the new equipment is not purchased.

1) Income Statement for the Five Scenarios

	Borrow €0	Borrow €50,000	Borrow €100,000	Borrow €150,000	Borrow €200,000
Revenue	€593,750	€593,750	€593,750	€593,750	€593,750
Cost of goods sold	€326,563	€326,563	€326,563	€326,563	€326,563
Gross profit	€267,188	€267,188	€267,188	€267,188	€267,188
General sales and administrative	€118,750	€118,750	€118,750	€118,750	€118,750
EBIT	€148,438	€148,438	€148,438	€148,438	€148,438
Interest	€—	€3,750	€10,000	€18,750	€30,000
Taxes	€44,531	€43,406	€41,531	€38,906	€35,531
Net profit	€103,906	€101,281	€96,906	€90,781	€82,906

All five scenarios have the same EBIT. The scenarios differ, however, in the interest payments. The first scenario assumes that a relative who is taking an equity position in the firm would provide all €200,000. This is not a loan, so there are no interest payments. In the remaining four scenarios, the interest payments are a function of the amount borrowed and the corresponding interest rate. The payment of interest obviously affects the earnings before taxes (EBT) and the amount of taxes that have to be paid. Although the tax bill for those scenarios where money has been borrowed is less than the scenario where the €200,000 is provided by equity, the net profit also declines as the amount borrowed increases.

2) Abbreviated Balance Sheet for the Five Scenarios

	Borrow €0	Borrow €50,000	Borrow €100,000	Borrow €150,000	Borrow €200,000
Total assets	€965,000	€965,000	€965,000	€965,000	€965,000
Long-term debt	€—	€50,000	€100,000	€150,000	€200,000
Owners' equity	€965,000	€915,000	€865,000	€815,000	€765,000
Total debt and equity	€965,000	€965,000	€965,000	€965,000	€965,000

The owners then calculated the ROA and the ROE for the five scenarios when they examined these results; they noticed that the greatest ROA occurred when the new machinery was financed exclusively by equity capital.

3) ROE and ROA in Five scenarios

	Borrow €0	Borrow €50,000	Borrow €100,000	Borrow €150,000	Borrow €200,000
ROA	10.77%	10.50%	10.04%	9.41%	8.59%
ROE	10.77%	11.07%	11.20%	11.14%	10.84%

The ROA declined as they began to fund new machinery with debt: the greater the debt, the lower the ROA. However, they saw a different situation when they looked at the ROE for each scenario. The ROE was greater in each scenario where the machinery was financed either exclusively or to some extent by debt. In fact, the lowest ROE (the firm borrowed the entire €200,000) was 50 percent higher than if the firm did not acquire the new equipment. A further examination of the ROE results provides a very interesting insight. The ROE increases as the firm borrows up to €100,000 of debt. When the firm borrows more money (€150,000 or €200,000), the ROE ratio declines. This is a highly simplified example of optimal capital structure. There is a level of debt beyond which the benefits measured by ROE, which begins to decline. Small businesses must be able to identify their "ideal" debt-to-equity ratio.

The owners decided to carry their analysis one-step further; they wondered if the sales projections were too enthusiastic. They were concerned about the firm's ability to repay any loan should there be a drop in sales. Therefore, they decided to examine a worst-case scenario. Such analyses are critical if one is to evaluate fully the risk of undertaking debt. . They ran the numbers to see what the results would be if there was a 25 percent decrease in sales in 2011 rather than a 25 percent increase in sales compared to 2010 (see the next table)

4) Income Statement for the Five Scenarios Assuming a 25 Percent Decrease in Sales

	Borrow €0	Borrow €50,000	Borrow €100,000	Borrow €150,000	Borrow €200,000
Revenue	€356,250	€356,250	€356,250	€356,250	€356,250
Cost of goods sold	€195,938	€195,938	€195,938	€195,938	€195,938
Gross profit	€160,313	€160,313	€160,313	€160,313	€160,313
General sales and administrative	€71,250	€71,250	€71,250	€71,250	€71,250
EBIT	€89,063	€89,063	€89,063	€89,063	€89,063
Interest	€—	€3,750	€10,000	€18,750	€30,000
Taxes	€26,719	€25,594	€23,719	€21,094	€17,719
Net profit	€62,344	€59,719	€55,344	€49,219	€41,344

Even with a heavy debt burden for the five scenarios, the firm is able to generate a profit, although it is a substantially lower profit compared to if sales increased by 25 percent. They examined the impact of this proposed declining sales on ROA and ROE. These results are found in Table "ROA and ROE for the Five Scenarios under the Condition of Declining Sales

5) ROA and ROE for the Five Scenarios under the Condition of Declining Sales

	Borrow €0	Borrow €50,000	Borrow €100,000	Borrow €150,000	Borrow €200,000
ROA	6.46%	6.19%	5.74%	5.10%	4.28%
ROE	6.46%	6.53%	6.40%	6.04%	5.40%

9.5.2 Breakeven Analysis

A breakeven analysis is remarkably useful to someone considering starting up a business. It examines a business's potential costs—both fixed and variable—and then determines the sales volume necessary to produce a profit for given selling price. This information enables one to determine if the entire concept is feasible. After all, if one has to sell five million shoes in a small town to turn a profit, one would immediately recognize that there might be a severe problem with the proposed business model.

A breakeven analysis begins with several simplifying assumptions. In its most basic form, it assumes that you are selling only one product at a particular price, and the production cost per unit is constant over a wide range of values. The purpose of a breakeven analysis is to determine the sales volume that is required so that you neither lose money nor make a profit. This translates into a situation in which the profit level is zero. Put in equation form, this simply means:

$$\boxed{\boldsymbol{total\ revenue\ (TR)\ -\ total\ costs(TC)\ =\ €0}} \quad (9–21)$$

By moving terms, we can see that the break-even point occurs when total revenues equal total costs:

$$\boxed{total\ revenue\ =\ total\ costs} \quad (9–22)$$

We can define total revenue (TR) as the selling price (SP) of the one-product times the number of units sold (Q), which can be represented as follows:

$$\boxed{\mathrm{TR} = \mathrm{SP} \times \mathrm{Q}} \quad (9–23)$$

Total costs are seen as being composed of two parts: fixed costs and total variable costs. Fixed costs exist whether or not a firm produces any product or have any sales and consist of rent, insurance, property taxes, administrative salaries, and depreciation. Total variable costs are those costs that change across the volume of production. As part of the simplifying assumptions of the breakeven analysis, it is assumed that there is a constant unit cost of production. This would be based on the labour input and the amount of materials required making one unit of product.

As production increases, the total variable cost (TVC) will likewise increase, which can be represented as follows:

$$\boxed{TVC\ =\ variable\ cost\ per\ unit\ \times\ Q} \quad (9–24)$$

Total costs (TC) are simply the summation of fixed costs (FC) plus the total variable costs (TVC):

$$TC = FC + TVC \text{ (9–25)}$$

The original equation for the break-even point can now be rewritten as follows:

$$[(SP) \times (Q)] - (TC) = €0 \text{ (9– 26)}$$

At the break-even point, revenues equal total costs, so this equation can be rewritten as:

$$SP \times Q = TC \text{ (9-27)}$$

Given that, the total costs (TC) equal the fixed costs (FC) and the total variable costs (TVC); this equation can now be extended as follows:

$$SP \times Q = FC + TVC \text{ (9-28)}$$

- This equation can be expanded by incorporating the definition of total variable costs as a function of sales volume (Q):

$$SP \times Q = FC + (VC \times Q) \text{ (9-29)}$$

- This equation can now be rewritten to solve for the sales value:

$$(SP \times Q) - (VC \times Q) = FC \text{ (9-30)}$$

Because the term *sales volume* is present in both terms on the left-hand side of the equation, it can be factored to produce:

$$Q \times (SP - VC) = FC \text{ (9-31)}$$

The *sales value* to produce the break-even point can now be solved for in the following equation:

$$Q = FC / (SP - VC) \text{ (9-32)}$$

CASE STUDY 6 CARL JACOBS

Carl Jacobs, a retired engineer, was a lifelong enthusiast of making plastic aircraft models. Over thirty years, he entered many regional and national competitions and received many awards for the quality of his model building. Part of this success was due to his ability to cast precision resin parts to enhance the look of his aircraft models. During the last ten years, he acquired a reputation as being an expert in this field of creating these resin parts. A friend of his, who started several businesses, suggested that Carl look at turning this hobby into a small business opportunity in his retirement. This opportunity stemmed from the fact that Carl had created a mould into which he could cast the resin part for a particular aircraft model; this same mould could be used to produce several hundred or several thousand copies of the part, all at relatively low cost.

Carl had experience only with sculpturing and casting parts in extremely low volumes-one to five parts at a time. If he were to create a business format for this hobby, he would have to have a significant investment in equipment. There would be a need to create multiple metal moulds of the same part so that they could be cast in volume. In addition, there would be a need for equipment for mixing and melting the chemicals that are required to produce the resin.

After researching, he could buy top-of-the-line equipment for a total of €33,000. He also found second hand but somewhat less efficient equipment. Carl estimated that the total cost of acquiring all the necessary second hand equipment would be close to €15,000. After reviewing the equipment specifications, he concluded that with new equipment, the unit cost of producing a set of resin parts for a model would run €9.25, whereas the unit cost for using the second hand equipment would be €11.00. After doing some market research, Carl determined that the maximum price he could set for his resin sets would be €23.00. This would be true whether the resin sets were produced with new or second hand equipment.

Carl wanted to determine how many resin sets would have to be sold to break even with each set of equipment. For simplicity's sake, he assumed that the initial purchase price of both options would be his fixed cost.

Option	Fixed Costs	Variable Cost	Selling Price	break-even point
New equipment	€33,000	€9.25/unit	€23.00	Q = €33,000 / (€23.00 – €9.25) Q = €33,000 / €13.75 Q = 2,400 units
Second hand equipment	€15.000	€11.00/unit	€23.00	Q = €15,000 / (€23.00 – €11.00) Q = €15,000 / €12.00 Q = 1,250 units

From this analysis, he could see that although the second hand equipment is not as efficient (hence, the higher variable cost per unit), it will break even at a significantly lower level of sales than the new equipment. Carl was still curious about the profitability of the two sets of equipment at different levels of sales. Therefore, he ran the numbers to calculate the profitability for both sets of equipment at sales levels of 1,000 units, 3,000 units, 5,000 units, 7,500 units, and 10,000 units.

	Second hand Equipment				**New Equipment**			
Sales Level	**Revenue**	**Fixed Cost**	**Total Variable Costs**	**Profit**	**Revenue**	**Fixed Cost**	**Total Variable Costs**	**Profit**
1,000	€23,000	€15,000	€11,000	€(3,000)	€23,000	€33,000	€9,250	€(19,250)
3,000	€69,000	€15,000	€33,000	€21,000	€69,000	€33,000	€27,750	€8,250
5,000	€115,000	€15,000	€55,000	€45,000	€115,000	€33,000	€46,250	€35,750
7,500	€172,500	€15,000	€82,500	€75,000	€172,500	€33,000	€69,375	€70,125
10,000	€230,000	€15,000	€110,000	€105,000	€230,000	€33,000	€92,500	€104,500

From these results, it is clear that the second hand equipment is preferable to the new equipment. At 10,000 units, the highest annual sales that Carl anticipated, the overall profits would be greater with second hand equipment.

It should not be too surprising to find that good financial management can benefit tremendously when a firm's cash flow is improved.

10 FAMILY BUSINESS

While the majority of family business owners would like to see their business transferred to the next generation, it is estimated that 70% will not survive into the 2nd generation and 90% will not make it to the 3rd generation (Walsh, 2011).

Family businesses are different and what makes them different is the family component. The potential impact the family component can have on the management and ownership of the business is such that it needs to be understood and effectively managed. Many family businesses have successfully managed their family components and have done so by applying proven family business 'best practices'.

There is no agreed-on definition of a family business. The percentage of ownership, the strategic control, the involvement of multiple generations, and the intention for the business to remain in the family are among the many criteria that experts use to distinguish family businesses from other types of businesses. For the purposes of this chapter, however, a family business is defined as a business that is actively owned and/or managed by more than one member of the same family (Cadden and Lueder 2008, p.130).

10.1 ADVANTAGES AND DISADVANTAGES OF A FAMILY FIRM

There are benefits to a family business, but there are disadvantages that must be considered as well. Starting a family business is not for everyone. A family business offers the following advantages:

- One of the popular misconceptions about family businesses is that they are unable to adapt easily to increasing competitiveness and technological progress. The reality is that family businesses frequently have the advantage of entrepreneurial spirit, flexibility, and opportunism.
- It is believed by some that family firms are "too soft" and rarely reach their potential. The reality is that family businesses actually outperform public companies. Oftentimes, the marketplace forces public companies to make short-term decisions, whereas a family business has the advantage of having more freedom to make its decisions.
- Family businesses can adapt to market fluctuations more easily because they can afford to be patient. They have common goals, shared values, and a commitment to brand building.
- Family-owned businesses are often seen as ideal because family members form a "grounded and loyal foundation" for the company, and family members tend to exhibit more dedication to their common goals.
- Family businesses are becoming more and more attractive to undergraduate business students who face a bleak job and salary outlook for new graduates.
- Many family-owned businesses tend to be stable and optimistic, even when economic times are uncertain. They seem to be better able to weather economic difficulties and stabilize the economy than their nonfamily counterparts. However, this is a function of the industry and the size of the business.
- Family businesses may be more open to flexible or part-time schedules or choosing your hours. This presents a very attractive work environment for people who need to tend to children, parents, or other family members in need.
- Family businesses tend to operate more ethically. In fact, many family businesses believe that their ethical standards are more stringent than those of their competitors are.

- Family businesses also exhibit more social responsibility than their competitors do. This has been attributed to their concern about image and local reputation as well as their closeness to the community.
- Family businesses may incur lower costs because of the greater willingness of family members to make financial sacrifices for the sake of the business. Accepting lower pay than they would get elsewhere to help the business in the longer term or deferring wages in a cash-flow crisis are examples of family altruistic behaviour.
- Family businesses, in general, have greater independence of action because they have less (or no) pressure from the stock market and less (or no) takeover risk.
- Family businesses tend to be more resilient in hard times because they are willing to flow profits back into the business.
- Family businesses are less bureaucratic and less impersonal, which allows for greater flexibility and quicker decision-making.
- Family businesses offer the possibility of great financial success. (Kets de Vries, 1993)

Disadvantages

As attractive as family businesses are on many fronts, they have the following disadvantages:

- Family businesses tend to be stable organizations. Although this is a good thing in many instances, stability can also make it difficult to change. A new, younger family member coming into the business will find tradition and structure. Changing that is not simple. The key to changing a family business lies in defining tradition in terms of the company's core values, not in specific ways of doing things.
- Family closeness can lead to sibling rivalry or problems when both the parent and the child want control. By the third or fourth generation, with many cousins possibly sharing ownership, governance can become very complicated.
- There may be times when the interests of a family member conflict with the interests of the business. One family member may want to expand the business, but other family members may not share this person's desire. The needs of the business are not in harmony with the needs of the family.
- Family ties have a downside. Family members frequently will be expected to work harder, make more of a commitment, and will be paid less than other employees in the business.
- Family business owners may automatically promote someone from the family or give family members a job even if they do not have adequate skills for the job. A nonfamily employee may be better qualified. This can cause dissension and resentment among other employees.
- The family business may be a breeding ground for jealousies, resentment, anger, and sabotage. Family problems may spill over into the workplace. The business may be plagued with managerial incompetence, the lack of exposure to other businesses, and the inability to separate family and work.
- Family businesses have limited sources of external capital because they tend to avoid sharing equity with nonfamily members. (Sirmon, Hitt, 2003)
- Family businesses frequently have a confusing organization, with "messy structure and no clear division of tasks." Authority and responsibility lines are unclear; jobs may overlap; executives may hold a number of different jobs; and the decision-making

hierarchy may be completely ignored, existing only to be bypassed. This can create a dysfunctional working environment.

- Family businesses frequently have paternalistic or autocratic rule that is characterized by a resistance to change, secrecy, and the attraction of dependent personalities.

10.2 CHALLENGES IN THE FAMILY BUSINESS

The owners and managers of family businesses face many unique challenges. These challenges stem from the overlap of family and business issues and include communication, employing family and nonfamily members, professional management, employment qualifications, salaries and compensation, and succession.

- **Communication** is important in any business, but the complexities of communication in a family business are particularly problematic. Experts say that communication is one of the most difficult parts of running a family business. The approach to communication needs to include commitment, the avoidance of secrecy, and an understanding of the risks of bad communication.
- **Commitment.** In a family business, it is critical that there be a commitment to communicate effectively with family and nonfamily members of the business. “Business leaders should be open about their awareness of the potential for communication issues to evolve and their willingness to accept feedback and input from all employees about opportunities for improvement and areas of concern
- **Secrecy**. In family businesses, it is particularly important not to convey the impression that family members are more knowledgeable than other employees are. Even when this is not the case, the potential for the perception of exclusivity may exist. Steps should be taken to address any issues that may arise openly, honestly, and without preference for family members.
- **Risks of Bad Communication**. These difficulties can be overcome if the family business makes a concerted effort to create and maintain an environment of open communication where people feel comfortable voicing opinions and concerns. It is important that family and nonfamily members have an equal opportunity to express their views.
- **Employing Family and Nonfamily Members**. It is natural for a family business to employ family members, especially in management positions. Family members tend to be the first people hired when a small business gets started, and as the business grows, so do their roles. There are both pros and cons to hiring family members. Both need to be considered carefully. Who to hire may well be the biggest management challenge that a family business owner faces.
- **Hiring Nonfamily Members**. There will be times when the better decision may be to hire a nonfamily person for a particular job. Experience has shown that a family business is less likely to be successful if it employs only family members; bringing in the fresh thinking that comes with external expertise can be valuable at all levels of a business. In addition, nonfamily members can offer stability to a family business by offering a fair and impartial perspective on business issues. Because it is likely that a growing family business will need to hire people from the outside, it is important that the business come to terms with that necessity. Policies and procedures can help with the transition, but the most important thing is to prepare the family culture of the business to accept a nonfamily member. Not surprisingly, this is much easier said than done.

