BBM210/05 Entrepreneurship Development course guide (Revised)

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Unit 4

BBM 210/05

Entrepreneurship Development

Ideas to a Sustainable Business



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Unit Overview

This unit provides the information required to begin the business planning process. You are going to learn more about how you may structure your business venture in terms of its ownership/organisation and financing. You are also going to reconsider your entrepreneurial profile in order to plan how you will help to create a great start-up culture.

Unit Objectives

By the end of Unit 4, you should be able to:

1. Identify and assess potential business opportunities.
2. Describe strategies that can make ventures profitable.
3. Compare advantages and disadvantages of different types of business organisations.
4. Describe key characteristics of great start up culture and explain their importance.
5. Explain how the sources of finance are related to time and risk.

4.1 Opportunity Recognition

Objectives

By the end of this section, you should be able to:

1. Describe opportunity and its role in the entrepreneurship process.
2. Describe the opportunity process.
3. Explain the difference between opportunity and idea.
4. Describe the three generic approaches for identifying opportunities.

Introduction

This section discusses the concept of opportunity recognition as an integral aspect of the entrepreneurial process. We will build our understanding on the need to recognise opportunity by taking action in a timely manner to address an identified opportunity.

What is opportunity recognition?

According to Barringer and Ireland (2010) an opportunity is "a favourable set of circumstances that creates a need for a new product, service or business." A business opportunity, they claim, must have four essential qualities:

1. Attractive.
2. Timely.
3. Durable or sustainable.
4. Adds value to customers and anchored in products services or a business.

A business opportunity needs to address a specific need in the market place. There must be expectation that the potential market will find value in the proposed service or product and be willing to pay money for it. The potential market has to be large enough to support continuous growth and ongoing sustainability. Ideally, the business idea will have few competitors. Ideally the business idea is new and innovative and if properly implemented will have a ready-made market.

Once you have identified an opportunity, you should test out your idea with the others around you. Explain your opportunity to others, gauge their reaction to your business idea and seek their input. Play the "what if" game with them. Ask them:

- Do you think this business opportunity has merit?
- Am I addressing a real problem, issue or need?
- Would someone pay money for this product or service?
- How would you change it to make the potential opportunity even better?
- Are there other organizations that have already developed this business idea?
- What issues do I need to consider when developing my business opportunity?
- What could cause this business opportunity to fail?

Examples of potential business opportunities

The examples below assume that there is a demand for this type of business and little or no competition exists.

1. **Tourism opportunities**
    a. Eco-tours into the jungle and rural areas.
    b. Day cruises up the rivers and waterways in the local area.
    c. City bus tours.
    d. Cultural tours.
    e. Car rental service.

2. **Manufacturing opportunities**
    a. Distribution of locally produced clothes or shoes to city retail outlets.
    b. Export and distribute local commodities and resources to off-shore buyers.
    c. Transportation services for agricultural sector.
    d. Building contract services.

3. **Retail opportunities**
    a. Fast-food restaurant.
    b. Boutique selling in-demand products from off-shore.

c. Electronics store.

4. **High tech opportunities**

   a. Computer sales and repair services.

   b. Computer school.

   c. E-learning consulting and implementation services.

   d. Programming and gaming services.

   e. Internet café.

Three approaches to opportunity recognition

With a good idea of what an opportunity is and its essential qualities, we can now examine the various approaches that you can use to identify a business opportunity. For this topic we will concentrate on three approaches namely:

- Observing trends.
- Solving a problem.
- Finding market gaps.

1. **Observing trends**

   According to www.thefreedictionary.com, a trend is defined as:

   - The general direction in which something tends to move.
   - The general tendency or inclination.
   - Current style or vogue.
   - The popular taste at a given time.

   From the above definition, it is clear that trends are what we observe in our everyday life whether it is new clothing or how we wear it; new language or slang in the community; a new song or dance craze in town; or maybe a complaint from a particular segment of our society. These trends create opportunities for entrepreneurs to pursue. Barringer & Ireland (2010) note that the most important trends are:

   a. Economic forces.

b. Social forces.

c. Technological advances.

d. Political action and regulatory change.

Figure 4.1 illustrates the impact of these trends. It is important for you as an entrepreneur to be aware of the changes in these areas as they will provide challenges and opportunities for your business venture.

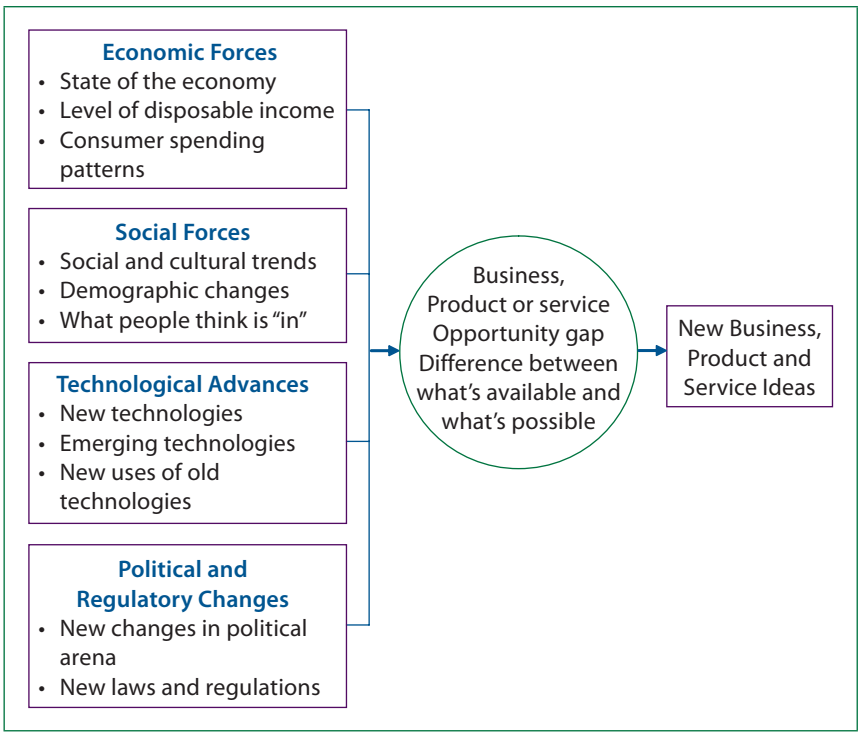


Figure 4.1 Trends suggesting business or product opportunity gaps

Dr. James Canton (2011) predicts that the top ten business trends in the future will include:

i. Business and technology have fused into one system, one conversation, and one strategy, for one world. This is central to understanding the New Future.