- **Professional Management**. The decision to hire a professional manager is one of the most important and difficult hiring decisions that a family business owner will have to make. The typical definition of professional managers equates them with external, nonfamily, no owner managers, thus declaring professional management and family management as mutually exclusive. There are several problems with this way of thinking.
    1. First, it perpetuates the outdated notion that family members are not professional, that the smartest thing for a family business to do is to bring in professional management—as quickly as possible.
    2. Second, professional managers are not always prepared to deal with the special nature of family-owned businesses. This does an injustice to the unique workings of a family-owned business.
    3. Third, a professional manager from the outside is not always prepared, perhaps not even most of the time, to deal with the special nature of family companies. The dominant view on professional management downplays the importance of the social and the cultural context. The hiring of an outside manager, therefore, should include an assessment of both formal competence and cultural competence. Formal competence refers to formal education, training, and experience outside the family business. Although it is certainly helpful and appropriate, formal competence is not sufficient for managerial effectiveness. It needs to be supplemented with cultural competence, an understanding of the culture of a specific firm. One concern of family businesses may be that the hiring of a nonfamily manager will result in the loss of their "familiness."
- **Employment Qualifications**. One of the more difficult challenges that a family business must face is determining employment qualifications for employees, both family and nonfamily. The lack of a clear employment policy and process can lead to major conflicts in the company. Unfortunately, it would appear that, despite their benefit, most family businesses have a family employment policy. As a result, many family businesses may end up with more employees from the family than the company needs, and some of these people may not even be qualified or suitable for the jobs they have been given. A written family-business employment policy can solve a myriad of problems because it spells out the specific terms for family and nonfamily members with respect to recruiting, hiring, promoting, compensating, and terminating. There are no rules that dictate the content of family business employment policy, so differences from one family business to another can be expected. The benefits of an employment policy notwithstanding, the idea may be met with resistance. There may be the feeling that hiring decisions for family members should be separate from the hiring decisions for nonfamily members because being a family member provides special qualifications that cannot be matched by someone outside the family. How to proceed will ultimately fall on the shoulders of the family business owner.
- **Salaries and Compensation**. As difficult as hiring decisions may be for the family business, decisions about salaries and compensation are probably even worse. No matter how well intentioned and well designed the company's compensation plan may be, there will still be jealousies, hard feelings, severed sibling relationships, and even lawsuits, particularly among those family members who feel they have been treated unfairly.

Family businesses often make several common mistakes when developing their compensation plans. They consider fair compensation to be equal compensation for all family members, sometimes even for the owner. This creates a very sticky situation because not all family members have treated equally.

Family members employed in the business will be paid according to the standards in our region, as reported by our trade association, for a specific position, in companies of our size. In order to retain good employees we will pay all employed family members and other managers within the top quartile of our industry's standards. Additional compensation will be based on success in reaching specific company goals, with bonuses shared among all members of the management team. Individual incentives will be determined according to measurable goals for job performance determined each year, and reviewed by the appropriate manager.

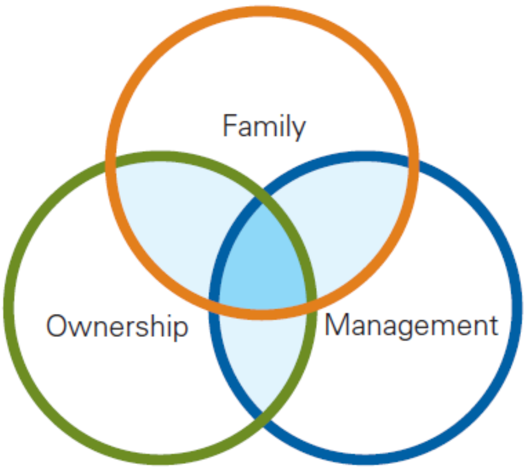
Another important issue that is particularly difficult for family businesses is succession. As mentioned, succession is about passing the business to the next generation. Decisions have to be made about who will take over the leadership and/or ownership of the company when the current generation dies or retires. There are family businesses that manage the transition across generations quite easily because the succession process chooses only the children willing and able to join and work with the prevailing family, business values, and goals. Unfortunately, there are also instances in which children have had to leave school as soon as legally allowed, not equipped to manage the business, their lives, or their family.

These are powerful forces working against succession planning, but they need to be overcome for the good of the founder, the family, and the business. It will be tricky to balance the needs of all three and fold them into a good succession plan.

10.3 The Succession Plan

The Three Circle Model outlined below is often used to illustrate the interaction/impact of the family component on the management and ownership of family businesses. The Three Circle Model is represented by the ownership circle, the management circle, and the family circle.

Figure 51 Three Circle Model

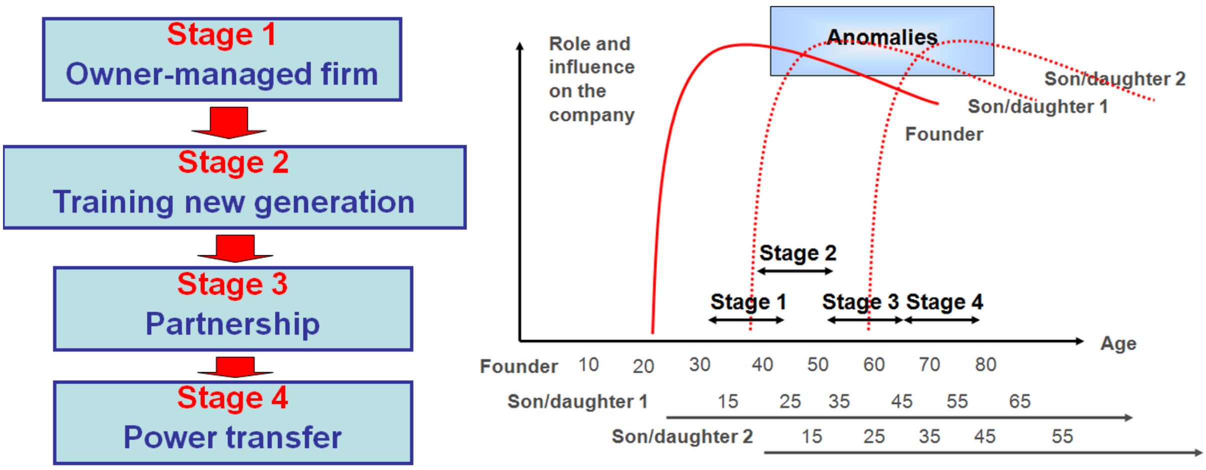


Source: Walsh, 2011 p.8

The ownership circle represents the interaction/impact that the owners have on the family and on the management of the business. The management circle represents the interaction/impact that management has on the family and on the ownership of the business. The family circle represents the interaction/impact that the family has on the management and ownership of the business. The ownership circle and the management circle are common to all businesses. The family circle is unique to family business and is what differentiates it from its nonfamily business counterparts. In many family businesses, the family permeates the management and the ownership of the business, making it a significant, if not the major component in the overall running of the family business. It is easy to see how the interaction between these three components can create family, management, and ownership challenges, as well as provide unique opportunities.

The Three Circle Model illustrates how each of the components interacts with each other and how all three circles meet in the middle, indicating that at some stage of the family business, ownership, management, and family are mixed together. The family business plan of succession comprises two processes, the 'management' succession process and the 'ownership' succession process. Numerous succession activities are outlined for each of the two processes to achieve the desired succession outcomes. The management and ownership succession processes can be undertaken simultaneously or one at a time.

Figure 52 Life cycle of Family Business



Source: Burns, 2007

It is recommended the management succession process to be carried out first so that the ownership succession plan reflects and supports the management succession. Although each succession plan will be different, the following components should be seen as necessary for a good succession plan:

- **Establish goals and objectives**. As the family business owner, you must establish your personal goals and vision for the business and your future role in its operation. You should include your retirement goals, family member goals, goals of other stakeholders (e.g., partners, shareholders, and employees), and goals relating to what should happen in the case of your illness, death, or disability.
- **Family involvement in the decision-making process**. If the family and stakeholders who are involved in the decision-making process are kept informed of the decisions being made, many of the problems related to inheritance, management, and ownership issues will be alleviated. Communication, the process for handling family change and disputes, the family vision for the business, and the relationship between the family and the business should be addressed. The surest path to family discord is developing the succession plan on your own and then announcing it.

- **Identify successor(s**). This section of the plan will address the issue of who takes over ownership and management of the business. Identification of the potential successor(s), training of the successor(s), building support for the successor(s), and teaching the successor(s) to build vision for the business are included here. Working with your successor for a year or two before you, hand over the business will increase the chances for success.
- **Estate planning**. Estate planning is important if you are planning to retire or want to take precautionary measures regarding the future of the business in the event you are unable to continue operation of the family business due to illness, disability, or death. You should consult a lawyer, an accountant, a financial/estate planner, and a life insurance representative so that your benefits will be maximized. You will need to consider taxation, retirement income, provisions for other family members, and active/no-active family members.
- **Contingency planning**. Contingency planning is about unforeseen circumstances. It is about strategizing for the most likely "what if" scenarios (e.g., your death or disability). By thinking in terms of the unforeseen, you will be taking a proactive rather than reactive approach.
- **Company structure and transfer methods**. This section of the succession plan involves the review and updating of the organizational and structural plan for the organization taking into account the strengths and weaknesses of the successor. The following needs to be identified: the roles and the responsibilities of the successor, the filling of key positions, structuring of the business to fit the successor, the potential roles for the retiring owner, any legal complications, and financial issues.
- **Business valuation**. This section is relevant only if the business is being sold. Passing the business to a family member would not involve a business valuation.
- **Exit strategy**. With any succession, ownership will be transferred, and you will remove yourself from the day-to-day operations of the business. Alternatives will be compared, and a framework for making your final choices will be developed. The transfer method and the timelines are decided. The exit plan should then be published and distributed to everyone who is involved in the succession process.
- **Implementation and follow-up**. The succession plan should be reviewed regularly and revised as situations change. It should be a dynamic and a flexible document.

As difficult as the planning process can be, the goal should be a succession plan that will be in the best interests of all—or most—of the parties involved. Business interests should be put ahead of family interests, and merit should be emphasized over family position.

10.3.1 SOURCES OF CONFLICTS AND EXIT

Several other sources of conflict can occur in a family-owned business. A sampling of those sources is discussed here. All have the potential to affect adversely family relationships, business operations, and business results.

Table 22 Potential sources of conflict

Family	Business
Emotional	Unemotional
Loyal	Self interest
Caring	Task based
Sharing	Reward performance
Inward-looking	Perform or leave
Lifetime membership	Outward-looking

Source: Burns, 2007

- **Rivalry.** Levinson (1971) maintains that, "the fundamental psychological conflict in family businesses is rivalry, compounded by feelings of guilt, when more than one family member is involved." This rivalry can occur between father and son, siblings, husband and wife, father and daughter, and in-laws with members of the family that own the business.
- **Differing vision**. Family members will often disagree with the founder and with each other about the vision and strategy for the business. Rivalries that spill into the workplace can get nasty, leading to destructive behaviours.
- **Jealousy**. There is always the potential for jealousy in the family business. It can arise from feelings of unfairness in such things as compensation, job responsibilities, promotions, "having the ear" of the business founder, and stock distributions. It can also arise with respect to the planned successor when there is a difference of opinion about who it should be. If it is not resolved, jealousy has the potential to divide the family and destroy the business.
- **Succession**. Succession is always a big obstacle for a family business. In some cases, the founder may feel that his or her children are not capable of running the business. This, in turn, becomes problematic for succession. It is also true that while the founder of the business wants to continue family ownership and leadership of the business, this may not be true of his or her immediate family or later-generation family members. (Davis, Harveston, 2001) This can create substantive conflict during succession planning.
- **Playing by different rules**. This cause of negative conflict "often presents itself as a form of elitism or entitlement that exists simply by virtue of being in a family that owns a business. Examples show up in allowing one or more family members to exhibit deficient standards of conduct or performance that violate sound business practices or important requirements that all other employees are expected to follow.
- **Decision making**. If roles and responsibilities are not clearly defined, conflict will arise over who can make decisions and how decisions should be made. This will lead to confusion, uncertainty, and haphazard decisions that will put the company at risk.
- **Compensation and benefits**. "This is one of the most frequent sources of conflict, especially among members of the younger generation." A person's compensation is inextricably linked to his or her feelings of importance and self-worth.

AVOIDING CONFLICT

Some measure of family squabbling is expected in a family business. Some of the arguments will be logical and necessary. The negative effects of family squabbling are as follows[33]:

- **Unprofessional image**. Family squabbling conjures up images of children - immaturity and pettiness. This sends a signal to customers and other employees that they are not in a professional environment that focuses on the right things.
- **Uncomfortable environment**. It is embarrassing to witness squabbling. No one likes to be in an awkward atmosphere; squabbling can cost you customers and employees, and it may result in expensive and unpleasant lawsuits. This can affect your bottom line very quickly.
- **Discrimination**. Nepotism is one of the biggest dangers of working in a family business. Arguing with relatives will only reinforce to other employees that they are in a family business. This can quickly lead to feelings of disparate treatment, which, in turn, can lead to discrimination charges.
- **Legal troubles**. In the worst cases of family squabbling, disagreements over business can lead to lawsuits. If one family member's role is minimized and his or her authority is restricted, this is violating the person's rights as a shareholder. This can lead to an oppressed minority shareholder suit against the family business. This would be expensive, it would be ugly, and it could lead to the demise of the company.

Avoiding conflict is no easy feat. However, a family business should consider several things. First, there are consultants who engage in conflict resolution for a living. The possibilities should be checked out. If the budget can handle the costs of a consultant, it could be the best choice. A consultant, having no reason to take one side or the other, will bring the necessary objectivity to resolution of the conflict.

EXAMPLE 10 CHILDREN AND ME

The founder of XYZ Company has decided to retire. He wants one of three children to take over leadership of the business—and he knows exactly, whom it should be. Other members of the family have their ideas as well. One segment of the family wants the oldest son, Michael, to take over, but the founder thinks Michael is a melon head.

The second son, Christopher, is a well-meaning and hard-working part of the business, but he just does not have what it takes to be a leader. Nonetheless, another group of family members favours him.

Samantha, the youngest child, is as sharp as a tack, with solid experience and accomplishments under her belt. On an objective basis, Samantha would be the best choice for the business. She is the founder's choice to take over the company and has other family supporters as well, although not as many as for Michael or Christopher. This is a situation tailor-made for conflict.

How does the founder finesse the selection of Samantha and minimize the conflict that is bound to occur? Can he win?

(based on Cadden and Lueder, 208, p.169)

[33] National Federation of Independent Business, 2010. *How Family Squabbling Affects Other Employees—and Customers*. [online] [Accessed: 23 Jan 2013].Available at: http://www.nfib.com/article/how-family-squabbling-affects-other-employees-and-customers-52150.

We have learned over the years that the best exit strategies for a family business are those for which the terms and conditions of the exit (death, disability, and voluntary exit) are pre-determined, agreed upon, and outlined in the shareholders agreement. This has proven to reduce much of the family conflict that can and does arise when a family member exits the ownership ranks of the family business. It also removes much of the uncertainty surrounding the impact to the business and to the family. As previously mentioned, in order to achieve this objective it may be necessary to forego tax efficiencies.

11 SOCIAL ENTREPRENEURSHIP

The concept of social entrepreneurship (SE) is, in practice, recognized as encompassing a wide range of activities as enterprising individuals devoted to making a difference from social purpose business ventures dedicated to adding for-profit motivations to the nonprofits sector, new types of philanthropists supporting venture capital-like ‘investment ‘portfolios; and nonprofits organizations that are reinventing themselves by drawing on lessons learned from the business world (Perrini and Vurro, 2006, p.58)

SE is a composite phenomenon and can initially be explained by the strengthening requests from various stakeholders to the non-profit sector to enhance its economic efficiency and effectiveness, as well as to the for-profit sector to encourage the adoption of socially responsible behaviour.

DEFINITION 16 SOCIAL ENTREPRENEUR

Social entrepreneur as ‘a path breaker with a powerful new idea, who combines visionary and real world problem solving creativity, who has a strong ethical fibre and who is “totally possessed” by his or her vision for change’ (Bornstein,1998, p.36)

Dees (1998, p.4) who defines social entrepreneurs as people whom: play the role of change agents in the social sector, by:

- Adopting a mission to create and sustain social value (not just private value),
- Recognizing and relentlessly pursuing new opportunities to serve that mission,
- Engaging in a process of continuous innovation, adaptation and learning,
- Acting boldly without being limited by resources currently in hand, and
- Exhibiting heightened accountability to the constituencies served and for the outcomes created.

11.1 SOCIAL ENTERPRISE AND THE SOCIAL ECONOMY

Social enterprise could be characterised as (Burns, 2007, p.456):

- Having a primary social purpose with a secondary commercial activity
- Achieving that purpose by engaging in trade
- Reinvesting profits in the enterprise or new social ventures
- Democratically involving members in governance
- Open accountability

This situation is shown in the figure below. The first system is private sector, which concentrates on trading with the maximum of profit as an objective. However, even this has its legal and illegal sectors. It operates from a local to a global basis. The second is the public services and government, which operates in a planned, non-trading way.

Figure 53 Three systems of economy

Source Burns, 2007, p.456

It is bureaucratic and inefficient. It also operates from a local to a global basis. The third system is the social economy that includes social enterprise, voluntary and charity organizations and the family economy. It is community based, could be planned, but is not homogenous.

DEFINITION 17 SOCIAL ENTREPRENEUR SKILLS

Who are they? Socially driven, ambitious leaders, with great skills in communicating a mission and inspiring staff, users and partners. In all cases, they have been capable of creating impressive schemes with virtually no resources. (Burns, 2007, p.457)

11.2 Typical behaviour of SE

Current literature agrees in recognizing three main steps, which, although typical of business entrepreneurship, take on anew value and therefore become useful in the overall comprehension of the SE phenomenon. They are:

- Opportunity definition.
- Organizational launch and functioning.
- Financial resource collection and leveraging.