ii. Innovations are about new business models, enterprise and marketplace collaboration, new leadership and knowledge engineering.

iii. Knowledge engineering, the formation and networking of knowledge-that which creates results, is the true asset of the 21st century.

iv. The capture and analysis of customer information about product/service use, needs, wants, desires and behaviour is mission-critical to the enterprise.

v. The integration of customer touch points across all channels is essential to future success. Watch out for the breakdowns.

vi. The capacity of an organisation to understand the key trends that will shape the future of technology, customers, society and the marketplace will determine the survival of the enterprise.

vii. More disruptions are coming in the form of emerging markets, electronic exchanges, security breaches, and changing customer demographics.

viii. Human capital, the value of talent will be the most valuable resource in the 21st century.

ix. Entirely new industries will be formed by innovations yet to be brought to market. Look for the health enhancement, interactive TV nanotech, and on-demand supply chains to emerge.

x. The New Future will need New Leaders that are aware of how to attract talent, manage innovation, set high visions and execute profitably. There is a new paradigm about leadership that is emerging.



Activity 4.1

1. Discuss in detail the three approaches to opportunity recognition process of a MNC.

2. **Problem solving**

A simple illustration of problem would simply be "the difference between what you want and what you have". It further suggests an old saying "there are no problems — only opportunities." For many entrepreneurs, opportunities come in the form of a problem looking for a solution. Once you are able to come up with a solution to a recurring problem in your society, you are well on your way to creating a product, service or business.

Problem-solving process

Many problem solving techniques and models exist, but almost all contain the following five major activities:

a. **Define the problem**: Ask the right question: who, what, when why and how.

b. **Options**: What options are available to solve the problem?

c. **Analyse the options**: Seek answers to the questions. Examine each potential option. Analyse the answers and options and evaluate the results.

d. **Implement the favoured option**: Put the results into practice by testing and fine tuning until it achieves an acceptable working standard.

e. **Evaluate the results**: Determine if the implemented solution addresses the problem at hand.

3. **Finding gaps in the marketplace**

Every now and then, demands in the marketplace go unfulfilled for a considerable length of time. Gaps occur when products or services needed by a specific group go largely ignored by the mainstream providers because of their small numbers. This is sometimes called a niche market. In such circumstances, an entrepreneur sees such a problem or gap in the marketplace as a potential opportunity waiting to become a business. In some other cases, gaps in the marketplace are found in existing products and services. Consumers normally voice their opinion about the products and services they currently consume through complaints and other forms of feedback. This information provides adequate data to examine the issues or problems involved with a view turning them into an opportunity for a solution.

Some examples of early entrepreneurs recognising gaps in the marketplace include:

- **Thomas Edison** identified a market need for the phonograph, movie camera and the light bulb. He opened the first power station on Manhattan Island to power street and home lights in New York.

- **Henry Ford** saw the need for making automobiles that were affordable for the general public. He created the production line to reduce manufacturing costs and thus made the automobile affordable.

- The bothers **Richard and Maurice McDonald** saw a need for a fast-food restaurant to support the growing and active population in San Bernardino, California.

- **Steven Jobs** saw the need for affordable entertainment options that support the mobile on the go individuals. The result was iTunes, the iPod, the iPhone and now the iPad.

What these early entrepreneurs brought to the market were innovative products that no one else had considered. Each new product was effectively marketed, met an immediate need and helped grow some very small companies into international corporations. All it takes is a need and innovative solutions.

Innovation and entrepreneurship

Innovation is the key to the success of any entrepreneur. Peter Drucker (1985) in his book *Innovation and Entrepreneurship* indicates that innovation is not just an inspired idea. Innovation requires organisation, systematic thought and practice and rational work.

David Zilberman (n.d.) states that "excessive regulation, rigid hierarchy, lack of freedom and excessive control discourage entrepreneurship". He implies that innovation comes from openness to new ideas and the freedom to investigate without interference. Zilberman defines innovation as a new way to achieve a specific task. He categorises innovation as either process innovation or product innovation.

Recognising an opportunity

The characteristics that make some people better at recognising opportunities than others include:

1. **Prior experience**: Prospective entrepreneurs with prior experience in a particular industry or sector stand a good chance of identifying an opportunity from the myriad of problems facing their industry. They are more inclined to think of possible solutions on a frequent basis than someone who is not in the industry.

2. **Intellectual curiosity**: Those who want to know why or are willing to explore new ideas as potential opportunities. The key idea here is "What If?".

3. **Innovative and creative**: Those that can think outside of the box and can create solutions that no one has considered will see opportunities everywhere?

4. **Networking**: The successful entrepreneur will be able to network with others and explore opportunities that his or her peers and colleagues identify as potential business ventures.

5. **Assess risk**: The potential entrepreneur can quickly identify a problem, identify potential solutions and has the ability to identify the potential risks facing any potential solution.

6. **Motivation**: The potential entrepreneur needs to be self-motivated and a self-starter to be able to see and pursue potential opportunities.

The opportunity recognition process

There are a number of models that explore the process of opportunity recognition. One is described below:

> According to Lumpkin, Hills & Shrader, Opportunity Recognition (OR) is a "vitally important area of entrepreneurship" and an "essential aspect of understanding entrepreneurship". Their model for opportunity recognition is illustrated in **Figure 4.2**:

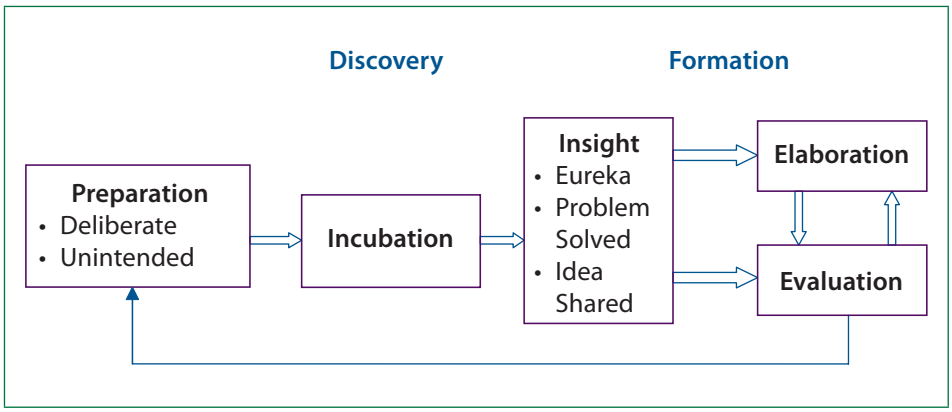


Figure 4.2 Opportunity Recognition (OR) Model

According to Lumpkins, Hills and Shrader (1999) the Opportunity Recognition Model identifies entrepreneurial opportunities through recognition rather than purposeful search which pre-requisites for successful opportunity discovery are a combination of entrepreneurial awareness, access to extended social networks, and prior knowledge of markets and customer problems; prior knowledge could exist due to work experience, personal, non-work related experiences and events, or due to relevant to these markets education.

Although the model offers to a clearer creative path, it has some practical implications. First, it highlights the importance of viewing opportunity recognition as a multidimensional process. Prior attempts to integrate creativity into entrepreneurial process models have minimised the iterative and staged nature of creative processes. Practitioners seeking more creative entrepreneurial outcomes can benefit from acknowledging that creativity enters into multiple stages of the opportunity recognition process. Furthermore, this research supports the central role that creativity plays in the opportunity recognition process. As such, management initiatives and consulting interventions aimed at improving the creativity of an organisation's workforce can be deployed in ways that make entrepreneurial outcomes more creative.

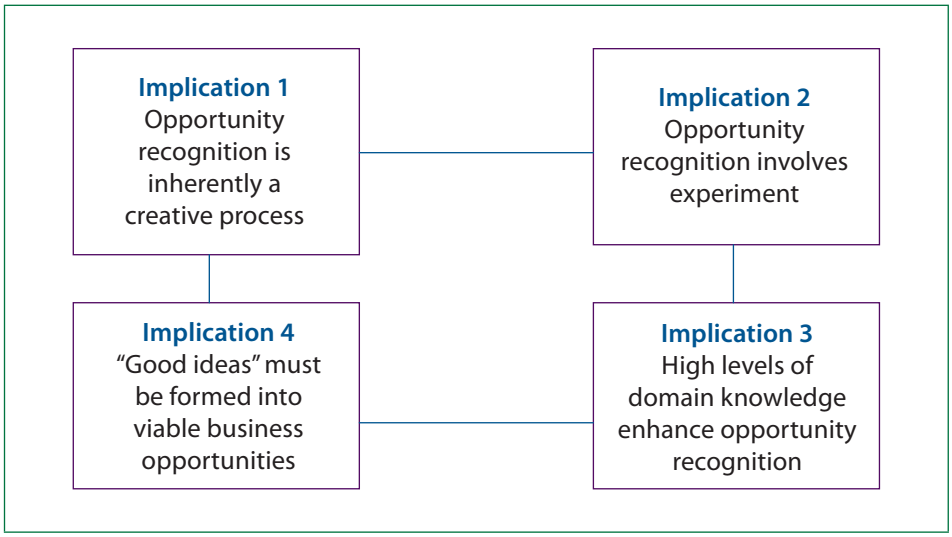


Figure 4.3 Opportunity recognition implication

Implication 1: Opportunity recognition is inherently a creative process.

Implication 2: Opportunity recognition involves experimentation.

Implication 3: High levels of domain knowledge enhance opportunity recognition.

Implication 4: "Good ideas" must be formed into viable business opportunities.



Summary

After reading this section, you should have a better understanding of how to recognise business opportunities. A business opportunity can arise from solving a problem or addressing an unmet need. It is important to observe trends and identify gaps in the marketplace. Prior experience is helpful in identifying business opportunities.



Self-test 4.1

1. Discuss the considerations for recognising opportunity by a business.

Suggested answers to activity



Feedback

Activity 4.1

The three approaches are as follows:

- Observing trends.
- Problem solving.
- Finding gaps in the marketplace.

4.2 The Competition

Objectives

By the end of this section, you should be able to:

1. Describe how to identify the potential competition.
2. Examine strategies on how to gain the competitive advantage.

Introduction

In previous section, we have discussed the market and how to identify the needs of your potential customers. But if you as a potential business person see opportunity, it is almost guaranteed that others have seen the same or similar opportunities. You should always assume that others are providing similar services or products. If the competition is not active in a specific market they may quickly enter that market if the profit opportunities present themselves. This section will explore how to assess the competition and how to create your own competitive advantage.

Who are your competitors?

Sometimes it is not easy to define who your competitors are. You must consider the products and services that you propose to develop as part of your new business direction. You need to search for companies, institutions or government agencies that provide similar services or products.

Stutely (2002) states you must look at your industry as a whole to determine who else is serving your target market. Many companies provide similar services or products but service industry sectors that you have no plan in supporting. Companies often concentrate on a single sector (e.g., agriculture) because each sector requires different knowledge of that particular industry. Often it is the knowledge and skills that they are selling. A company that specialises in providing education products or services to the military would not normally be able to provide similar products or services to the conventional university.

Why analyse the competition?