These phases are not temporally consequent but can both follow one another in a very different order as well as be concomitant.

Opportunity definition

The first step of the SE process comprises opportunity definition: *the cognitive process followed by entrepreneurs as they intentionally identify a solution to a specific problem or need because of diverse motivations, including financial rewards*. Surprisingly, now, social entrepreneurial opportunity is the aspect of SE most explored by scholars. They consider entrepreneurial opportunities as ‘opportunities to bring into existence new goods, services, raw materials, and organizing methods that allow outputs to be sold at more than their cost of production’ and affirm that a central way to differentiate between traditional business entrepreneurship and SE is by looking at the identification of opportunities. In this sense, even if social opportunities share the same source as their business counterparts, that is, arising from unsatisfied needs whether they are social or not, in SE process the interest is centred on the possibility to 'meet a social need in a sustainable matter, and thus to (partially) alleviate social problems.

Hockerts (2006) identifies, in activism, self-help, and philanthropy, the three main sources of social entrepreneurial opportunities. In particular, an entrepreneur's previous personal experience combines with social needs, 'gaps between socially desirable conditions and the existing reality', social assets, and change to stimulate entrepreneurial ideas or innovations for social impact.

Finally, they identify three major types of social innovation.

1. The first, building local capacity, refers to the possibility of enhancing local conditions by giving power to underused local capacities: 'Local actors may solve many of their own problems given increases in local capacities'
2. The second consists of disseminating a package of innovations through the reconfiguration of products, resources and management practices into forms that fit better with local specificities.
3. Thirdly, they identify as socially innovative, the possibility to contribute in building a movement, giving voice to marginalized groups.

Table 23 Sources of opportunities

Opportunity	Main actors	Economic value proposition	Social value proposition
Activism	Activists	Provides moral legitimization to the social enterprise. Communication and distribution through activist networks	Social concerns championed by the activist group
Self-help	Beneficiaries	Cheap labour and marketing Cheap and patient capital Loyal and patient clients	Social needs or concerns of main beneficiaries of the social enterprise
Philanthropy	Donors	Charitable grants and donations Business development advice Networking with other	Social issues social defined by the donor entrepreneurs

Source: Hockerts, 2006, p. 144

ORGANIZATIONAL LAUNCH AND FUNCTIONING

The circle is closed only when, by adopting an opportunity-oriented mindset, SEs transforms a viable idea into a functioning organization. This leads us towards the next step of the SE process: organizational launch and functioning. To become concrete, a social innovation needs a social impact theory, a specific business model and a composite social strategy. However, it is possible to list some preliminary features that have been claimed as typical and specific of SE functioning:

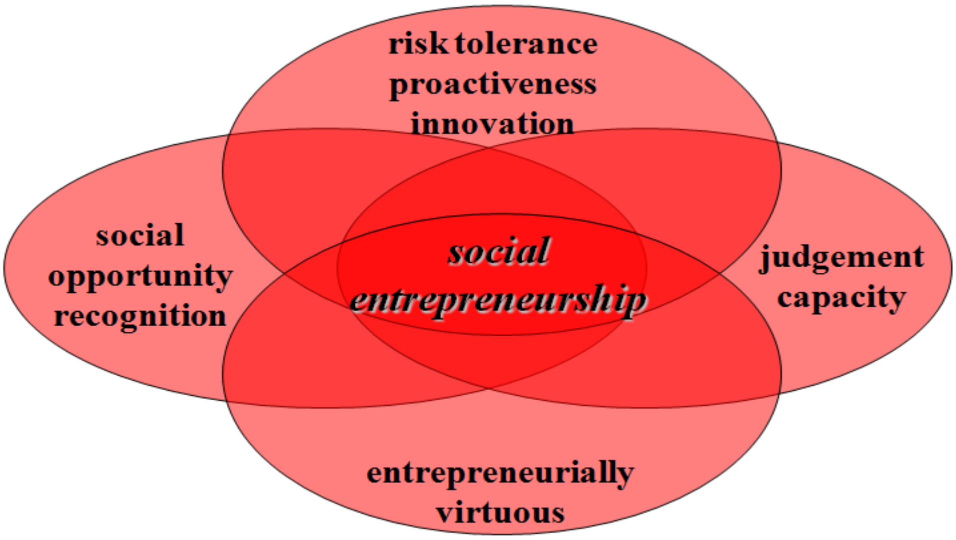
- SEs makes the production of goods and services on an ongoing basis, with a firm orientation towards problem solving and emphasis on the ability to obtain measurable results.
- A low dependence level and, therefore, a high level of autonomy characterize SEs: they may receive public grants but public actors do not manage them directly or indirectly.

- In the management of SEs, decisional power is not dependent on capital shares; individual behaviour aimed at profit maximization and company rights is generally excluded within SEs; powers are widened and shared by all stakeholders.
- Operations within SEs are based on a complex mix of monetary and nonmonetary resources (for example, volunteers) and are oriented towards a collaborative and participatory spirit.
- Partially tied to the former point, training and capacity building is crucial in all the phases of the SE process, because of both the difficulty to achieve skill replication and the consequent necessity to build an organizational environment in which competencies and skills can easily flow around.
- In general, practice shows how regularities in building organizational capacity are still not present. Even if SE initiatives vary considerably, the larger the organizational size, the more sophisticated are the organizational systems and arrangements. In any case, now, the organizational form does not seem to be the driver of social entrepreneurial character. On the contrary, the focus remains on the nexus among entrepreneurial aptitude, innovation, and social change and its results.

FINANCIAL RESOURCE COLLECTION AND LEVERAGING

The third major step of the SE process refers to the collecting and leveraging of financial resources. In parallel with analysis of the SE concept and features of SEVs, research on the financial aspects of SE and, in particular, on the innovative sources of such financing, are becoming widespread. Among others, the most quoted source of financing is a particular kind of patient capital social venture capital or venture philanthropy (VP).

Figure 54 Social Entrepreneurship concept



Source Burns, 2007, p. 457

11.2.1 ENTREPRENEURIAL MODEL

Looking at the way SE manage social transformation, the most evident component of the business style of SEs is their orientation towards the market. SEs declares they to be explicitly market driven, directing their efforts to customer and stakeholder satisfaction. Microcredit and community venture capital are two examples of what knowledge of the consumer base means for SEs. In looking for business where others (typically business actors) see nothing. SEs starts the entrepreneurial process from an explicit, combined evaluation of social and economic potential. In this sense, SEs declares them to start business by evaluating their own aptitude to help the community and their ability to be self-sustaining. The key to sustainability is constantly pursued through combining low costs with efficiency, quality and profitability.

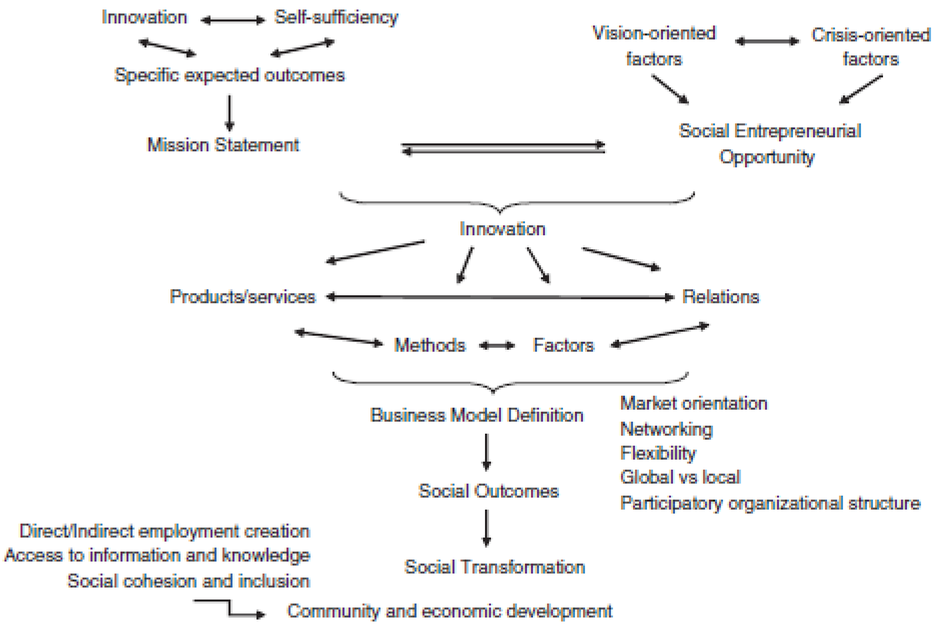
This tension also arises from a further characteristic element: the analysed SEs manifest rising trends and underline the adoption of a proper scalable business/social strategy. In particular, the growth attitude is considered to be strictly linked to three factors:

- **Networking**: SE´s share a strong attitude to sustain growth with partnerships and collaborations with non-profit partners, companies and public actors. The reasons that justify this behaviour are diverse. SE´s can tend both to eliminate duplicative costs and excess capacity through shared facilities, services or activities, or can be pushed by critical input combinations. In fact, no single entity has all the inputs necessary to address effectively an identified social need. Other reasons that explain partnership-orientation are to be found in the necessity to increase impact by bringing together complementary capabilities or, on the other hand, to enlarge market or client base sand also to acquire new expertise or enhance contractual power towards funding institutions.
- **Flexibility**: most of the SE’s organizational structures are extremely flexible, participatory and transparent. This characteristic can be explained by the newness that characterizes the phenomenon. In such a situation, where the scarcity of models of reference and acknowledged best practices makes the links among growth, innovation and the unpredictability of outcomes and impacts considerably strong, it becomes critical to share information and let it flow easily at each level of the organization in order to stimulate creativity.
- Balancing the local dimension with the global dimension: this last growth specificity has been noticed to be quite a constant of SE’s behaviour. To be sure, of not losing out in quality, SE´s tend to maximize impact at each site through a sort of tied-up diversification. In other words, they add new sites through a targeted new site development plan, often helping communities to independently replicate a community-built model. This can be read as an attempt to maintain a constant level of personality in the provision of social services and avoid the proved ineffectiveness of improving social conditions through standardized services.

In generalizing, we can say that SEs aim at creating an overall vision that embraces both non-profit and business culture. They constantly look for synergy, leveraging transferable skills and best practices, and business or social partners in order to enhance the general impact. They are based on a learning and participatory organizational structure, in order to promote innovative solutions. As a result, SE emerges as an extremely adaptive culture.

This objective is often supported by technology with a process of progressive dissemination and adaptation of technological progress to the different communities. Finally, a general consideration: as innovation, social change is anything but a one-dimensional construct. SEs tends to pursue voluntarily and involuntarily simultaneously, different social outcomes. In light of the argument developed so far in the shift from theory to practice, we can now suggest a tentative framework for the SE process, as follows (Figure 54):

Figure 55 SE process



Source: Perrini and Vurro, 2006, p.78

CASE STUDY 7 BIG ISSUE

The magazine The Big Issue is a weekly entertainment and news magazine styled like a commercial magazine, which is sold on the streets of many British cities by homeless people. The aim is to provide work for them so they can earn their own income. This is intended to raise their awareness for their own situation and poverty and their willingness to take over control of their lives again. Another (indirect) aim is to call attention to social grievances. The magazine is positioned through the quality of the thematic contents. It is not just designed as a means to the end of collecting donations.

The magazine is sold on the streets exclusively and not in shops or newspaper kiosks. When customers are asked if they want to buy the magazine they find themselves in a face-to-face situation with the vendor. The price of the magazine is 2 GBP (2, 50 Euro approximately). The street vendors buy the magazine for 1 GBP from the Big Issue Ltd. and sell it at a price of 2 GBP to the customers on the streets. Each (certified) new vendor receives short instructions for the sale of the magazine and 5 free copies (in London 10). Copies, which are not sold, cannot be returned and no money is refunded. Any further turnover of the magazine, for example from advertisements, is realized directly by the Big Issue Foundation.

The organization behind The Big Issue is divided into two parts: On the one hand, there is Big Issue Limited Company (Big Issue Ltd), which produces the magazine and sells it to a street vendor network. On the other hand, there is the Big Issue Foundation, a non-profit foundation that aims at helping the street vendors regain control of their lives. The Big Issue Foundation offers counselling services and references in the areas housing, health, financial independence and (career) expectations.

The government only to a minimum extent supports the Big Issue organization. The whole organization depends almost exclusively on (voluntary) donations. Without the generosity of the individual donors and charitable organizations, the magazine and the counselling services could not be provided. Currently the organization supports 2,900 homeless people all over Great Britain. Every week 670,000 copies of The Big Issue are sold. This magazine in its present form is (almost) unique in Great Britain now.

Is this an example of social entrepreneurship? If so, why?

Is the big issue a social enterprise?

Is the best response to the social problem?

Answers:

1. Yes. The definition of social entrepreneurship is 'the use of entrepreneurial behaviour for social rather than profit objectives'. Here we have a magazine start-up with the profits going to the homeless who sell the magazine. The definition fits.
2. Yes, because after initial pump priming it is primarily a self-funding response, it involves getting the homeless to work for their reward and finally because it is an innovative idea.
3. This is a big question because the Big Issue is only one part of the totality of the response needed to move the homeless into housing. How will the individual find their way back into other employment? Are there other social or psychological problems with the individual that need to be addressed? How will they find a home? Research indicates most homeless are there at least partly by choice, so how can that decision be reversed. Indeed, should we attempt to do so, or should the Big Issue simply be there to support the homeless in their chosen life style?

This is a list of the fields in which social transformation is expected to be reached in the social entrepreneurship:

- Arts, culture and humanities
- Children and youth
- Community and economic development
- Disaster relief
- Education and research
- Employment training
- Environment and sustainable development
- Health enhancement
- Homelessness
- Hunger and poverty relief
- Rehabilitative services

Yet these are only fields of action: to be more specific, what kinds of social transformation can be identified in current practice? Nevertheless, the contribution of SEs, in this sense, is not limited to the employment-training field, they may 'help in developing both demand and supply, as well as in reconfiguring public expenditure composition'. The fact that SEs often employs low-income or at-risk workers does not imply quality reduction or less attention to attracting the best skills.

On the contrary, these are major strengths of the SE approach. SEs adapt traditional business practices to unexpected resources that are not characterized by low growth potential but that only need to be stimulated and balanced in accordance with innovative approaches. Furthermore, SEs' social outcomes extend to the field of access to information. Especially, encouraged by those SEVs that work at the bottom of the pyramid, gaining access to information through technological progress is the main driver to enhance democracy and reduce overall asymmetry. Thirdly, SEVs can actually contribute to changing patterns of interaction in order to enhance social cohesion through personalization and participative approaches.

By contributing to solving or to alleviating the problems of specific groups, and by favouring the integration of disadvantaged people into the labour market with higher wages than those paid by sheltered employment workshops and sometimes for-profit companies, social enterprises also contribute to improving life conditions, the well-being of communities and the level of social integration'.

DANGERS IN SE

- Mixing social and commercial values – what is core mission?
- Conflict of social and commercial behaviour – which comes first?
- Over dependence on aid - sustainability?
- Impact of market values on democracy and citizenship – How to accounting for both market and social activities?
- The market model places too little emphasis on democratic ideals like fairness and justice

Remember, social business has the same life cycle as normal business unit without any social mission!

Figure 56 Life cycle of SE

Source: Burns, 2007 p.458

12 INNOVATIONS IN THE SMALL BUSINESS

Innovation is an important topic in the study of economics, business, sociology, and other social sciences. Since innovation is also considered a major driver of the economy, the factors that lead to innovation are also considered critical to policy makers.

Everybody has a good idea. Companies thrive and survive on good ideas. Those who place a priority on generating and acting on good ideas frequently assume market leadership. Too often, corporations allow good ideas - indeed, not-so-good ideas as well - to exist merely within the structure. They are treated as wisps and allowed to float unchecked. Companies often fail to consider ideas as a business asset and fail to care for them as they would other assets. In today's hyper-competitive business environment that can be a multimillion-dollar mistake. Companies owe it to themselves, their stockholders and their customers to consider turning the collection and development of ideas into an innovation management process, just as they would any other business operation (Hisrich et al.2010, p. 24-25)

Innovation management, however, is typically one of the last business processes within an organization to be systematized and computerized. Unlike other business processes, innovation can be highly difficult to manage, mostly due to the challenges associated with creating the ideal environment in which to foster innovation. Organizations that can capture the elements of innovation and systemize them create cultures that can outlast all other competitors. However, creating this culture is no easy task. It begins by creating innovation marketplaces, integrating multidisciplinary views into the innovation process and encouraging early data capture and decision making. In practical application, the basic tenets of innovation are sometimes hard to implement, but the results are well worth the effort.

In practice, for all the difficulty in creating an innovative environment, the rewards are even more spectacular, such as industry-beating profitability, growth and stock performance, not to mention employee career enhancement and personal satisfaction. Without a doubt, innovation is a purely human quality that can be nurtured and coaxed to bear fruit on behalf of the organization. This explains why innovation, radical innovation, is perhaps the only way to maintain competitive advantage in this fiercely competitive world.

Three types of innovation:

- Ordinary - New products with little technological change.
- Technological – New products with significant technological advancement.
- Breakthrough – New products with some technological change.