Some would ask "Why do I need to analyse the competition?" I have a product or service that I can offer to the market and I know that the market would be interested in purchasing my proposed product or service based on my feasibility/market analysis. But what you do not know is:

1. Who is selling into the same market?

2. Who offers similar products and services?

3. What the average price is for my proposed products and services?

4. What types of customer service and support the company needs to provide to satisfy my potential customers?

Assessing the competition

Stutely (2002) provides a number of questions that you must consider when sizing up your competition.

1. What business model does the competitor focus on? Do they sell to individuals, small companies or large industries? Are they retailer or a wholesaler?

2. What industry sector(s) do they sell into? University, health, security, tourist, government, etc.? Or are they diversified and service a number of different sectors?

3. What type of services or products do they provide? How similar are their products and services to the ones that I propose to provide?

4. Does the competition develop their own products or do they resell the products of others?

5. Do they focus on price or product?

6. Are they a full service company that provides on-going support to their customers?

7. How do they market to their customers?

8. What do they charge for their products or services?

9. How many employees do they have?

10. Where are they located?

11. Do they have an effective web site?

Collecting data on the competition

Many of the data sources you used to identify the potential market can also be used to identify similar information about your competitors. The more information you gather, the better you will be. You may also ask your potential customers who they currently use to support their requirements and do they provide all of the support they need or is there something that your potential company can do better.

Results of a competitor analysis

Once you have completed your detailed competitor analysis, you have some decisions to make. You must decide if your business idea still has a chance of succeeding. You need to decide if you need to modify your initial business idea based on your understanding of the competition or whether you should continue to develop the plan in more detail. You would want to make changes to your original plan if you discover:

If the competition	Then you should consider
Services the same target market.	Changing your intended target market to one that is underserviced.
Provides the same products and services.	Thinking about different products or services that the competition is not providing. Or Modifying your proposed products and services to make them substantially different.
Has a price point you find difficult matching.	Determining if you can change the products and services in a way that would reduce cost and thus price point.

Table 4.1 Result of competitor analysis

In formulating a competitor analysis, managers must consider the strategies of the firm's competitors. While in highly fragmented commodity industries, the movement of any single competitor may be less important. Therefore, in concentrated industries, competitor analysis is a vital part of strategic planning.

Competitor analysis has two primary activities: 1) obtaining information about important competitors, and 2) using that information to predict competitor behaviour. The goal of competitor analysis is to understand:

- which competitors to compete;
- competitors' strategies and planned actions;
- how competitors might react to a firm's actions;
- how to influence competitor behaviour to the firm's own advantage.

Casual knowledge about competitors usually is insufficient in competitor analysis. Rather, competitors should be analysed systematically using organised competitor intelligence-gathering to compile a wide array of information so that well informed strategy decisions can be made.

Knowledge of a competitor's objectives facilitates a better prediction of the competitor's reaction to different competitive moves. For example, a competitor that is focused on reaching short-term financial goals might not be willing to spend much money responding to a competitive attack. Rather, such a competitor might favour focusing on the products that hold positions that better can be defended. On the other hand, a company that has no short term profitability objectives might be willing to participate in destructive price competition in which neither firm earns a profit.

Competitor objectives may be financial or other types. Some examples include growth rate, market share, and technology leadership. Goals may be associated with each hierarchical level of strategy — corporate, business unit, and functional level.

The competitor's organisational structure provides clues as to which functions of the company are deemed to be more important. For example, those functions that report directly to the chief executive officer are likely to be given priority over those that report to a senior vice president.

Other aspects of the competitor that serve as indicators of its objectives include risk tolerance, management incentives, backgrounds of the executives, composition of the board of directors, legal or contractual restrictions, and any additional corporate-level goals that may influence the competing business unit.

Whether the competitor is meeting its objectives provides an indication of how likely it is to change its strategy.

The competitive advantage

Once you have completed your analysis of the competition you need to determine what competitive advantage your proposed business enterprise can create over your competitors. Stutely (2002) states that a competitive advantage can be one or more of the following:

1. **Price point**. Your services or products are cheaper than your competitors.

2. **Quality of products**. Your products will be better made than your competitors.

3. **Customer service**. Your proposed company will provide supportive sales and timely customer service and support.

4. **Innovation**. Strong research and development skills and effective and innovative solutions to the products and services you provide.

5. **Exclusivity**. Your company has exclusive rights to products or services that others do not offer. This is usually through the process of trade marking, patents or copyright enforcement.

Once you have defined your competitive advantage, this will eventually become part of your marketing approach to potential customers. This will be reflected in your marketing plan later in the process.



Activity 4.2

Discuss how important of competitive advantage analysis to an entrepreneur.



Summary

In this section, you have learnt how to identify and assess your current and future competitors. Every business has competitors and a new business must determine how they can gain the competitive advantage over their competitors.



Self-test 4.2

1. Discuss the importance of competitor analysis to improve your service.

4.3 Financing Your New Business

Objectives

By the end of this section, you should be able to:

1. Identify internal and external sources of financing.
2. Identify what type of cost must be covered to start and run a business.
3. Define venture capital, angel investors and investment concepts.

Introduction

Most start-up businesses fail because they are underfunded. The need for identifying and procuring sufficient funds to support the implementation and growth of a start-up company is essential to the success of any new business. Identifying sources of financing and convincing others to invest in your proposed enterprise is an essential part of the business planning process. Managing limited funds and seeking new sources of revenue are essential skills for the new entrepreneur.

Financial basics

To operate a small business owner must identify the anticipated costs, estimate the potential revenues and produce a budget. To do this a detailed financial plan that reflects the first two to three years of operation must be produced. To do this the entrepreneur must have a good grasp of finances and budgeting.

In order to determine the firm's financial requirements one will have to produce a **forecast**. Nieman, Hough & Nieuwenhuizen (2003) describe three steps in the financial planning process:

1. Project the firm's sales revenues and expense over the planning period.

   The key ingredients in a firm's planning process are the sales forecast. This projection will generally be derived using information from number of sources. At a minimum, the sales forecast for the coming year will reflect, (a) any past trends in sales that is expected to carry through a new year, (b) the influence of any events that might materially affect the sale trend. An example would be the initiation of a major advertising campaign or a change in the company's pricing policy.

2. Estimate the levels of investment in current and fixed assets that are necessary to support the projected sales.

Traditional financing forecasting takes the sales forecast as a given or starting point. The level of sales that enables projections to be made of the firm's various expenses, assets and liabilities. The most commonly used method for making these projections in the percent of sales method.

3. Determine the firm's financing needs throughout the planning period.

   The percent of sales method of forecasting involves estimating the level of an expense, an asset or a liability for the future period as a percentage of that period's sales period. For example, cost of sales might be projected as 60% of sales, which means in turn that gross profit will be estimated 40%. Or inventories might have averaged 20% of sales, so this figure could be used in the coming period's forecast.

A business needs to assess the cash flow requirements based on the following criteria:

1. Amount of money required — As an unproven start-up company it may be difficult raising large amounts of start-up funds. You must project the minimum amount of financial support, at least until you have established your own source of revenues.

2. How quickly the money is needed — The longer a business can spend trying to raise the money, normally the cheaper it is. The business will have to accept a higher cost if it needs the money quickly. Often start-up funds come from the personal funds available to the entrepreneur and his or her family and friends. Things like second mortgages, small loans from parents; money from credit cards is often used to finance the start-up of a business. Most investors (be it family, friends or others) will want the entrepreneur to accept some of the financial risks by investing in his or her own business.

3. The amount of risk involved in the reason for the cash — A project which has less chance of leading to a profit is deemed more risky than one that will result in a profit. Potential sources of finance (especially external sources) may not lend money to higher risk business projects; unless there is some sort of guarantee that their money will be returned.

4. The length of time for repaying funds — A good entrepreneur will judge whether the funds needed is for a long-term project or short-term and therefore decide what type of finance they wish to use. The longer it takes to repay the initial investors the more difficult it will be to get them to give up the money you need.

The cost of operating a business

When developing a financial plan consider the following types of expenses that your new company may need to undertake.

1 Start-up costs money. It may be some time before the business generates enough cash from sales to pay for these costs. The point where you are at a break-even point (when revenues equal expenses) may take several months or even years. You need to have sufficient funds to operate the business until you hit the break-even point. Start-up costs include:

   a. Procuring infrastructure, office space, furniture, computer equipment, etc.

   b. Initial marketing materials.

   c. Legal and accounting costs.

   d. Business planning costs.

2. Day-to-day business operations continually draw on finances. These could include:

   a. Rent.

   b. Monthly costs for phone, Internet, transportation.

   c. Marketing and sales.

   d. Employee or contractor costs.

   e. Production costs.

3. Growing a business involves creating higher capacity and innovating with new technology to cut unit costs and keep up with competitors. Examples of these costs are:

   a. Research and development costs.

   b. Consulting costs.

   c. Investment in new technologies or new equipment.

4. Developing and marketing your products and service. Is your business competing in a fast-moving market where the product is continually updated? Is it necessary to conduct marketing research or to test new products? Marketing costs could include:

   a. Creation and maintenance of a web site.

   b. Radio and paper based advertising.

c. Printing and distribution of marketing materials.

d. Attendance at industry conferences where you will market your products.

e. Commissions paid to others who provide new customers.

5. Expanding and entering new markets can draw on funds for setting up new retail outlets and/or advertising in new areas.

6. Acquiring or taking over a new business can involve "buying out" your competitor.

7. Moving your business can include the cost of renting of removal vans, through to relocation packages for employees and the installation of machinery.

Types of expenses and revenues

Every company has expenses to pay and requires revenues to cover the expenses. You must identify what your expenses and revenues are before you can determine how to finance the start-up and growth of your new company. As you begin the detailed planning phase of your business you will need to produce a start-up budget and operating budget that reflects all of the activities that you must support as your produce and sell your products and services.

In general there are three types of expenses that you must budget for: Start-Up Expenses; Operating Expenses; and Capital Expenses. At the other end there are three types of revenues that you will eventually generate or require to cover the expenses: Revenues Generated from Sales; Revenues Generated from Borrowing; and Revenues Generated from Sale of Shares in the Company. We will briefly explore each type of expense and revenue.

Start-up expenses

It not only takes an idea to launch a new company, it takes funds to plan and eventually start the company. During the planning and start-up phases expenses will widely vary depending on the business model, scenarios and type of products and services the proposed company will provide.

Money must be invested even before the company opens the doors for business. Start-up costs will vary depending on the type of business you start. Some typical start-up costs include:

- Legal fees and government fees for incorporation, naming, etc.

- Research and development costs to create new products or refine existing ones.
- Costs related to the completion of feasibility studies, market analysis and competitor analysis.
- Marketing expenses, including web site design, packaging design, etc.
- Production of initial products that can be used to show clients.
- Leasing costs to procure appropriate office space.
- Cost of furniture and office equipment.
- Cost of telecommunications and Internet installation and equipment.
- Purchase or lease of computer equipment and software.
- Business insurance.

Other start-up expenses will depend on the type of business. If you are starting a delivery business, you will need to procure a vehicle and insure it for business operations. If you are starting a vegetable wholesale and distribution business you would need to rent or purchase large storage space and potential refrigeration units.

You need to clearly define what you need before you can begin selling your products and services and then you need to procure funds to make the necessary investment in the start-up costs.

Operating expenses

Once you launch your business you will have on-going expenses to keep the business operating from day to day. You need to identify what these costs will be and then estimate how much it will cost each year. Some typical operating expenses include:

- Heating/cooling expenses.
- Electric and water bills.
- Telephone/cell phone bills (including estimates for long distance expenses).
- Internet and ICT connections.
- Monthly rent/leasing expenses.
- Employee salaries and benefits.
- Contractor/sub-contractor payments.

- Payment of any loans.
- Vehicle operating costs.
- Payment to suppliers and wholesalers used by the company.
- Ongoing marketing expenses, including travel to and from customer locations.