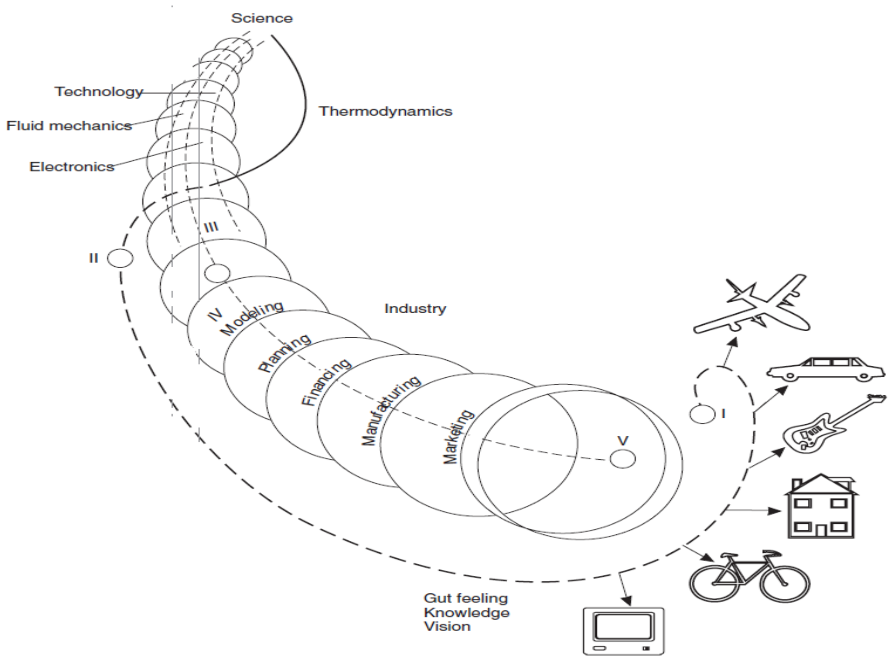
The innovation can be, of course, of varying degrees of uniqueness. Most innovations introduced to the market are ordinary innovations with little uniqueness or technology. As expected, there are fewer technological innovations and breakthrough innovations with the number of actual innovations decreasing as the technology involved increases. Regardless of its level of uniqueness or technology, each innovation (particularly the latter two types) evolves into, develops toward commercialization, and generates economic wealth.

In addition to dividing innovations into types, innovation is often characterized by its impact on existing markets or businesses. Sustaining innovations allows organizations to continue to approach markets the same way, such as the development of a faster or more fuel-efficient car. Disruptive innovations on the other hand, significantly change a market or product category, such as the invention of a cheap, safe personal flying machine that could replace cars.

Similarly, incremental innovation is evolutionary innovation, a step forward along a technology trajectory, with a high chance of success and low uncertainty about outcomes.

Radical innovation, on the other hand, involves larger leaps in the advancement of a technology or process.

Figure 57 Types of innovations



I Recognition of social need
II Initiation of technological innovation
III Iterative synthesis leading to invention (pressing toward invention)
IV Development phase
V Industrial phase

Hisrich et al., 2010, p.25

It is possible that small size will pose an advantage with respect to being more innovative. The reasons for this have been attributed to several factors (Cornwall, 2009):

- **Passion.** Small-business owners are interested in making businesses successful and are more open to new concepts and ideas to achieve that end.
- **Customer connection**. Being small, these firms better know their customers' needs and therefore are better positioned to meet them.
- **Agility**. Being small, these firms can adapt more readily to changing environment.
- **Willingness to experiment**. Small-business owners are willing to risk failure on some experiments.
- **Resource limitation**. Having fewer resources, small businesses become adept at doing more with less.
- **Information sharing**. Smaller size may mean that there is a tighter social network for sharing ideas.

In business and economics, innovation is often divided into five types:

- **Product innovation**, which involves the introduction of a new good or service that is substantially improved. This might include improvements in functional characteristics, technical abilities, ease of use, or any other dimension
- **Process innovation** involves the implementation of a new or significantly improved production or delivery method.
- **Marketing innovation** is the development of new marketing methods with improvement in product design or packaging, product promotion or pricing.

- **Organizational innovation** (also referred as social innovation) involves the creation of new organizations, business practices, and ways of running organizations or new organizational behaviour.

Innovation systems are also highly sensitive to disruption. People are not typically judged on how well they innovate. Although the concept is difficult to embody in software, careful understanding of the cultural and political aspects of the organization will lead to higher and sustained participation on the part of the inventors. There are companies responding to this new practical view of innovation management with software that empowers businesses and their employees with the ability to manage their innovation assets or commercialization assets - intangible assets - under similar demands as their physical asset counterparts.

Considering the nature of the innovation process, one of the most critical aspects is building a process that is respected within the organization. People look for consistency and respect in everything they do, from the law to how they deal with their children. Universally, if a person believes that he or she is being treated fairly and the process is fair, even if the outcome is not what he or she wanted, it is possible to feel still satisfied with the result.

The process by which innovation is captured, managed and mediated must be equally respected. If employees believe their ideas are judged differently than others or if they never receive feedback, they lose respect for the process and eventually stop participating. The leading downfall of "idea collection" applications is that there is a huge turnout for the first couple of months, and then the submission rate slowly falls until it is near zero.

To offset this, people must believe that their submissions are beneficial to their own goals in addition to the organization goals. (Think of the "what's in it for me" syndrome.) By nature, people do not usually like to waste time on activities with little or no obvious personal benefit. How do people decide that something has a benefit? They receive clear, timely feedback about their input; they perceive that success is attainable based on merit and not based on politics; and success results in positive reinforcement in the form of recognition, participation in the success, job security and financial well being. Management must listen and respond to all high-quality suggestions - it is critical for repeat participation.

The majority of individuals do require some guiding principles to use to spur new thinking. Management support is also needed to outline and clarify the strategic goals of the organization with regard to its business objectives. A methodology of communicating these goals to the company at large should be established to reinforce the stated direction of the company. The market-facing groups must also have the ability to broadcast the voice of the customer to the company, focusing the innovative process on real and tangible targets. Providing a mechanism that cultivates this type of communication creates that "innovation community" environment enabling the full use of the creative talent and tacit knowledge within the organization.

Innovation in business is achieved in many ways, with much attention now given to formal research and development for "breakthrough innovations." However, innovations may be developed by less formal on-the-job modifications of practice, through exchange and combination of professional experience and by many other routes. The more radical and revolutionary innovations tend to stem from R&D, while more incremental innovations may emerge from practice - but there are many exceptions to each of these trends.

Another key source of innovation is user innovation, innovations developed by individuals when existing products do not meet their current needs. User innovators may become entrepreneurs, selling their product, or they may choose to freely reveal their innovations, using methods like open source. In such networks of innovation, the creativity of the users or communities of users can further develop technologies and their use.

Encouraging, rather than allowing, employees to use unsupervised, freethinking time to dream and develop the next product or business concept or participate in the analysis of ideas is a powerful ingredient in this innovation recipe. For example, it is widely known that 3M encourages employees to spend no less than 15% of their time at work developing their own new ideas and projects. This policy helps make 3M an industry leader in innovation.

Categorizing an innovation management system according to its functionality and architecture in an organizational environment helps an organization decide what system of innovation management is right for them. When the system needs to be deployed to a large audience, the employee's experience, expectations and requirements are broad and, consequently, the application must accommodate all possible situations. Depending on the view of innovation and its relative importance within the organization, there will be a natural equilibrium with respect to software complexity.

Many current processes for capturing and managing innovation and its associated intellectual property are surprisingly archaic. Some help companies decide early on (prior to significant investment) which assets to focus on - and, importantly, which assets to discard. This saves money once earmarked for those irrelevant technologies, but also produces a by-product of focus and corporate alignment for priority technologies. Benefits seen through a successful innovation management program include early "kill" decisions, overall better record management, better overall company understanding of corporate direction, cultural improvement, better corporate compliance, governance and accounting of intangible assets and more effective utilization of intangibles in the commercialization process.

Leading companies have moved to advanced levels of innovation asset management deploying true multidisciplinary approaches, incorporating business, legal and technological views into the commercialization process at the earliest relevant moments. Many desire a system that is capable of expanding across their enterprise, and that can handle the complex business processes associated with orchestrating the innovation process from unmet market needs to breakthrough products.

A successful system, capable of handling those business processes, must incorporate software, methodology and approach, and be able to provide companies with an upfront understanding of opportunity areas, enabling refined workflow, capture, catalogue and evaluation of innovation assets, incorporating all relevant views (i.e., legal, technological and business) into the process. The result is better overall understanding of innovation assets of all types, properly catalogued, valued and propagated downstream into established commercialization and IP docketing processes.

Innovation is traditionally related to products and processes. This is "new technology". New technology disrupts traditional business models, machineries and a trained workforce. Any innovation, gadget or contrivance can turn in to disruptive technology if it has the following basic qualities.

- It expands the scope of operations at negligible cost.
- Common employees can comfortably use the technology with nominal training.
- It cuts down cost, efforts, time and/or all three involved in performance of any remunerative activity.
- Inputs required to implement the technology are available abundantly at low cost.
- It is difficult to patent the technology.

Any new technology with any one of the above attributes can disrupt existing systems. Any technology that bears all these attributes is highly disruptive.

Innovation has no bar in time and place. It can transform anything at any time. It can upset centuries old traditions in one single stroke of intellectual application. Innovative thinking is a genetic inheritance, which cannot be learned. An innovative person is always thinking of doing something new or doing it in new manner. If he has resources to implement his thinking he will do so, else he will wait until he gets those resources. The intellectual process involved in innovation may be complete; resource constraint may compel it to be implemented at later date. Resource allocation fuels innovation during boom times. Survival instinct fuels innovation in doom times.

Broad level innovation can be classified in three categories.

- **Expected innovation**. This is something that everyone wants. We want a cure for Aids, we want a substitute for fossil fuels, etc., etc., these innovations are project specific. There is conscious allocation of specific resources and definite period to complete it. We are aware of it and we are prepared for it. Boom times fuels this type of innovation.
- **Unexpected innovation**. When normal processes go haywire, a normal person will take steps to bring them to normalcy. An alert and flexible mind can spot implication of abnormal processes and define how they can be advantageous in a different context. Chance impurities in chemical process can lead to the synthesis of new product, which may have value in different application. Lots of innovation has come thru analysis of waste realized from misfired processes.
- **Innovation in process of evolution**. Each product or process is not complete and appropriate at all times. As time marches on, environment changes, market requirements alter, processes demand change etc., etc. Each product and process has to evolve to survive and fulfil the market demands. This evolution is possible thru innovation in product design and process parameter.

Innovation in all three categories has drastic implications for entrepreneurs. It sends traditional products and services into oblivion, plant and machinery becomes redundant, technology becomes outdated, work force becomes useless and highly profitable enterprise is faced with red balance sheets.

This does not mean innovation is bad. It spells doom for those who are not innovative themselves. When scientists and technologists burn candles to innovate products and processes; an entrepreneur has to burn his candles to innovate management practices. Luckily, innovation in management practices can be learned. All you have to do is change the mindset - your own mindset and that of everybody in the organization, right from peon to the managing director.

Successful implementation of innovative management practices can help an enterprise to change and effectively exploit opportunities created by new technology to mint money.

Innovation in management of business includes:

- Definition of new application of existing products and services offered by the company. Effectively this implies innovation of new market segment.
- Definition of new application of existing resources. The men, machine, material and technology can be effectively redeployed to gainful purposes.
- Definition of probable new application to which existing resources can be applied with slight modification to enhance returns.

12.1 Protection of Innovation

The inability of competitors to imitate a strategic resource is a key to leveraging the resource to achieve long–term competitive advantages. Companies are clever, and effective imitation is often very possible. However, resources that involve intellectual property reduce or even eliminate this risk. As a result, developing intellectual property is important to many organizations.

Intellectual property refers to creations of the mind, such as inventions, artistic products, and symbols. **The four main types of intellectual property are patents, trademarks, copyrights, and trade secrets.** If a piece of intellectual property is also valuable, rare, and no substitutable, it constitutes a strategic resource. Even if a piece of intellectual property does not meet all four criteria for serving as a strategic resource, it can be bundled with other resources and activities to create a resource.

A variety of formal and informal methods is available to protect a firm's intellectual property from imitation by rivals. Some forms of intellectual property are best protected by legal means, while defending others depends on surrounding them in secrecy

DEFINITION 18 PATENTS

Patents[34] are legal decrees that protect inventions from direct imitation for a limited period. Obtaining a patent involves navigating a challenging process. To earn a patent from the US Patent and Trademark Office, an inventor must demonstrate than an invention is new, no obvious, and useful. If the owner of a patent believes that a company or person has infringed on the patent, the owner can sue for damages. Patents can be renewed for a maximum of 20 years.

DEFINITION 19 TRADEMARKS ®, ™

Trademarks ®,™are phrases, pictures, names, or symbols used to identify a particular organization. Trademarks are important because they help an organization stand out and build an identity in the marketplace. Some trademarks are so iconic that almost all consumers recognize them, including McDonald's golden arches, the Nike swoosh, and Apple's outline of an apple. Trademarks have to be renewed every 10 years.

Trademarks are important to colleges and universities. Schools earn tremendous sums of money through royalties on T-shirts, sweatshirts, hats, backpacks, and other consumer goods sporting their names and logos. On any given day, there are probably several students in your class wearing one or more pieces of clothing featuring your school's insignia; your school benefits every time items like this are sold.

DEFINITION 20 COPYRIGHTS ©

Copyrights © provide exclusive rights to the creators of original artistic works such as books, movies, songs, and screenplays Sometimes copyrights are sold and licensed. Copyright does not protect ideas. The work must be fixed (e.g. written or recorded). There is no official registration system for copyright. It is an automatic right. A Copyright work could be marked with ©, the owner's name, and the year it was created.

DEFINITION 21 TRADE SECRETS

Trade secrets refer to formulas, practices, and designs that are central to a firm's business and that remain unknown to competitors. Trade secrets are protected by laws on theft, but once a secret is revealed, it cannot be a secret any longer. This leads firms to rely mainly on silence and privacy rather than the legal system to protect trade secrets.

[34] *Intellectual Property Office - Trade marks*. [online] [Accessed: 23 Nov 2013]Available at: http://www.ipo.gov.uk/types/tm.htm

DEFINITION 22 REGISTERED DESIGN

A Registered Design grants exclusive rights in the look and appearance of your product. You can stop people making, offering, putting on the market, importing, exporting, using or stocking for those purposes, a product to which your design is applied.

It looks very simple in theory, but it is very difficult to implement in practice. Just as "if someone invents a car to move from place to place, you don't flog your horse to beat the car.' That way your horse will probably die and you have to walk on foot. The smart thing to do is to sell your horse and something else along-with it at first available chance to buy a car". This applies to everything that an enterprise does. Nobody can change equipments, systems and work force overnight. The process has to be gradual. This is where innovative management practices are most effective.

Innovation is the implementation of a new or significantly improved idea, good, service, process or practice that is intended to be useful. Scholars who have studied innovation generally differentiate among five main types of innovation: product innovation, process innovation, organizational innovation, marketing innovation and business model innovation.

SOLVED EXERCISE 6 LEGO COMPANY

LEGO[35] – the well-known children's building system – has been around for a long time and, in an age when new toys come and go with astonishing rapidity and technology-based toys like video games; are reaching astonishing heights of sophistication, it might be difficult to understand the enduring market appeal of these basic building blocks. Well the answer is that LEGO has changed with the market and the company, currently owned by the founder's grandson Kjeld Kirk Christiansen, continues to invest large sums around the world to understand changes in children's tastes and to explore new product developments based around its mission 'to inspire children to explore and challenge their own creative potential'.

Concept and product development take place primarily at the Concept Centre within the company's headquarters in Billund. This creative core is made up of 120 designers representing about 15 nationalities, most of who trained at art school. The company also has what it calls 'listening posts' – otherwise known as Concept Labs – in Munich, Barcelona, Los Angeles and Tokyo. At these Labs children from four very different countries are encouraged to try out different combinations with the same LEGO pieces and create worlds of their own, which the company can incorporate into its 'play themes'. The Labs try to spottrends in children's play, to understand the motivations behind this and to translate them into what it means for the company and new product development – effectively trying to understand systematically children's creativity by observing them at play. The Labs also take an active role in the product concept and early development phase of any new product.

1 Why is innovation important to each of these companies?

2 How do they link creativity and innovation with market opportunities?

3 What are the lessons for a start-up business?

Possible answer:

1. Innovation is important to all three firms but for different reasons. Lego needs to innovate to keep abreast of how children play. This helps them influence their marketing (just look at the web site to see how they 'suggest' children might play with their products) and their product development.

2. This is a very difficult question with no easy, straightforward answer. Only the issues can be explored with these three mini cases. Lego links creativity and innovation with

[35] Burns, P.,2011.

developments in the market place. Lego observe how children play with their products. They use the creativity of some children to develop 'play themes' and to pass these on to others about how they might use Lego – go to the web site. They also use children to both see opportunities to develop new products, understanding children's motivations about how the product is used, sometimes unsuccessfully, by children to play games and to try out new products Lego have developed.

3. These are enduring big firms. Lego spends a lot of time observing children at play, understanding their motivations, trying to spot new trends. They stay close to their customer.

12.2 INNOVATION MANAGEMENT

Innovation management is an important part of growing your business. You need to understand the specific techniques and strategies that you can implement to get the most out of your innovation activities.

- Scanning the Market

Market scanning refers to recognising emerging or future markets, analysing your own target market for changes and looking for commercial opportunities. Market scanning not only helps you to identify opportunities, but to recognise also the potential threats to your business.

- Research and Development Managing Innovation

Research and development plays a key role in the innovation process for many organisations.

1. Research - a systematic approach to gaining new knowledge or building a better understanding of concepts.
2. Development - the process of applying and using the research and knowledge to generate new ideas that can be applied in the market.

Research and development plays an important part in gaining a competitive advantage. Without investing in some form of R&D, you are relying on others to come up with new ideas, new products and new technology. This puts your organisation at a disadvantage as you are forever playing catch up with your competition, merely copying what works and not being a leader in your field.

- Managing Innovative Projects

The effective management of an innovative project is crucial to its success. A good manager will be able to take good ideas forward and work with the team to develop a product with market potential. Even a great idea will fail to reach ever its potential if each stage of the innovation process is not managed in a coordinated manner.

Effective management of innovative projects involves:

- Identifying processes and policies that your team can follow when implementing ideas.
- Developing a work plan for every project and implement procedures to work within specified periods.
- Developing budgets and constraints to control costs and resources.
- Efficiently utilising resources and delegating tasks effectively to ensure the skills and experience of your team are utilised to maximum effect.

SUMMARY

In recent decades, the role of entrepreneurs has been considered of very great significance in accelerating the pace of growth and economic development in both developed and developing countries. An entrepreneur is a person who perceives opportunities, organises the resources needed to develop the opportunity and sets up an enterprise. The process of setting up an enterprise is called entrepreneurship.

An enterprise is a business venture. It is an undertaking that involves uncertainty and risk as well as innovation. An individual has the right to choose any income generating activity or self-employment or entrepreneurship as a career option. Functional income generating and self-employment activities are the initial stages of entrepreneurship.

The most important functions of an entrepreneur are innovation, risk and uncertainty bearing and organisation building. An entrepreneur usually has to perform all the functions of production, marketing, finance, human relations etc. particularly at the time of the start-up and establishing the enterprise.

After studying this textbook, you will not have obtained a set of instructions on how to secure the success of your business plan, but you will have learned how to eliminate potential problems in your future business and how to discover these problems.

Secondly, you will understand the uniqueness of small businesses and their dominant position in the labour market. You will learn the initial steps of opportunity evaluation before you decide to start up a business.

Finally you will understand that external and internal factors exist which have an influence on the business. The decisions in the case of retail or wholesale businesses are also different. When you establish a business, the motivation is to ensure your business grows. It is important to recognize the lifecycle of your business and prevent any future crisis by preparing a proper strategy and business model.

THE LIST OF LITERATURE

ARROW, K. J. and F. HAHN, 1971. *General competitive analysis*. San Francisco: Holden-Day.

BAARD, V. C., A. VAN DEN BERG, 2004. Interactive information consulting system for South African small businesses–Part 1. *SA Journal of Information Management* [online]. **6** (2), 1-27 [Accessed: 10 Jan 2014]. ISSN 1560-683X. Available at: http://www.sajim.co.za/index.php/SAJIM/article/view/385

BARWISE P. and S. MEEHAN, 2010. The One Thing You Must Get Right When Building a Brand. *Harvard Business Review*, **54** (12), p.80–84. ISSN 0017-8012.

BLACKFORD, M. G., 2003. A *history of small business in America*. 2nd ed. Chapel Hill: University of North Carolina Press. ISBN 08-078-5453-0.

BORNSTEIN, D. 1998. Changing the world on a shoestring. *Atlantic Monthly*, **281**(1), p. 34–39. ISSN 1072-7825.

BROWN, C., 1996. The Dos and Don’ts of Writing a Winning Business Plan. *Black Enterprise*, **26**(4), p. 114–122. ISSN 0006-4165.

BURNS, P. 2007. *Entrepreneurship and small business*. Basingstoke : Palgrave. ISBN 14-039-4733-3.

BURNS, P., 2011. *Entrepreneurship and small business: start-up, growth and maturity*. 3rd ed. New York: Palgrave Macmillan. ISBN 978-023-0247-802.

CADDEN, D. T. and S. LUEDER, 2008. *Small business management in the 21st century*. 3rd ed. Irvington: Flat World Knowledge. ISBN 978-145-3345-542.

CASALS, F.E. 2011. The SME Co-operation Framework: a Multi-method Secondary Research Approach to SME Collaboration. International Conference on E-business, Management and Economics. IPEDR IACSIT Press, Hong Kong pp. 118-124 [online] [Accessed: 25 Jan 2014].Available at: http://www.ipedr.com/vol3/25-M00036.pdf.

CHANDLER, A. D., 1962. *Strategy and structure: chapters in the history of the industrial enterprise*. Cambridge: M.I.T. Press.

CHUNG, K. YR and W. TIBBEN, 2006. Understanding the Adoption of Clusters by SMEs using Innovation Theory. The 3rd IEEE International Conference on Management of Innovation and Technology (ICMIT 2006),Singapore, 21-23 June 2006, [online] 1, pp. 389-393 [Accessed: 25 Jan 2014].Available at: http://ro.uow.edu.au/infopapers/545/

CHURCHILL, N. C. and V. L. LEWIS, 1983. The Five Stages of Small Business Growth. *Harvard Business Review* **27**(3): p. 30–44, 48–50. ISSN 0017-8012.

COLLINS, K. 2008. *Exploring business*. Upper Saddle River : Pearson. ISBN 01-314-0365-6.

CORNWALL, J., 2009. Innovation in Small Business. *The Entrepreneurial Mind* [online], March 16, 2009, [Accessed: 10 Nov 2013] Available at: http://www.drjeffcornwall.com/2009/03/16/innovation _in_small_business/.

DAVIS, P. S. and P. D. HARVESTON, 2001. The Phenomenon of Substantive Conflict in the Family Firm: A Cross-Generational Study. *Journal of Small Business Management* **39** (1) p. 14–30. ISSN 1540-627X.

DEES, J. G. 1998. *The meaning of social entrepreneurship*. [online] Center for the Advancement of Social Entrepreneurship, Fuqua School of Business, Duke University, Durham. [Accessed: 10 Nov 2013]. Available at: http://www.fuqua.duke.edu/centers/case/documents/dees_SE.pdf.

DOLLINGER, M. J. 2003. *Entrepreneurship*. Upper Saddle River: Prentice Hall. ISBN 978-097-1313-064.

EU COMMISION, 2005. *The new SME definition: user guide and model declaration*. Luxembourg: Office for Official Publications of the European Communities. ISBN 92-894-7909-4.

FILION, L.J. , 2011. Defining the entrepreneur. In Dana, L. P. *World encyclopedia of entrepreneurship*. Cheltenham: Edward Elgar. p.41-52. ISBN 978-085-7935-939.

GIERSZEWSKA, G. and M. ROMANOWSKA, 2009. *Analiza strategiczna przedsiębiorstwa*. Warszawa: Polskie Wydawnictwo Ekonomiczne. ISBN 978-832-0818-246.

HAMBRICK, D. and J. FREDRICKSON, 2001. Are You Sure You Have a Strategy? *Academy of Management Executive* **15**, (4) p. 48-59. ISSN 0896-3789.

HANDLER, W. C., 1994. Succession in Family Business: A Review of the Literature. *Family Business Review*, **7**(2) p.133–157. ISSN 0894-4865.

HARRISON, W. T., C. T. HORNGREN and C. W. THOMAS, 2010. *Financial accounting*. Upper Saddle River : Pearson Prentice Hall. ISBN 978-981-0685-515.

HISRICH, R. D. and M. P. PETERS, 2002. *Entrepreneurship*. Boston: McGraw-Hill. ISBN 978- 00-712-6768-9.

HISRICH, R. D., M. P. PETERS, and D. A. SHEPHERD, 2010. *Entrepreneurship*. New York: McGraw-Hill. ISBN 00-712-6768-9.

HOCKERTS, K. Entrepreneurial Opportunity in Social Purpose Business Ventures. In MAIR, J., J. ROBINSON and K. HOCKERTS. *Social entrepreneurship*. Basingstoke : Palgrave Macmillan p.142-152. ISBN 14-039-9664-4.

HORMOZI, A.M., G.S. SUTTON, R. D. MCMINN and W. LUCIO, 2002. Business Plans for New or Small Businesses: Paving the Path to Success. *Management Decision*, **40**(8) p.755 - 763. ISSN 0025-1747.

IVANCEVICH, J. M. and T. N. DUENING, 2004. *Business*. Cincinnati: Atomic Dog Pub. ISBN 15-926-0043-3.

KATZ, J. A. and R. P. GREEN, 2009. *Entrepreneurial small business*. Boston: McGraw-Hill. ISBN 978-125-9060-618.

KERR, S., 1995. On the folly of rewarding for A, while hoping for B. *Academy of Management Executive,* **9**(1), p. 25–37 ISSN 0896-3789.

KETS DE VRIES, M. F. R., 1993. The Dynamics of Family Controlled Firms: The Good and the Bad News. *Organizational Dynamics*, **21**, (3) p.59–71. ISSN 0090-2616.

KOTLER, P. and K. L. KELLER, 2009. *Marketing management*. Upper Saddle River: Pearson Prentice Hall. ISBN 01-313-5797-2.

KURATKO, D.F., 2009. *Entrepreneurship: theory, process, practice*. 8th ed. South-Western Cengage Learning. ISBN 03-245-9823-8.

KURTZ, D. L. and L. E. BOONE, 2011. *Contemporary business*. 14. ed., Internat. student vers. Hoboken: Wiley. ISBN 978-047-0873-762.

LASCU, D. and K. E. CLOW, 2008. *Essentials of marketing*. 3rd ed. Mason: Cengage Learning. ISBN 14-266-2644-4.

LEVINSON, H., 1971. Conflicts That Plague Family Businesses. *Harvard Business Review* **15**(3) p. 90–98. ISSN 0017-8012.

LINDSTRÖM, M., 2005. *Brand sense*. New York: Free Press. ISBN 978-143-9103-456.

LUNDSTRÖM, A. and L. STEVENSON, 2005. *Entrepreneurship policy*. New York: Springer. ISBN 978-038-7242-026.

LUNDSTRÖM, A., M. ALMERUD and STEVENSON, L. 2008. *Entrepreneurship and innovation policies*. Örebro: Swedish Foundation for Small Business Research. ISBN 978-91-89301-245.

MADURA, J., 1998. *Introduction to business*. Cincinnati: South-Western College Pub. ISBN 978-032-4272-116.

McGOWEN, J. and M. Kelly, 2013. *BUSN: a guide for small business*. Mason: South-Western. ISBN 978-113-3188-926.

MROSKO, T., 2006. The personnel puzzle: Preemployment testing can help your bottom line. Inside Business, **8**(8), p. 60–73. ISSN 0160-8533.

OBŁÓJ, K. 1999. *Strategia organizacji*. Warszawa: Polskie Wydawnictwo Ekonomiczne. ISBN 83-208-1187-2.

OHMAE, K,1982. *The mind of the strategist*. New York: McGraw-Hill.

OSTERWALDER, A., Y. PIGNEUR and CLARK, T., 2010. *Business model generation*. Amsterdam: Alexander Osterwalder & Yves Pigneur. ISBN 978-2-8399-0580-0.

PENDERGAST, W. R.,2003. Entrepreneurial Contexts and Traits of Entrepreneurs. In BAUM E. and C. McHARGUE (eds.) *Teaching Entrepreneurship to Engineering Students*. [online] ECI Symposium Series, Volume P02 (2003). p.39-53 [Accessed: 10 Nov 2013]. Available at: http://dc.engconfintl.org/teaching/8.

PERRINI F. AND C. VURRO, 2006. Social Entrepreneurship: Innovation and Social Change Across Theory and Practice. In MAIR, J., J. ROBINSON and K. HOCKERTS. *Social entrepreneurship*. Basingstoke : Palgrave Macmillan. p.57-87. ISBN 14-039-9664-4.

PÍCHA, K., L. SKOŘEPA and J. NAVRÁTIL,2013. Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis [online]. 61(4), pp. 1061-1068 [Accessed: 25 Jan 2014]. DOI: 10.11118/actaun201361041061. Available at: http://acta.mendelu.cz/61/4/1061/

PICKLE, H. B. and R. L. ABRAHAMSON, 1990. *Small business management*. New York: Wiley. ISBN 978-047-1502-401.

PINCHOT, G. and R. PELLMAN, 1999. *Intrapreneuring in action*. San Francisco: Berrett-Koehler. ISBN 15-767-5061-2.

PORTER, M. E. 1980. *Competitive strategy*. New York: Free Press.

RAE, D., 2007. *Entrepreneurship*. Houndnills, Basingstoke: Palgrave Macmillan. ISBN 978-140-3941-756.

RWIGEMA, H., B. URBAN and R. VENTER, 2008. *Entrepreneurship*. 2nd ed.Cape Town: Oxford University Press Southern Africa. ISBN 978-019-5983-548.

SAHLMAN, W. A., 2008. *How to write a great business plan*. Boston: Harvard Business School Press. ISBN 14-221-2142-9.

SAPIENZA, H., M. A. KORSGAARD and D. FORBES, 2003. The Self-Determination Mode of an Entrepreneur's Choice of Financing. In KATZ, J. A. and SHEPHERD, D. A. *Cognitive approaches to entrepreneurship research*. Amsterdam: JAI. p. 105–138. ISBN 07-623-1052-9.

SCHMITT, B. 1999. *Experiential marketing*. New York: Free Press. ISBN 978-8130914756.

SIRMON D. G. AND M. A. HITT, 2003. Managing Resources: Linking Unique Resources, Management, and Wealth Creation in Family Firms. *Entrepreneurship Theory and Practice*, **27** (4) pp.339-358. ISSN 1540-6520.

STOKES, D. and N. WILSON, 2010. *Small business management and entrepreneurship*. 6th ed. Andover: Cengage Learning. ISBN 978-140-8017-999.

STOREY, D. J., 2008. Evaluating SME policies and programmes: technical and political dimensions, In CASSON, M. *The Oxford handbook of entrepreneurship*. Oxford: Oxford Univ. Press. p. 248-278. ISBN 978-019-9288-984.

STRAUSS, JUDY, A. I. ANSARY and R. FROST, 2006. *E-marketing*. Upper Saddle River : Prentice Hall, 2006. ISBN 978-013-2806-466.

ŠÚBERTOVÁ, E. and D. GAJDOVÁ, 2010. Analysis of the forms the cooperation micro and small enterprises in the Slovak republic. Scientific papers of the University of Pardubice. Series D, Faculty of Economics and Administration. [online]. 17 (2), pp.317-327[Accessed: 25 Jan 2014]. Available at: http://hdl.handle.net/10195/38505.

TAVANA, M. and S. BANERJEE, 1995. Evaluating strategic alternatives: An analytical model *Computers* & *Operations Research*, **22** (7), pp. 731-743. ISSN 0305-0548.

THOMAS, L. 2011. *The McGraw-Hill 36-hour course online marketing*. New York: McGraw-Hill. ISBN 00-717-4386-3.

TIMMONS, J. A., S. SPINELLI, and A. ZACHARAKIS, 2004. *Business plans that work*. New York: McGraw-Hill. ISBN 978-007-1748-834.

WALSH, G., 2011. Family Business Succession Managing the All-Important Family Component. [online] 2011 KPMG, [Accessed: 20 Nov 2013]. Available at: https://www.kpmg.com/ca/en/services/kpmg-enterprise/centre-for-family-business/documents/3468_succession.pdf.

WEATHERLY, L., 2003. Human capital—the elusive asset; measuring and managing human capital: A strategic imperative for HR. *Research Quarterly* [online] **48** (3), 1-7 [Accessed: 10 Dec 2013]. ISSN 1047-3149. Available at: http://www.ispi.org/pdf/suggestedReading/6_Weatherly_HumanCapital.pdf.

WINSTON, S. 1979. *The entrepreneurial woman*. New York: Newsweek Books. ISBN 08-822-5259-3.

ENCLOSURE NO. 1 DETERMINE YOUR EQ (ENTREPRENEURIAL QUOTIENT)[36]

Definition: An "EN-TRE-PRE-NEUR" is an individual who creates, develops, and manages a business venture, with personal risk, for a potential profit.

Description: The EQ, more commonly known as the Entrepreneur Quotient, is a self-directed learning tool. It is not a test, but rather a method by which an individual can compare his or her own personal characteristics with those of successful entrepreneurs.

Instructions: Answer each question to the best of your ability. There is no time limit. Correct answers are given to each question to further stimulate your interest.

Interpretation: Remember, this is not a test. If you cannot answer any of the questions, do not be alarmed. You can learn to be an entrepreneur. For those individuals who prefer a scoring format, the procedure below provides rough guidelines.