Capital expenses

Capital expenses are long term multi-year expenses that must be planned for and monies allocated over several years. A capital budget is usually necessary to support these types of expenditures. Annual payments to the capital account may be reflected in your operating budgets. Capital expenses are accounted for differently and in many cases have a depreciated value over time. Some examples of expenses incurred over several years are:

1. Purchase of a fleet of equipment.
2. Purchase and/or upgrading of computer equipment/hardware.
3. Building of an office or storage facility.
4. Investment in multi-year production requirements to support the creation of a new product.

Sales revenues

Revenues or company income is normally generated through the sale of products and services. Without steady and growing sales revenues a company will fail. The greater the sales volume the larger will be the revenues. Thus time and money must be spent in the marketing and sales of your products and services.

You must also select a price point for your products and services that will generate more revenue. If you price your products and services to high you will generate fewer sales. Volume sales can generate more revenue through lower prices and higher throughput.

Revenues generated through borrowing

In the start-up stage of a business or during a growth period, many businesses may not have the cash on hand or sufficient revenues to support this effort. In these cases the entrepreneur may need to borrow the cash to support the start-up or growth. Sources of borrowing include:

1. **Banks**: Some banks or lending agencies will lend to new or growing businesses that have a sound business plan and ideally some form of collateral to

guarantee the loan. If you are in the start-up phase you may have little or no collateral and thus many entrepreneurs may have to use their homes or other assets to get the cash they need to start the business.

2. **Family or friends**: In the early stages of business start-up you may need to borrow money from family or friends who have confidence in your ability to succeed in your business. If you do borrow money from relatives ensure you still have a legal contract that specifies the interest you will pay and a repayment schedule for the loan.

3. **Personal assets**: If you have confidence in your business plan then you should be willing to invest your own assets in your company. Any savings you have, use of lines of credit or even re-mortgaging your house are potential revenue sources for your business. Although it may not cover all of the start-up expenses the banks, family and friends will feel that you have taken a considerable part of the financial risk by investing in yourself.



Activity 4.3

Browse Malaysian Franchise Association (MFA) at http://www.mfa.gov.my and describe the government support system to a franchise business in Malaysia.

Revenues from investors

There are a number of different sources of revenues from investors. The difference between lenders and investors is that investors are buying a portion of your company and as such the investors may have a say on how you grow and operate a business. Without investors you own 100% of the company. When investors become sources of revenues you are selling them a portion of the company. Before you can offer investors an opportunity to buy into your company, the company must be incorporated and you must establish a board of directors. The different types of investors includes:

1. **Family or friends**: The difference between being a lender as a family member and an investor is that you are giving your family member or friend a legal portion of the company and thus opportunity to share in any future profits.

2. **Partners**: Individuals who collectively join together to launch a new company should be willing to invest in the company. A partnership agreement must be entered into that specifies that amount of control that each partner has in the operation of the company. Often this is based on the amount of cash that they provided to support the initial start-up. If one partner provides 25% of the cash then he or she probably should have 25% of the voting rights when decisions are to be made.

3. **Angel investors**: Angel investors are individuals who are willing to provide the capital required to start the business in exchange for equity in the company. Usually, a former entrepreneur or professional who provides starting or growth capital in promising ventures, and helps also with advice and contacts. Unlike venture capitalist, angel investors usually operate alone (or in very small groups) and play only an indirect role as advisors in the operations of the investee firm. They are deemed to be 'angels' in comparison with grasping investors who are termed 'vulture capitalist.' Also called business angel.

4. **Venture capitalists**: Venture capitalists are somewhat different from angel investors in that they are high risk investment companies whose aim is to buy into a new business venture with the expectation that they will make a quick profit. Often venture capital companies want a significant part of the company or even a controlling interest of the company. Usually they become engaged in the company in the early stages of its growth. Money provided by investors to start up firms and small businesses with perceived long-term growth potential. This is a very important source of funding for start ups that do not have access to capital markets. It typically entails high risk for the investor, but it has the potential for above-average returns.

5. **Public/Private offerings**: Once your business has reached its first level of success and begins to turn a profit you wish to grow it to the next level. At this time you may want to make a public or private offering of stocks in the company to raise the cash reserves needed to grow the company. This is done by listing your company on a public or private stock exchange. The level of effort required to become listed is considerable.

Cash reserves

A business should have a cash reserve of at least three months to cover operations and expenses without any infusion of revenues. By contrast, you may be owed money. If you are a supplier to other businesses, you may be providing a trade credit. A special factoring company may offer to handle the debt collection process for a charge. The factoring company pays the business most of the value of the debt first and then collects the money from the debtor. A financing method in which a business owner sells accounts receivable at a discount to a third-party funding source to raise capital. One of the oldest forms of business financing, factoring is the cash-management tool of choice for many companies. Factoring is very common in certain industries, such as the clothing industry, where long receivables are part of the business cycle. This is a short term source of finance.

Government assistance

Governments have various programmes which help start-ups and small businesses grow. Government assistance may be in the form of:

- Small business loans.

- Business plan preparation.
- Assistance with potential lenders.
- Education and training on how to operate a small business.
- Creation of partnerships.

Franchising

Franchising is a method of expanding business on less capital than would otherwise be needed. Under a franchising arrangement, a franchisee pays a franchisor for the right to operate a local business, under the franchisor's trade name. Although the franchisor will probably pay a large part of the initial investment cost of a franchisee's outlet, the franchisee will be expected to contribute a share of the investment himself. The franchisor may well help the franchisee to obtain loan capital to provide his-share of the investment cost.



Summary

In this section, you have learnt about financing a business. You have also learnt about the different types of expenses you must consider and the sources of revenue you must generate.



Self-test 4.3

1. Discuss the forms of expenses that a business would likely face?
2. List the funding and mentoring assistance provided by Malaysian government to entrepreneurs.

4.4 Marketing and Sales

Objectives

By the end of this section, you should be able to:

1. Describe the difference between marketing and sales.
2. Explain the process of marketing and sales.
3. Examine the guidelines for pricing your products and services.
4. Identify the marketing and sales principles that all businesses should embrace.