1. As a child, did you have a paper route, sell candy or magazine subscriptions, or shine shoes for money? Yes ___ No ___
2. Did you come from a family that owned a business? Yes ___ No___
3. Do you have a relative who is in business? Yes ___ No ___
4. Have you ever worked for a small firm where you had close contact with the owner? Yes ___ No___
5. Are you between the ages of 16 and 44? Yes ___ No ___
6. Have you ever worked for a large company where you worked closely with a top manager? Yes___ No___
7. Have you ever been fired from a job? Yes ___ No ___
8. Do you have experience in organization, planning, budgeting, personnel, marketing, advertising, administration, or evaluation? Yes___ No___
9. If you are married, is your spouse supportive of the personal and financial risks involved in starting a business? Yes___ No___
10. Do you have a library of "self-help" success books? Yes ___ No___
11. Are you respected by your peers at work and by your friends in other areas of your life? Yes ___ No___
12. Are you inquisitive, inventive, creative, innovative, and aggressive? Yes___ No___
13. Do you enjoy solving problems? Yes ____ No ____
14. Would you rather be your own boss? Yes ___ No ___
15. Do you like to make things happen? Yes ___ No ___
16. Do you enjoy taking personal and financial risks? Yes ___ No ___
17. Were you a first-born child in your family? Yes ____ No ____
18. Are you male or female? Male ___ Female ___
19. Are you married or single? Married ___ Single ___
20. Do you consider yourself a free and independent spirit? Yes___ No___
21. Do you have a high need for achievement? Yes ___ No ___
22. Did you have a good relationship with your father? Yes___ No___
23. Small businesses employ more than 50 percent of the work force, generate 50 percent of all new jobs, and account for 44 percent of the gross national product. True ___ False ___
24. Do you take rejection personally? Yes ___ No ___
25. Do you like to move around a lot? Yes ____ No ___
26. Is it true that entrepreneurs make good managers? Yes ____ No____

[36] Based on Kuratko, 2009, chapter 2

27. To be a successful entrepreneur, an individual needs a lot of good luck. True____ False___
28. Successful entrepreneurs often use the advice of expert outside consultants.
True___ False____
29. Do you believe that you can control your own destiny? Yes___ No____
30. Are you a consistent goal setter and a results-oriented individual? Yes___ No____
31. Have you ever been forced to move, gone through a divorce, or suffered a death of a spouse or parent? Yes___ No___
32. Do you have specific experience in the area of business you plan to go into? Yes___ No___
33. Personal savings is the most important source of start-up funds for entrepreneurs.
True___ False___
34. Do you have managerial skills? Yes ___ No ___
35. Are you willing to work longer hours for the same salary you now make? Yes___ No___
36. Do you have a college degree or special skills and knowledge from a vocational or technical school? Yes___ No___
37. Do you know how to raise money for starting a business? Yes___ No___
38. Do you like people? Yes ___ No ____
39. Can you make quick decisions? Yes ___ No ___
40. Do you have a high energy level? Yes ___ No ___
41. Do your friends and acquaintances place a great deal of faith and trust in you? Yes___ No___
42. Do you follow through with implementation when a decision has been made? Yes___ No___
43. Do you believe in your own power to accomplish goals? Yes___ No___
44. Are you willing to change your negative habit patterns? Yes___ No___
45. Do you have high moral and ethical standards? Yes ____ No ____
46. Do you have a good idea or product and/or know how to get one? Yes___ No ___
47. Do you know how to tap the power of your subconscious mind? Yes___ No___
48. Are you dedicated and committed to being in business for you? Yes ___ No ___
49. Do you know how to develop a business plan for presentation to a group of investors?
Yes___ No___
50. Can you inspire and motivate other individuals? Yes ____ No ____
51. Do you know how to use radio, TV, direct mail, and space advertising? Yes___ No___
52. Do you know what the four Ps of marketing are? Yes ___ No ___
53. Are you familiar with the OPM (**O**ther **P**eople **M**oney) principle? Yes ___ No ___
54. Do you know how to multiply your talents? Yes ___ No ___
55. Do you know how the 20/80 rule affects success? Yes ____ No ____
56. Have you ever assessed your personality characteristics? Yes ___ No ____
57. Have you ever determined your net worth? Yes ___ No ____
58. Do you know what the 12 laws of universal success are? Yes___ No___
59. Have you ever explored your career potential? Yes ___ No ___
60. Do you believe in the power and success of self-directed learning? Yes___ No___
61. Do you wake up happy 99 percent of the time? Yes ___ No ___
62. Do you provide a period during each day for thinking, studying, planning, or relaxation?
Yes___ No___
63. Do you consider yourself ambitious? Yes ___ No ___
64. Do you enjoy power, control, and authority? Yes ___ No ___
65. Would you be willing to quit your job today and start at the bottom? Yes___ No___
66. Do you know how to determine the "break-even" point? Yes___ No___
67. Do you know what motivates customer behaviour and buying habits? Yes___ No___
68. Student organizations such as ATA, VICA, DECA, FFA, and others help students learn about entrepreneurship. True___ False___
69. Do you know where to get information on franchising? Yes___ No___

70. Do you know the rules of buying an existing business? Yes___ No___
71. Are you willing to follow a proven success system even if it differs from yours? Yes___ No___
72. The National Federation of Business is the largest small business organization in the United States. True___ False___
73. Can you accept failure without admitting defeat? Yes ___ No ____
74. Do you know how to project cash flow? Yes ___ No ___
75. Do you know how to read a balance sheet and profit and loss statement? Yes___ No___
76. Are you familiar with the current business and tax laws? Yes___ No___
77. Are you familiar with the laws affecting recruitment and selection of personnel? Yes___ No___
78. Do you know, or are you willing to learn, how to sell? Yes__ No___
79. Do you consider yourself enthusiastic, imaginative, and tenacious? Yes___ No___
80. Are you willing to participate in both the profits and losses of a business? Yes___ No___
81. Do you know how to protect your ideas from thieves? Yes___ No___
82. Do you have a savings account? Yes ___ No ___
83. Are you familiar with the principles of bartering? Yes ___ No ___
84. Are you familiar with the rules and laws pertaining to investments? Yes___ No___
85. Are you familiar with the 30,000 occupational titles in the United States? Yes___ No___
86. Do you know how to get free publicity for your product or service? Yes___ No___
87. Are you dissatisfied with your present employment or schoolwork? Yes___ No___
88. Women entrepreneurs represent about 7 percent of all self-employed. True___ False___
89. Minority entrepreneurs represent about 5.5 percent of all self-employed. True___ False___
90. On the average, incorporated self-employed persons make more than self-employed proprietors do. True___ False___
91. On the average, women entrepreneurs make less than men do. True___ False___
92. Do you know where to find business and operating ratios for specific industries? Yes___ No___
93. Are you familiar with the differences between a general corporation, partnership and proprietorship? Yes___ No___
94. Do you know how to find adult training programs in entrepreneurship? Yes___ No___
95. Are you familiar with the services offered by the SBA? Yes___ No___
96. Are you familiar with the services offered by the Minority Business Development Agency and the Minority Business Development Centres? Yes___ No___
97. Are you familiar with federal government contracting and R&D monies available to small business? Yes___ No___
98. If you are a parent or teenager, are you familiar with entrepreneur programs available in high schools and colleges? Yes___- No___
99. Are you familiar with business control systems such as accounting, record keeping, financial analysis, bookkeeping, profit centre, collections, forecasting, and so on? Yes___ No____
100. Do you know the secrets of working with bankers, accountants, and attorneys? Yes___ No____
101. The failure rate of most small-business start-ups is about 80 percent within the first three years.True___False___
102. Immigrants have a high rate of entrepreneurship in the United States. True___ False___
103. More than 90 percent of all businesses in the United States are small, employ fewer than 20 persons, and are organized as sole proprietorships. True___ False__

Correct Answers

1.Yes	12. Yes	23. True	34. Yes	45. Yes	56. Yes	68. True	80. Yes	92. Yes	103. True
2. Yes	13. Yes	24. No	35. Yes	46. Yes	57. Yes	69. Yes	81. Yes	93. Yes	
3. Yes	14. Yes	25. Yes	36. Yes	47. Yes	58. Yes	70. Yes	82. Yes	94. Yes	
4. Yes	15. Yes	26. No	37. Yes	48. Yes	60. Yes	71. Yes	83. Yes	95. Yes	
5. Yes	16. Yes	27. True	38. Yes	49. Yes	61. Yes	72. True	84. Yes	96. Yes	
6. Yes	17. Yes	28. True	39. Yes	50. Yes	62. Yes	73. Yes	85. Yes	97. Yes	
7. Yes	18. Either	29. Yes	40. Yes	51. Yes	63. Yes	75. Yes	86. Yes	98. Yes	
8. Yes	19. Either	30. Yes	41. Yes	52. Yes	64. Yes	76. Yes	87. Yes	99. Yes	
9. Yes	20. Yes	31. Yes	42. Yes	53. Yes	65. Yes	77. Yes	88. True	100. Yes	
10. Yes	21. Yes	32. Yes	43. Yes	54. Yes	66. Yes	78. Yes	90. True	101. True	
11. Yes	22. Yes	33. True	44. Yes	55. Yes	67. Yes	79. Yes	91. True	102. True	

Correct Number*:*

100 If you are not already an entrepreneur, you should be.

85 You are compatible. Get started.

70 You have potential. Study the rules.

55 You are behind, but you can still make it.

40 You do not seem to be interested, but that does not mean you cannot make it.

25 You still have a chance. Go for it.

0 You're probably dead.

ENCLOSURE NO. 2 BUSINESS PLAN TEMPLATE

Table of Contents	This section should:	After reviewing this section the reader should (know):
Executive Summary	• Be written last • Provide an enthusiastic snapshot of your company, • explaining who you are, what you do and why • Be less than 2 pages	• Want to learn more about your business • Have a basic understanding about your company
Business Description & Vision	• Mission statement (business purpose) • Company vision (statement about company growth) • Business goals and objectives • Brief history of the business • List of key company principals	• Mission statement (business purpose) • Company vision (statement about company growth) • Business goals and objectives • Brief history of the business • List of key company principals
Definition of the Market	• Describe your business industry and outlook • Define the critical needs of your perceived or existing market • Identify your target market • Provide a general profile of your targeted clients • Describe what share of the market you currently have and/or anticipate	• Basic information about the industry you operate in and the customer needs you are fulfilling • The scope and share of your business market, as well as who your target customers are
Description of Products and Services	• Specifically describe all of your products and services • Explain how your products and services are competitive • If applicable, reference a picture or brochure of your products, which would be included in the plan's appendix	• Why you are in business • What your products and services are and how much they sell for • How and why your products & services are competitive
Organization & Management	• Provide a description of how your company is organized as well as an organization chart, if available • Describe the legal structure of your business (proprietorship, partnership, corporation, etc.) • Identify necessary or special licenses and/or permits your business operates with • Provide a brief bio description of key managers within the company	• The legal form of ownership for your business • Who the leaders are in your business as well as thein roles • The general flow of operations within the firm
Marketing and Sales Strategy	• Identify and describe your market – who your • customers are and what the demand is for your • products & services • Describe your channels of distribution • Explain your sales strategy, specific to pricing, • promotion, products and place (4Ps)	• Who your market is and how you will reach it • How your company will apply pricing, promotion, product diversification and channel distribution to sell your products and services competitively
Financial Management	**New Business** • Estimate of start-up costs • Projected balance sheet (1 year forward) • Projected income statement (1 year forward) • Projected cash flow statement (12 months forward) **Existing Business** • Balance sheets (last 3 years)	• Have a good understanding regarding the financial capacity and/or projections for your company

	• Income statements (last 3 years) • Cash flow statement (12 months) **If Applying for a Loan** • Current personal financial statement on each principal • Tax return for prior year	
Appendices	Include: • Company brochures • Resumes of key employees • List of business equipment • Copies of press articles and advertisements (if available) • Pictures of your business location and products (optional) • Information supporting the growth of your industry and/or products (optional) • Key business agreements, such as lease, contracts, etc. (optional)	

Source: SBA.gov,2011. How to Write a Business Plan . [online] [Accessed: 3 Oct 2013]. Available at: http://www.sba.gov/category/navigation-structure/starting-managing-business/starting-business/writing-business-plan

ENCLOSURE NO. 3 EXAMPLE OF REAL BUSINESS PLAN

This business plan is for company development. Source: Cadden and Lueder,2008, pp.870-898

FRANK'S BARBEQUE

EXECUTIVE SUMMARY

Frank's BarBeQue has operated for decades in the southern Bavaria, Germany shore region. With a tradition of superlative food at fair prices served in a family-friendly atmosphere, the owners now believe it is time to open a second restaurant and expand the production and the distribution of Frank's signature barbecue sauces. This second restaurant will be in Darien, Bavaria, Germany, and will be nearly twice as large, in terms of seating capacity, as the current Rosenheim restaurant. The company also plans to ramp up production of its sauces and increase their sales fourfold in the next three years.

Objectives

The owners of Frank's BarBeQue and other investors plan to put €160,000 of their own money into the second restaurant and expand the production of the signature sauces. They seek to raise an addition €175,000 from a bank loan that will be repaid in two years.

BUSINESS DESCRIPTION & VISION

Vision Statement

To produce the best barbecue food in the southern Bavaria (Germany).

Mission Statement

The mission of Frank's BarBeQue is to provide the southern Bavaria, Germany shore region with the finest barbecue food in four major regional styles at affordable prices in a family-friendly setting. As we grow, we will never forget and remain faithful to those factors that have made us a success.

Keys to Success

Frank's BarBeQue has been in business for nearly forty years. It has weathered good times and bad times through all types of economic conditions. We have survived because Frank's has remained committed to several principles.

The only objective of a restaurant is to serve the finest food it can prepare. Good food—not more gimmicks or advertising—brings in customers and, more importantly, *keeps* customers. Preparing the finest foods means a commitment to excellence, which means obtaining the best ingredients and a dedication to cooking barbecue properly, which means cooking carefully and *slowly*.

In addition to providing the finest food, we remain committed to providing excellent service. To means friendly, this knowledgeable staff members and us who make the customers feel like they are dining with family. We provide the right atmosphere. Our goal is to have a setting that says "barbecue." We do not provide a fancy setting; our basic setting complements the food we serve.

Company Summary

Frank's BarBeQue has been a highly successful restaurant in Rosenheim, Bavaria, Germany, for nearly forty years. It was started and is still managed by Frank Rainsford. Its food and sauces have won awards at both regional and national barbecue cook-offs. In addition, Frank's has been voted the best barbecue establishment in Bavaria, Germany numerous times by many local newspapers and magazines.

The management team of Frank's BarBeQue has decided that *now* is the time to expand to an additional location. After careful analysis, a second Frank's BarBeQue can and should be opened in Darien, Bavaria, Germany. This restaurant will be larger and geared to tap better into the growing premade, take-home dinner market.

In the last few years, Frank's has been selling its four signature barbecue sauces—Beccy and Carolina in local supermarkets. Although this represents a small portion of overall revenues, sales have been growing at a remarkable pace. This market must be exploited. Preliminary market research indicates that this segment of the business will grow at 20 percent per year for the next five years.

Company Ownership

Presently, Frank's BarBeQue is a limited liability partnership with Frank Rainsford and his wife Betty as owners. Each has a 50 percent share in the business.

The plans for expansion will bring in capital from three other investors: Robert Rainsford, Susan Rainsford Rogers, and Alice Jacobs. Robert Rainsford and Susan Rainsford Rogers are the son and daughter of Frank and Betty. Both have extensive work experience at Frank's. Alice Jacobs has been the restaurant's accountant for over twenty years. To assist the financing of the expansion, Robert Rainsford and Susan Rainsford Rogers will each invest €50,000, while Alice Jacobs will invest €60,000. The new limited liability partnership will result in the investors holding the following equity percentages:

Frank Rainsford	40.00%
Betty Rainsford	40.00%
Robert Rainsford	6.25%
Susan Rainsford Rogers	6.25%
Alice Jacobs	7.50%

Company History

Frank's BarBeQue was founded in 1972 by Frank Rainsford. Although a native Englander, Frank learned about cooking barbecue while serving in the US Air Force. During his twelve years of service, he learned about the four major styles of American barbecue-Texas, Memphis, Kansas City, and Carolina. His plan was to introduce people in southern Bavaria, Germany to *real* barbecue that entailed high-quality meats properly cooked and smoked over an appropriate length of time.

In the beginning, Frank's BarBeQue was a small facility; it could seat about thirty people. It was located near the Rosenheim railroad station and was the first full-service barbecue restaurant in Rosenheim. Frank's placed an emphasis on featuring the food; it had a highly simplified decor where the tables were covered with butcher paper, not linen tablecloths. The restaurant was an immediate hit, received considerable local press, and won several food awards. This success enabled Frank's to move to a larger facility in Rosenheim on the town's main thoroughfare Rosenheim Post Road. The new location was a midsize restaurant of about eighty seats. Frank has built this location into a relatively successful and locally well-known enterprise. It has been at the present location since the early 1980s. It shares a parking lot with several other stores in the small mall in which it is located.

Frank's has won many awards at regional and national barbecue cook-offs (for both the food and the sauces), which is unusual for a barbecue business in southern Bavaria. The restaurant has been written up, repeatedly, in the local and German newspapers for the quality of its food and its four signature barbecue sauces. In the last few years, Frank's has sold small lots of these sauces in local supermarkets. They have been distributed because of Frank's personal connections with the store managers. Frank Rainsford has been approached by a major regional supermarket to sell his sauces. The supermarket is willing to find a facility that could produce Frank's sauces in significantly larger volumes, which would represent a substantial increase in the sales of sauces.

Table Past Performance of Frank's BarBeQue" provides a summary of key financial figures for the last three years-2008 to 2010.

Past Performance	**2008**	**2009**	**2010**
Sales	€1,637,610	€1,696,564	€1,793,268
Gross margin	€851,557	€909,358	€943,259
Gross margin %	52.00%	53.60%	52.60%
Operating expenses	€542,080	€577,315	€600,408
Inventory turnover	13.20	12.10	12.90
Balance Sheet	**2008**	**2009**	**2010**
Current Assets			
Cash	€102,665	€125,172	€102,665
Inventory	€391,238	€331,045	€345,678
Other current assets	€278,372	€230,074	€278,372
Total current assets	€772,275	€686,291	€726,715
Long-Term Assets			
Long-term assets	€504,580	€388,820	€423,675
Accumulated depreciation	€180,856	€135,739	€145,765
Total long-term assets	€323,724	€253,081	€277,910
Total assets	€1,095,999	€939,372	€1,004,625
Current Liabilities			
Accounts payable	€155,534	€132,206	€145,321
Current borrowing	€170,000	€150,000	€135,000
Other current liabilities (interest free)	€81,888	€63,972	€74,329
Total current liabilities	€407,422	€346,178	€354,650
Long-term liabilities	€220,000	€190,000	€175,000
Total liabilities	€627,422	€536,178	€529,650
Paid-in capital	€75,000	€75,000	€75,000

Retained earnings	€281,838	€234,377	€287,114
Earnings	€111,739	€93,817	€112,861
Total capital	€468,577	€403,194	€474,975
Total capital and liabilities	€1,095,999	€939,372	€1,004,625
Other Inputs			
Payment Days	30	30	30

DEFINITION OF THE MARKET

Company Locations and Facilities

Frank's BarBeQue has been in Rosenheim, Bavaria, Germany, for decades. It has a reputation throughout the southern Bavaria, Germany shore region for excellent food and it has received numerous awards. The management team determined that a second location could tap into this local name recognition. Several towns in the region were evaluated for total population, population density, family income, and home value. These factors were considered because of their impact on generating traffic and consumers being able to pay for meals that are priced slightly higher than typical fast-food outlets. In addition, the average family size and the percentage of family households were considered because Frank's is a family restaurant.

Lastly, data were gathered on the average travel time to and from work for residents and the real estate tax rate. Because the new location of Frank's will emphasize prepared meals, we felt that individuals with longer commutes would be more likely to order meals and pick them up at Frank's. A summary of these data is provided in Table "Demographic Data for Selected Bavaria, Germany Towns—Part 1" and Table "Demographic Data for Selected Bavaria, Germany Towns—Part 2".