Introduction

An effective marketing and sales plan is essential to the success of any new (or mature) business. We explore some of the principles you must consider when trying to market and sell your products and services.

Marketing versus sales

People often use the terms marketing and sales interchangeably but in fact they are very different, but complimentary concepts that employ different strategies. Let us examine some definitions. The American Marketing Association defines marketing as "the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large". The Chartered Institute of Marketing defines marketing as "the management process responsible for identifying, anticipating and satisfying customer requirements profitably". The two definitions have the following:

- Marketing is a management process.
- Marketing is aimed at satisfying customer needs.
- Marketing is a communications process.
- Marketing provides value to the customer.

InvestorWords.com defines sales as the "total dollar amount collected for goods and services provided". BusinessDictionary.com defines sales as "the activity or business of selling products or services". As you can see there are similarities to marketing in that:

- Sales is a process.
- Sales speak to the exchange of revenues for goods and services.

Lake (n.d.) examines the difference between sales and marketing. She explains:

> *"Marketing is everything that you do to reach and persuade prospects. The sales process is everything that you do to close the sale and get a signed agreement or contract. Both are necessities to the success of a business. You cannot do without either process. By strategically combining both efforts you will experience a successful amount of business growth. However, by the same token if the efforts are unbalanced it can detour your growth".*

The marketing and sales process

The marketing process begins the moment you decide you wish to offer products and services to potential customers. You must first complete market research about customer needs and requirements. Customer needs should drive the types of products and services your offer. Market research should drive the design and development of the products and services.

The next step in a simple marketing process is to decide on the price for your products and services. This requires an understanding of your target market, the competition and what others charge for similar products and services. The idea is to price your products and services in a way that gives your new business entity the competitive edge. The third step in the marketing process is raising customer awareness and educating them about the products and services you are providing. You will need to implement a marketing plan and employ a variety of marketing strategies to introduce your products and services to your potential customers. Once the potential customers see a need for your products and services, the sales process should kick-in. Now you must employ a process of investigation and negotiation. You need to investigate and clearly define exactly what the customer needs. Second, you need to negotiate the cost, delivery times, support and other activities needed to support the sale. Finally, you need to close the deal with a formal contract or at best the exchange of monies for the products received.

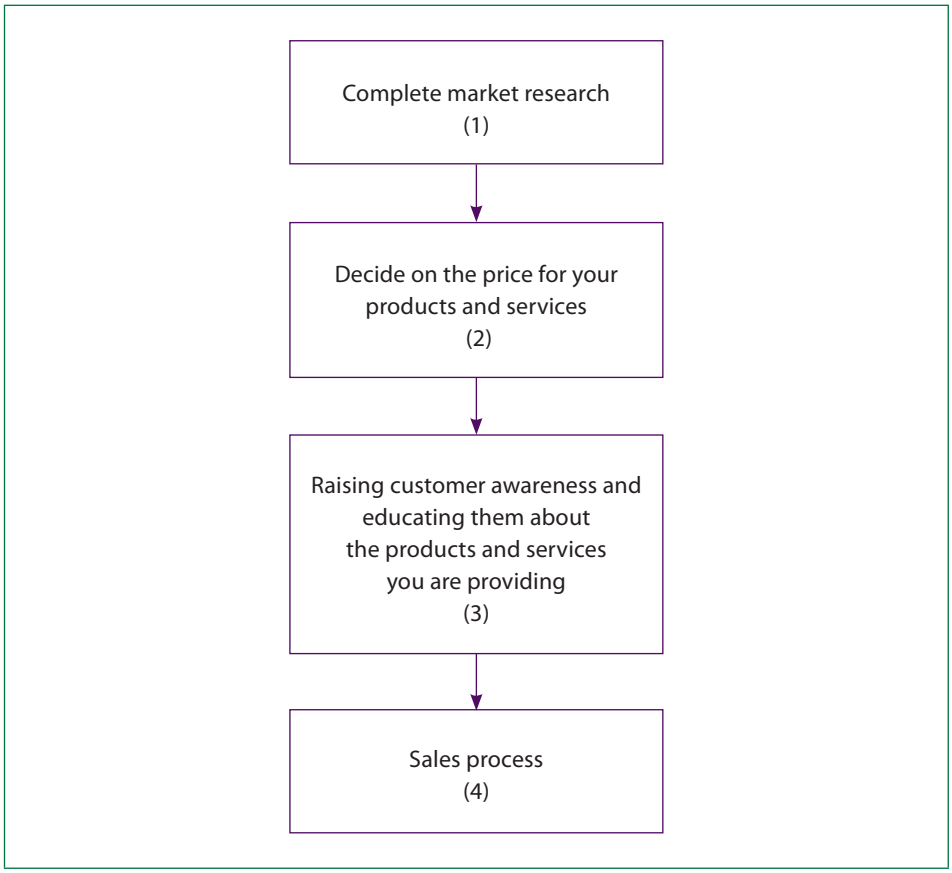


Figure 4.4 Marketing and sales process



Activity 4.4

Discuss the importance of marketing strategies to a business.

Marketing strategies

Marketing strategies will vary based on the potential target audience and the industry or sector you are trying to communicate with or sell into. Marketing strategies are used to raise awareness, communicate and educate potential clients. The strategies may be as simple of printed pamphlets, to as complex as thirty minute info commercial. Some typical strategies used by companies include:

1. Advertising in local, national or professional newspapers, journals or magazines.
2. Creating radio or television advertising.
3. Direct mail brochures.
4. Presentations at trade shows or conferences.

5. Information web sites, webinars or social media sites.

6. Cold-calls on potential customers.

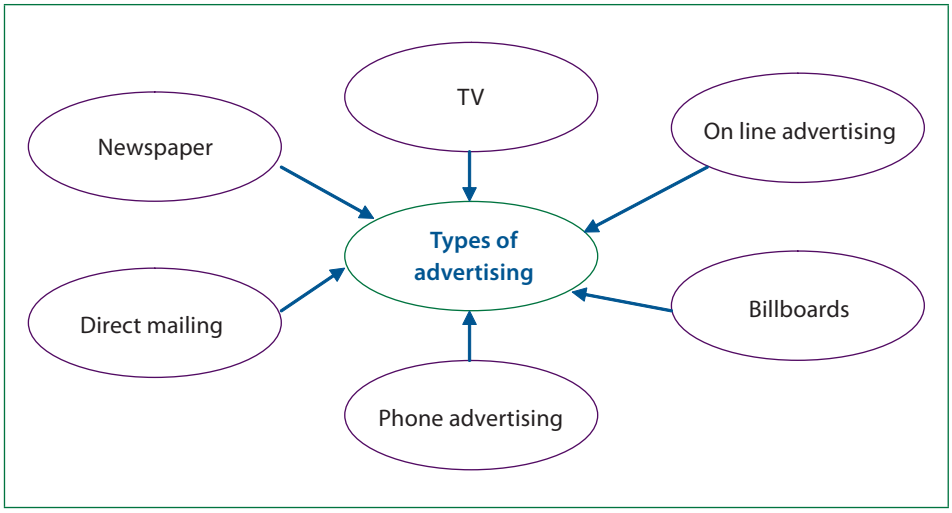


Figure 4.5 Types of advertising

Closing the sale

Often the process of closing the sale is overlooked. You must not only sell the product to the customer, but you must ensure the customer is happy with the product or service. You need to provide guarantees or return policies. You need to ensure your company has established a customer service approach to support customers after the sale has been closed. This may include:

1. Technical support.

2. A return desk.

3. Feedback sheets/surveys.

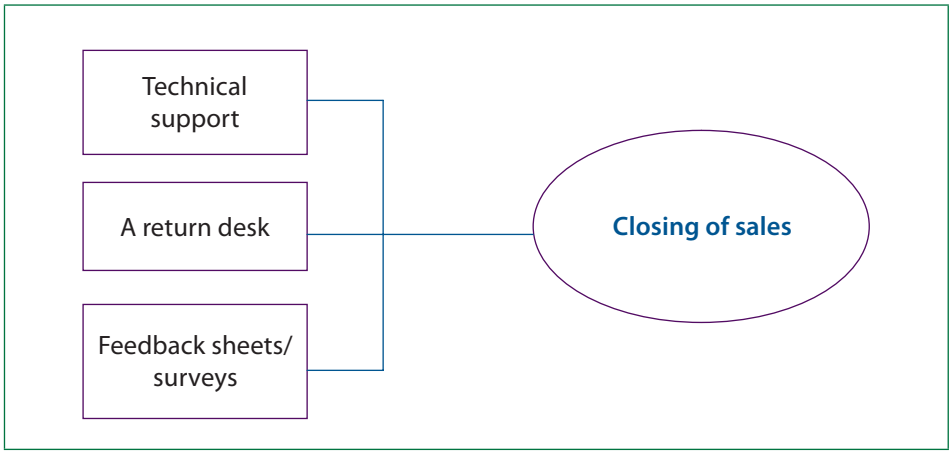


Figure 4.6 Closing of sales



Summary

You have now gained some insight into the marketing and sales process. It is important to spend time and money in defining your market and implementing appropriate marketing strategies. Finally you need to consider the types of post-sales support you will need and how you will provide it.



Self-test 4.4

1. Distinguish the difference between marketing and sales.

Summary of Unit 4



Summary

In this unit, we have explored the key elements of a business structure. You should be able to identify and distinguish between different types of businesses based on how they are organised and financed. You have also learnt about the importance of understanding your competition and how to market your products and services.

Suggested Answers to Self-tests



Feedback

Self-test 4.1

1. Considerations for recognising opportunity are;

   - **Prior experience**: Prospective entrepreneurs with prior experience in a particular industry or sector stand a good chance of identifying an opportunity from the myriad of problems facing their industry. They are more inclined to think of possible solutions on a frequent basis than someone who is not in the industry.

   - **Intellectual curiosity**: Those who want to know why or are willing to explore new ideas as potential opportunities. The key idea here is "What If?".

   - **Innovative and creative**: Those that can think outside of the box and can create solutions that no one has considered will see opportunities everywhere?

   - **Networking**: The successful entrepreneur will be able to network with others and explore opportunities that his or her peers and colleagues identify as potential business ventures.

   - **Assess risk**: The potential entrepreneur can quickly identify a problem, identify potential solutions and has the ability to identify the potential risks facing any potential solution.

   - **Motivation**: The potential entrepreneur needs to be self-motivated and a self-starter to be able to see and pursue potential opportunities.

Self-test 4.2

1. Despite being dimly aware that everyone does it, us British business owners hate being too upfront about looking at our competitors.

   However, tact and politeness aside, knowing as much as possible about your five closest competitors is a business necessity. Competitor analysis is not about copying other businesses; it's

about understanding what they are doing, especially in terms of marketing strategy.

To succeed in business, it is imperative that you know the following about your competitors:

- What range of products (or services) do they offer?
- How have they packaged their products?
- How have they priced their products?
- How do they write about their products and what style of marketing copy do they use?

Self-test 4.3

1. The three types of expenses those are likely to be faced by a business.
   - Start-up expenses
   - Operating expenses
   - Capital expenses

2. Few funding and mentoring assistance provided by Malaysian government to entrepreneurs.
   - National SME Development Council
   - Mavcap
   - Malaysian Franchise Association
   - MSC Malaysia
   - E-Perolehan

Self-test 4.4

1. The typical goal of marketing is to generate interest in the product and create leads or prospects. Marketing activities include:

- Consumer research to identify the needs of the customers
- Product development — designing innovative products to meet existing or latent needs
- Advertising the products to raise awareness and build the brand.
- Pricing products and services to maximise long-term revenue.

On the other hand, sales activities are focused on converting prospects to actual paying customers. A sale involves directly interacting with the prospects to persuade them to purchase the product.

Marketing thus tends to focus on the general population (or, in any case, a large set of people) whereas sales tend to focus on individuals or a small group of prospects.

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