After thorough analysis, it was concluded that Darien, Bavaria, Germany, would be the best location for the new branch of Frank's BarBeQue. It has a high-income population and a high population density, and a large percentage of its inhabitants are members of family households. They have longer commuting times, which increase the potential need for prepared meals.

Table Demographic Data for Selected Bavaria, Germany Towns—Part 1

Item	Rosenheim	Town 1	Town 2	Darien	Town 3
Population	57,578	25.884	7,383	19,375	83,802
Population density	1,917	1,293	269	1,508	3,675
Income	€108,209	€155,322	€162,688	€180,474	€79,693
House value	€589,179	€1,169,081	€868,622	€1,430,589	€504,100
Percentage of family households	72.6%	74.6%	84.3%	81.7%	64.1%
Travel time (minutes)	31.3	39.4	34.8	36.4	25.4
Real estate tax rate	1.3%	0.9%	1.3%	0.8%	1.1%
Family size	3.07	2.70	3.0	3.0	2.50

Table Demographic Data for Selected Bavaria, Germany Towns—Part 2

Item	Town 1	Town 2	Town 3	Town 4	State of Bavaria, Germany
Population	121,026	10,199	17,771	34,422	3,574,097
Population density	3,206	515	659	478	739/sq. mile
Income	€81,206	€190,080	€183,252	€103,019	€68,595
House value	€612,900	€1,198,615	€1,044,316	€492,623	€306,000
Percentage of family households	63.8%	84.9%	82.3%	81.5%	67.7%
Travel time (minutes)	24.0	41.6	39.2	27.1	
Real estate tax rate	0.7%	1.1%	1.2%	1.5%	1.8%
Family size	2.50	3.0	3.25	2.80	

A specific location has been identified in Darien for the second Frank's BarBeQue. It is in a small mall and is large enough to have a seating capacity of 150–160 plus takeout facilities. The mall has, more than adequate parking for future customers. The mall is located three blocks from the railroad station and is four blocks from the Darien I-95 exit. It is therefore well positioned to attract traffic from both car and rail commuters. The lease fee for a three-year contract is very reasonable for a property of this size.

Market Analysis Summary

Since the 1930s, the German public has spent at least 5 percent of its disposable income on eating out. Even with annual fluctuations, this is a strong indicator of the viability of this industry. This can be illustrated by reviewing industry results for the last few years.

Both 2009 and 2010 were difficult years for the restaurant industry. In 2008, sales increased by 3.8 percent. However, sales fell by nearly 0.75 percent in 2009. *This was the first year in the history of the industry that sales actually declined.* The restaurant industry's sales in 2009 were €566 billion, down from over €570 billion. Prices rose by 2.2 percent in 2009. The increase in sales for 2010 was 0.5 percent, and price increases stabilized at 0.75 percent.

It is anticipated that there will be significant price competition in every segment of the restaurant industry. Some analysts argued that the poor performances for the restaurant industry in both 2009 and 2010 could be attributed to declines in both business and personal travel. Hotel occupancy rates in 2009 were down by nearly 10 percent. A study conducted by the National Restaurant Association argued that 20 percent of the sales in casual dining restaurants might be due to travellers and visitors. Frank's BarBeQue relies to a far lesser extent on travellers as customers. A rough estimate based on credit card receipts, for the period 2006–2010, indicated that travellers represented less than 2 percent of Frank's sales. The pressure on the restaurant industry has been felt by many chain restaurants, which significantly curtailed their expansion plans.

Even though the recession was in full bloom in 2009, many food prices rose significantly. Beef prices rose between 4 percent and 12 percent, while pork prices rose between 5 percent and 13 percent. Numerous studies have indicated that the increase in commodity prices will not be a transitory phenomenon.

With 925,000 food service locations in operation in Germany, this translates into 1 restaurant for every 330 Germans.

The Mintel Group, a market research firm, found that consumers who are interested in quality opt for independent restaurants over chain outlets. An increasing consumer focus on health translates into an emphasis on natural ingredients. In the barbecue industry, this translates into naturally raised meats (i.e., the avoidance of artificial growth hormones in cattle), which are a hallmark of Frank's BarBeQue.

The National Restaurant Association estimated that sales in full-service restaurants in 2010 would exceed €184 billion—an increase of 1.2 percent from 2009 sales.

Several macroeconomic factors make opening a restaurant in Darien attractive, including the following:

Increase in the growth domestic product (GDP). The GDP is estimated to grow 1.7 percent in 2011 and 1.5 percent in 2012. The estimates for Rosenheim County are significantly higher.

Disposable personal income. The national level of personal income should rise nearly 4 percent in 2011, and there is an expectation of 3 percent growth in 2012. These numbers appear to be much stronger in the Rosenheim County area.

Although 2010 was not a banner year for the restaurant industry—it was one where more restaurants closed than opened each month—there was one bright spot: Chain barbecue restaurants grew between 2 percent and 3 percent—an auspicious sign even for independent operators.

The home meal replacement market and the existing investment in restaurant equipment provide a nice growth opportunity for restaurants. It is been estimated that takeout sales in limited service chain restaurants might be as large as 60 percent of total sales. The same study found that takeout food has been growing twice as fast as the overall restaurant industry. Natural competitors in this market are supermarkets that offer pre-packaged meals. However, we feel that few—if any—supermarkets provide the quality barbecue food that can be found at Frank's.

Market Segmentation

Frank's BarBeQue views its major market segment as suburbanites in the south shore region of Bavaria, Germany. One way of further segmenting the market is by the type of meal being provided. Table "Market Analysis" provides estimated growth rates for each type of meal (plus sauce sales) and projected number of meals (and jars of sauce) for the period 2011 to 2015.

Table Market Analysis

Potential Customers	Growth	2011	2012	2013	2014	2015
Lunch	8%	17,0	18,2	19,6	21,11	22,70
		0	7	4		
Dinner	5%	40,00	42,00	44,10	46,30	48,62
Takeout	20%	10,00	12,00	14,40	17,28	20,73
Sauces	15%	12,00	13,80	15,87	18,25	20,98
Total	9.37%	79,00	86,07	94,01	102,95	113,04

Market Needs

We believe that the market centres on excellent barbecue food served at reasonable prices and served in a family-friendly manner. We further believe that a growing segment of the market will want prepared meals that can be conveniently picked up and served at home. Table "Market Analysis" provides a projected breakdown of the potential customers for the next five years. This breakdown is predicated on the type of meals served and includes the sale of sauces. We provide estimated growth rates and forecasted sale of meals (and bottles of sauces) for the period 2011 to 2015.

DESCRIPTION OF PRODUCTS AND SERVICES

Products and Services

Frank's BarBeQue specializes in the finest barbecue served in a family-friendly format. It uses the finest cuts of meats that are free of any growth hormones. It is known for a variety of slow-smoked and slow-cooked meats, such as ribs, beef, pulled pork, and chicken. These are served with Frank's famous and award-winning sauce varieties, which represent the four major styles of barbecue cooking. Frank's is also noted for its side dishes and desserts. Our goal is to expand operations to a second location in Darien, Bavaria, Germany. This outlet will be significantly larger and will have a section devoted to takeout meals.

Competitive Comparison

There are approximately forty specialty barbecue restaurants in Bavaria, Germany. They are spread throughout the state, but only four (including Frank's BarBeQue) are in the southern shore region. The three competitors are smaller operations. None of the barbecue restaurants in Bavaria, Germany has the history, reputation, acclaim, or awards that match Frank's BarBeQue. It is not an exaggeration to say that Frank's is the preeminent barbecue restaurant in Bavaria, Germany. It has a loyal following that reaches as far as Munich.

Frank's is the only barbecue restaurant in Bavaria, Germany where supermarkets are vying for the right to market Frank's signature barbecue sauces. This sideline business promises to be extremely profitable and support the overall marketing efforts for both locations of Frank's BarBeQue.

Fulfilment

Frank's BarBeQue has always been committed to providing the absolute best in barbecue food. This has meant assuring the highest quality ingredients in food preparation. Frank has established a decades-long relationship with suppliers in the Munich and Bavaria, Germany areas. He selects nothing but the choicest selections of beef, pork, and chicken. He has always made sure that his meats come from suppliers who are committed to quality ingredients and who never use growth hormones. This long-term relationship with a variety of key suppliers enables Frank to secure the best cuts at reasonable prices. Frank is equally careful in using the finest spices for his barbecue sauces. The same is true for all the side dishes that Frank's BarBeQue offers its customers.

This commitment to quality is not limited to the selection of meats and ingredients. Frank and his staff recognize that top-quality barbecue food requires a knowledgeable and deep commitment to cooking the food properly. All meats must be cooked and smoked slowly. This requires time, effort, expense, and commitment, but the results are spectacular. Some cuts of meat at Frank's may require as many as eleven hours of preparation and cooking. Excellence is not achieved without a commitment to effort. This effort has been recognized with numerous awards at national barbecue cook-offs. Frank has clearly recognized that the meal is clearly a function of the quality of the meat, quality ingredients, and careful preparation.

Future Products and Services

Frank's BarBeQue is ready to accept new challenges. Opening a second restaurant will significantly increase sales, but the second location is only the beginning of new directions for Frank's. Although Frank has been selling his regional barbecue sauces in local outlets for years, he is now ready to sign a contract with a major regional supermarket chain to market and sell these sauces throughout southern Bavaria. Preliminary studies indicate that Frank can anticipate a 20 percent annual growth rate in the sales of sauces for the next five years.

With the growth of two-income families, less and less time is available to prepare meals at home. Recognizing this simple fact, Frank's BarBeQue plans to offer a variety of pre-packaged barbecue meals that can be picked up at the restaurant and reheated at home. As part of its new commitment to a web-based presence, customers will be able to order these meals by regular phone, with Smartphone's, or through the Internet. Customers will be able to select from a list of pre-packaged dinner meals or any combination of items. Customers can designate the time to pick up the meals, and the meals will be ready for them. This service promises significant revenue growth.

ORGANIZATION & MANAGEMENT

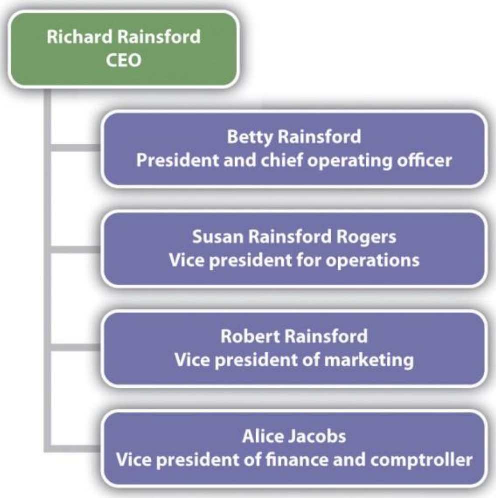
Currently, Frank Rainsford is the CEO and chief operating officer of Frank's BarBeQue. He is also the restaurant manager at the Rosenheim restaurant. During the week, his daughter (Susan Rainsford Rogers) often replaces Frank as the restaurant manager. The Rosenheim restaurant has a full-time cook who operates under Frank's supervision, and two other full-time employees function as waiters and waitresses. These full-time employees are supplemented by six part-time employees.

Under the new management structure, Frank Rainsford will hold the position of CEO. His wife, Betty Rainsford, will be designated the president and chief operating officer. Their daughter, Susan Rainsford Rogers, will be given the title vice president for operations. She will be responsible for the day-to-day operations of the Darien, Bavaria, Germany, and restaurant. Robert Rainsford will have the title of vice president of marketing. He will be responsible for all marketing activities and the operation of the website. Alice Jacobs will be the vice president of finance and the comptroller of Frank's BarBeQue.

Organizational Structure

The new management structure of Frank's BarBeQue is a basic functional layout appropriate for this type of business and is shown in Figure "Organizational Chart".

Figure Organizational Chart



Personnel Plan

Table "Forecasts of Personnel" is a five-year breakdown of the types and costs of personnel.

Personnel Plan	**2011**	**2012**	**2013**	**2014**	**2015**
Cooks Personnel					
Cook (Rosenheim)	€54,000	€54,600	€55,000	€55,500	€56,000
Cook (Darien)	€66,000	€66,000	€66,500	€67,000	€67,500
Subtotal	€120,000	€120,600	€121,500	€122,500	€123,500
Servers Personnel					
Full-time servers (Rosenheim)	€28,800	€28,800	€16,000	€17,500	€18,000
Full-time servers (Darien)	€57,600	€57,600	€24,500	€25,000	€2,600
Part-time servers both locations	€192,000	€192,000	€192,000	€192,000	€192,000
Subtotal	€278,400	€278,400	€232,500	€234,500	€212,600
General and Administrative Personnel					
Restaurant manager (Rosenheim)	€42,000	€42,000	€43,000	€43,500	€44,000
Restaurant manager (Darien)	€54,000	€54,600	€56,000	€56,500	€57,000
Subtotal	€96,000	€96,600	€99,000	€100,000	€101,000
Total people	39	39	39	39	39
Total payroll	€494,400	€495,600	€453,000	€457,000	€437,100

MARKETING AND SALES STRATEGY

Web Plan Summary

Presently, Frank's BarBeQue has a very simple website. The website provides minimal information—listing some of the menu items and the restaurant's telephone number. A college student, who was working at Frank's, created it eight years ago.

Robert Rainsford's professional expertise is in the area of website development. After graduating from college, Robert was hired by a firm that specialized in developing web and social media presences for other companies. He worked for that firm in New York City for seven years. Robert rose rapidly through the company's ranks, eventually becoming one of its vice presidents. His expertise in this area will enable Frank's BarBeQue to enhance significantly its web presence. Rather than just having a website that identifies the restaurant's location and telephone number, along with a brief summary of its menu, the new website will be far richer in content and capability. It will provide a complete menu listing, identifying all items with corresponding images. The new website will enable customers to place orders through the Internet for lunch, dinner, or takeout items. The section devoted to takeout items will enable a customer to purchase prepared meals or choose from all items on the menu to develop a pre-packaged meal. Customers will be able to identify the time that they will arrive for the pickup.

The website will have links to the Facebook and Twitter accounts of Frank's BarBeQue. These connections will enhance its social media presence. Customers will be asked to post comments about their dining experience and suggestions on how Frank's can improve its operations and service. It will enable Frank's to expand operations and still maintain the same close customer relationship that currently exists at the Rosenheim restaurant.

Website Marketing Strategy

The new web presence for Frank's BarBeQue will be geared to developing a new level of customer relationships. Customers at both restaurants will be asked to fill out forms where they will supply an e-mail address and a birthdates. (This information can also be supplied through Frank's new website.) This information will enable Frank's to keep customers informed of specials and offer coupons and the new rewards card program for special occasions, such as holidays or birthdays.

We view the website of Frank's BarBeQue as a major component of enhancing our relationship with our customers. It should provide convenience to customers through their ability to see what is on the menu, identify new specials, and order meals and pick them up at their convenience. The use of social media will expand awareness of Frank's and enable it to develop closer relationships with present and future customers.

Development Requirements

Robert Rainsford tapped into his expertise in social media and has already developed a far more sophisticated website for Frank's BarBeQue. He has secured the necessary server capacity to handle additional traffic on the website. In addition, he has set up several social media accounts for Frank's BarBeQue, including Facebook and Twitter. Robert also created a program linked to a database that will monitor customer purchases through the rewards card program. This program will send out birthday notices, discounts to customers, and will inform them of their status in the rewards card program.

Robert contacted several former colleagues at his former place of employment and has identified several candidates for the role of website manager. This individual will be responsible for updating the website and the social media sites on a daily basis. He or she will also be responsible for analyzing the flow of information that comes through these sites and preparing management reports.

Strategy and Implementation Summary

The core strategy of Frank's BarBeQue is to continue what has made it a success at a new location. Simply put, our strategy is to provide our customers with the finest barbecue food in Bavaria, Germany, at reasonable prices, in a family-friendly environment. In addition, we hope to improve our ability to meet customer needs by making life more convenient for our customers. We believe that these fundamentals are universally applicable.

SWOT Analysis

A strengths, weaknesses, opportunities, and threats (SWOT) analysis was undertaken for Frank's BarBeQue (very simple; in real need to be more detailed).

- Strengths

The key strength of Frank's BarBeQue is the quality of its food and service. It has been the recipient of numerous local and national awards for its foods and sauces. Other strengths include a highly knowledgeable management team with expertise in operating a barbecue restaurant, a close working relationship with suppliers of premier cuts of meats, and a loyal clientele in the south shore region.

- Weaknesses

The weaknesses associated with this business plan centre on operating an additional restaurant with a much larger capacity than the Rosenheim, Bavaria, Germany, and restaurant. The second location will require an experienced restaurant manager. This plan calls for a significant increase in prepared (takeout) meals. Orders will be placed either by phone or through the website. Current personnel have little experience in ratcheting up the takeout portion of the business.

- Opportunities

This business plan offers significant opportunities for Frank's BarBeQue. A second, larger location will translate into a significant increase in sales. Finalizing a business relationship with the regional supermarket chain will enable Frank's to increase significantly the production and the sales of its signature sauces. The sales of sauces are expected to increase by 20 percent per year for the next five years.

- Threats

Any expansion with the opening of a new location always entails some risk. The principals of Frank's BarBeQue will be investing a significant amount of capital and will be borrowing money from a bank to open a second location. It is strongly believed that the second location will capitalize on the success of the Rosenheim restaurant and will become a success.

Competitive Edge

The competitive edge of Frank's BarBeQue resides mainly in the quality of its food and its commitment to serve the food in a family-friendly environment. The quality of its food is unmatched in the entire state. No other barbecue restaurant has received the awards and the accolades that Frank's BarBeQue has received for the past forty years. Its reputation for quality gives it an edge that no other barbecue restaurant or chain can match.

Marketing Strategy

The target market for Frank's BarBeQue is essentially suburban families in the south shore region of Bavaria, Germany. These people appreciate the finest barbecue food at reasonable prices. It is expected that an important group within this target market will be families with two incomes whose busy schedules would make prepared meals a very attractive option. We further assume that this market is technically sophisticated and will appreciate the convenience of ordering these meals via the Internet.

A key component of the marketing strategy of Frank's BarBeQue is to use the Internet and technology to enhance the relationship with its customer base. Frank's will use the website, Facebook, Twitter, and e-mails to inform customers of special food items or discounts based on holidays and customers' birthdays. We intend to use the website as a mechanism to gain an improved insight into customer needs and wants.

Frank's BarBeQue will also initiate a rewards card program. Customers will sign up for the rewards card program either at the two locations or online. They can use this program every time they make a purchase either at the restaurants or online. After a set number of visits (seven), customers will be entitled to either discounts or free items. The rewards card program will enable Frank's BarBeQue to track customers' buying patterns and anticipate the ways in which they can better serve their customers.

Sales Forecasts

We provide a five-year forecast of the dollar value of sales broken down by the two restaurants and the sauces in Table "Sales Forecast".

Sales	2011	2012	2013	2014	2015
Frank's (Rosenheim)	€1,907,183	€1,954,863	€2,003,734	€2,053,827	€2,105,173
Frank's (Darien)	€2,222,000	€2,555,300	€2,810,830	€3,091,913	€3,401,104
Sauces	€62,500	€75,000	€90,000	€108,000	€130,000
Total sales	€4,191,683	€4,585,163	€4,904,564	€5,253,740	€5,636,277

Direct Cost of Sales	2011	2012	2013	2014	2015
Frank's (Rosenheim)	€953,594	€977,430	€1,001,867	€1,026,914	€1,052,587
Frank's (Darien)	€1,111,000	€1,277,650	€1,405,415	€1,545,957	€1,700,552
Sauces	€31,250	€37,500	€45,000	€54,000	€64,800
Subtotal direct cost of sales	€2,095,844	€2,292,580	€2,452,282	€2,626,871	€2,817,939

Financial Management

Frank's BarBeQue will be financing the creation of a second restaurant through a combination of private investment and a bank loan. The private investment will raise €160,000, and Frank's will seek another €175,000 as a two-year loan. These funds will be used to pay for equipment and leasing expenses associated with opening a second restaurant.

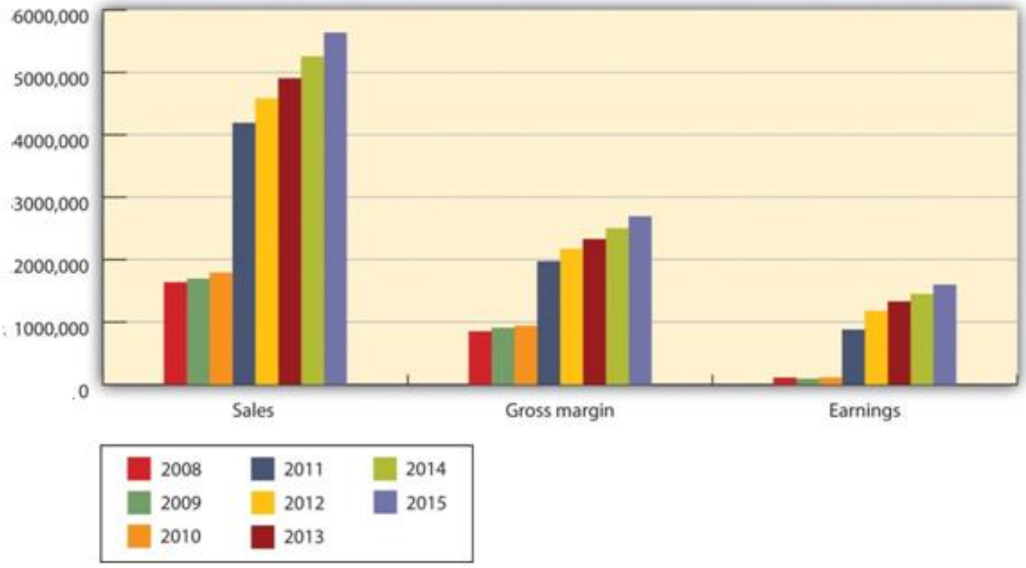
Important Assumptions

The assumptions associated with the grow rates of sales each year for the next five years are the keys to the financial planning process. We began with very modest assumptions of 8 percent growth in lunch sales and 5 percent growth in dinner sales. We anticipate vigorous growth in takeout meals (20 percent) and sauces (15 percent). Although these are large growth rates, we do not feel that they are unrealistic.

Key Financial Indicators

Figure "Key Financial Indicators" provides historical (2008–2010) and forecasted (2011–2015) values for the key financial indicators.

Figure Key Financial Indicators



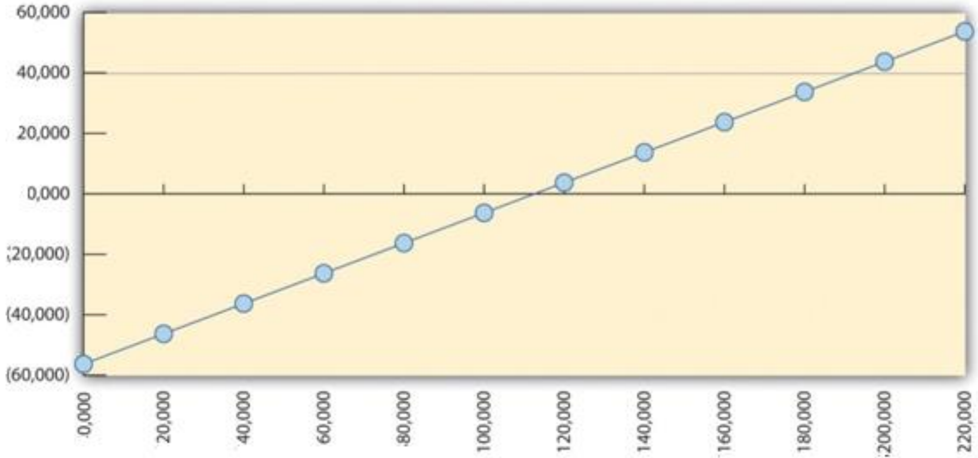
Breakeven Analysis

In Table "Breakeven Analysis" and Figure "Breakeven Analysis", we show the results of our breakeven analysis for Frank's BarBeQue. The results indicate that with sales of approximately €110,000 each month, Frank's BarBeQue will break even.

Table Breakeven Analysis

Monthly revenue	€112,627
Assumptions	
Average variable cost	50%
Estimated monthly fixed cost	€56,313

Figure Breakeven Analysis



Projected Profit and Loss

Our analysis anticipates significant growth in profits in the next five years with the opening of a second Frank's BarBeQue in Darien. The profit margins should increase from in excess of €850,000 in 2011 to nearly €1,600,000 by 2015 and should be in excess of 20 percent for all five years. A complete analysis of the profit and loss statements is in Table "Profit and Loss". The annual profits are illustrated in Figure "Yearly Profits".

Table Profit and Loss

Pro Forma Profit and Loss	**2011**	**2012**	**2013**	**2014**	**2015**
Sales	€4,191,683	€4,585,163	€4,904,564	€5,253,740	€5,636,277
Direct cost of sales	€2,095,844	€2,292,580	€2,452,282	€2,626,871	€2,817,939
Cooks payroll	€120,000	€120,600	€121,500	€122,500	€123,500
Other costs of sales	€0	€0	€0	€0	€0
Total cost of sales	€2,215,844	€2,413,180	€2,573,782	€2,749,371	€2,941,439
Gross margin	€1,975,839	€2,171,983	€2,330,782	€2,504,369	€2,694,838
Gross margin %	47.14%	47.37%	47.52%	47.67%	47.81%

Pro Forma Profit and Loss	**2011**	**2012**	**2013**	**2014**	**2015**
Operating Expenses					
Servers payroll	€278,400	€278,400	€232,500	€234,500	€212,600
Advertising/promotion	€0	€0	€0	€0	€0
Other servers expenses	€0	€0	€0	€0	€0
Total servers expenses	€278,400	€278,400	€232,500	€234,500	€212,600
Servers %	6.64%	6.07%	4.74%	4.46%	3.77%
General and Administrative Expenses					
General and administrative payroll	€96,000	€96,600	€99,000	€100,000	€101,000
Marketing/promotion	€12,000	€0	€0	€0	€0
Depreciation	€0	€0	€0	€0	€0
Rent	€180,000	€0	€0	€0	€0
Utilities	€13,200	€0	€0	€0	€0

Pro Forma Profit and Loss	2011	2012	2013	2014	2015
Insurance	€22,000	€0	€0	€0	€0
Payroll taxes	€74,160	€74,340	€67,950	€68,550	€65,56 5
Other general and administr ative expenses	€0	€0	€0	€0	€0
Total general and administr ative expenses	€397,36 0	€170,94 0	€166,95 0	€168,550	€166,5 65
General and administr ative %	9.48%	3.73%	3.40%	3.21%	2.96%
Other Expenses					
Other payroll	€0	€0	€0	€0	€0
Consultan ts	€0	€0	€0	€0	€0
Other expenses	€0	€0	€0	€0	€0
Total other expenses	€0	€0	€0	€0	€0
Other %	0.00%	0.00%	0.00%	0.00%	0.00%
Total operating expenses	€675,76 0	€449,34 0	€399,45 0	€403,050	€379,1 65
Profit before interest and taxes	€1,300,0 79	€1,722,6 43	€1,931,3 32	€2,101,31 9	€2,315, 673
EBITDA (Earnings Before Interest, Taxes, Depreciati on, and Amortizat ion)	€1,300,0 79	€1,722,6 43	€1,931,3 32	€2,101,31 9	€2,315, 673
Interest expense	€43,755	€34,995	€30,980	€30,980	€30,98 0
Taxes incurred	€376,89 7	€506,29 4	€570,10 6	€621,102	€685,4 08
Net profit	€879,42	€1,181,3	€1,330,2	€1,449,23	€1,599,

Pro Forma Profit and Loss	2011	2012	2013	2014	2015
	7	54	46	7	285
Net profit/sal es	20.98%	25.76%	27.12%	27.58%	28.37%

Projected Cash Flow

Table „Cash Flow Forecast" is a five-year forecast of cash flows for Frank's BarBeQue. The forecast shows extremely strong and positive cash flows for each year.

Pro Forma Cash Flow					
Cash Received	**2011**	**2012**	**2013**	**2014**	**2015**
Cash from Operations					
Cash sales	€4,191, 683	€4,585, 163	€4,904, 564	€5,253, 740	€5,636, 277
Subtotal cash from operation s	€4,191, 683	€4,585, 163	€4,904, 564	€5,253, 740	€5,636, 277
Subtotal cash received	€4,366, 683	€4,585, 163	€4,904, 564	€5,253, 740	€5,636, 277
Expendit ures	**2011**	**2012**	**2013**	**2014**	**2015**
Expenditures from Operations					
Cash spending	€494,4 00	€495,6 00	€453,0 00	€457,0 00	€437,1 00
Bill payments	€2,500, 504	€2,911, 392	€3,085, 406	€3,338, 682	€3,587, 794
Subtotal spent on operation s	€2,994, 904	€3,406, 992	€3,538, 406	€3,795, 682	€4,024, 894
Other liabilities principal repaymen t	€54,00 0	€54,00 0	€54,00 0	€0	€0
Long-term liabilities principal repaymen t	€87,60 0	€87,60 0	€0	€0	€0
Subtotal cash spent	€3,296, 504	€3,548, 592	€3,592, 406	€3,795, 682	€4,024, 894

Pro Forma Cash Flow					
Net cash flow	€1,070,179	€1,036,571	€1,312,158	€1,458,058	€1,611,383
Cash balance	€1,172,844	€2,209,415	€3,521,573	€4,979,631	€6,591,014

Projected Balance Sheet

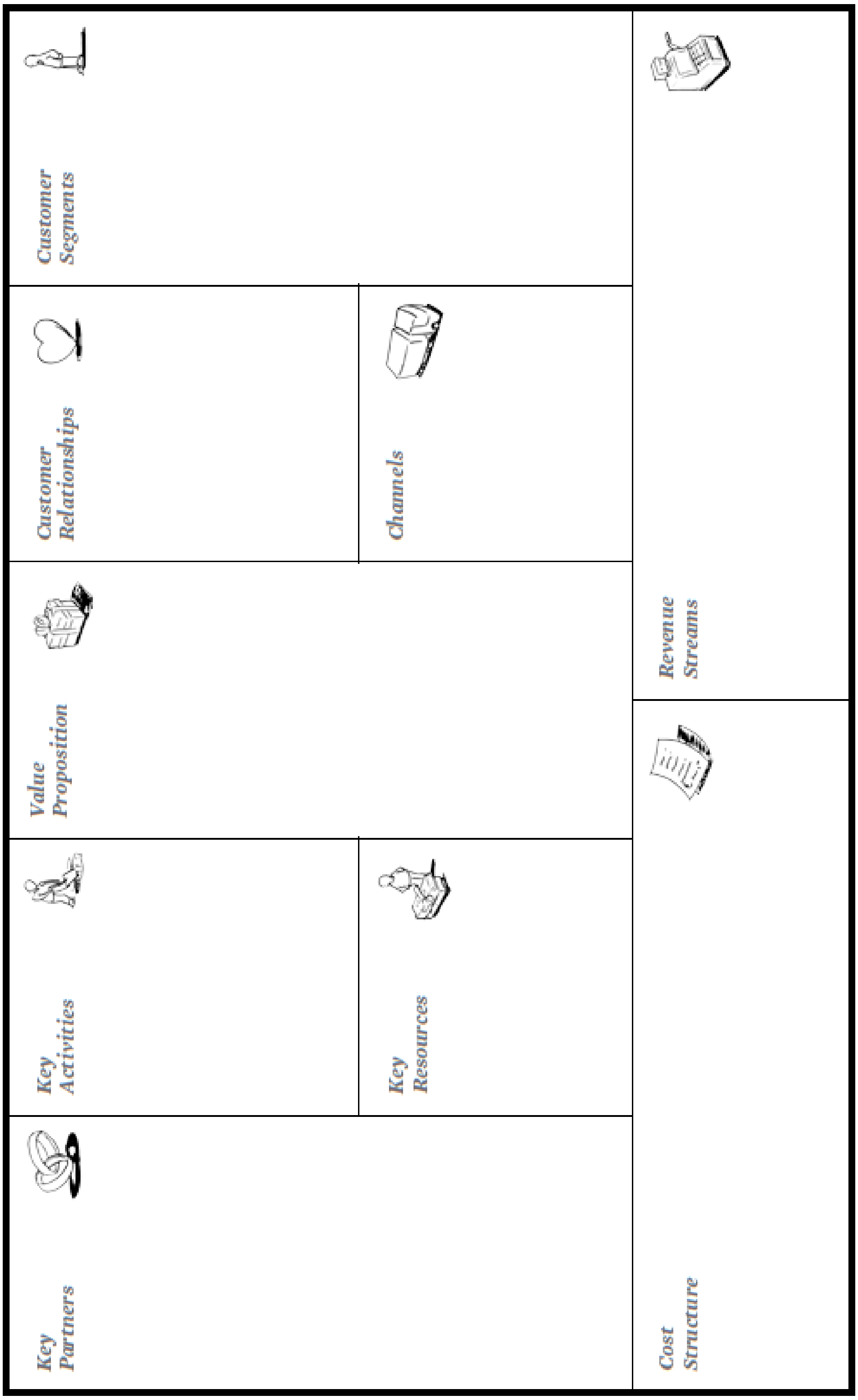
Table "Balance Sheet Forecast" is a balance sheet forecast for Frank's BarBeQue.

Pro Forma Cash Flow					
Assets	**2011**	**2012**	**2013**	**2014**	**2015**
Current Assets					
Cash	€1,172,844	€2,209,415	€3,521,573	€4,979,631	€6,591,014
Inventory	€72,421	€79,197	€109,296	€117,245	€125,954
Other current assets	€278,372	€278,372	€278,372	€278,372	€278,372
Total current assets	€1,523,636	€2,566,983	€3,909,241	€5,375,249	€6,995,341
Long-Term Assets					
Long-term assets	€583,675	€583,675	€583,675	€583,675	€583,675
Accumulated depreciation	€145,765	€145,765	€145,765	€145,765	€145,765
Total long-term assets	€437,910	€437,910	€437,910	€437,910	€437,910
Total assets	€1,961,546	€3,004,893	€4,347,151	€5,813,159	€7,433,251
Liabilities and Capital	**2011**	**2012**	**2013**	**2014**	**2015**

Pro Forma Cash Flow					
Current Liabilities					
Accounts payable	€189,416	€193,009	€259,021	€275,791	€296,597
Current borrowing	€135,000	€135,000	€135,000	€135,000	€135,000
Other current liabilities	€20,329	(€33,671)	(€87,671)	(€87,671)	(€87,671)
Subtotal current liabilities	€344,745	€294,338	€306,350	€323,120	€343,926
Long-term liabilities	€262,400	€174,800	€174,800	€174,800	€174,800
Total liabilities	€607,145	€469,138	€481,150	€497,920	€518,726
Paid-in capital	€75,000	€75,000	€75,000	€75,000	€75,000
Retained earnings	€399,975	€1,279,402	€2,460,755	€3,791,002	€5,240,239
Earnings	€879,427	€1,181,354	€1,330,246	€1,449,237	€1,599,285
Total capital	€1,354,402	€2,535,755	€3,866,002	€5,315,239	€6,914,524
Total liabilities and capital	€1,961,546	€3,004,893	€4,347,151	€5,813,159	€7,433,251
Net worth	€1,354,402	€2,535,755	€3,866,002	€5,315,239	€6,914,524

These figures clearly demonstrate that the proposed opening of a second restaurant is more than economically viable; it is an extremely lucrative project, which promises to increase the net worth of the firm by 500 percent in five years.

ENCLOSURE NO. 4 BUSINESS MODEL CANVAS



ENCLOSURE NO. 5 CANVAS MODEL STRUCTURE