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# INTRODUCTION Lesson 01

## LEARNING OBJECTIVES

1. 1. To introduce the concept of entrepreneurship and its historical development.
2. 2. To explain the entrepreneurial decision process.
3. 3. To identify the basic types of start-up ventures.
4. 4. To explain the role of entrepreneurship in economic development.
5. 5. To discuss the ethics and racial responsibility of entrepreneurs.

## NATURE AND DEVELOPMENT OF ENTREPRENEURSHIP

The term *entrepreneur* comes from the French and translates "between-taker" or "go-between."

### Earliest Period

In this period the money person (forerunner of the capitalist) entered into a contract with the go-between to sell his goods. While the capitalist was a passive risk bearer, the merchant bore all the physical and emotional risks.

### Middle Ages

In this age the term **entrepreneur** was used to describe both an actor and a person who managed large production projects. In such large production projects, this person did not take any risks, managing the project with the resources provided. A typical entrepreneur was the cleric who managed architectural projects.

### 17th Century

In the 17th century the entrepreneur was a person who entered into a contract with the government to perform a service Richard Cantillon, a noted economist of the 1700s, developed theories of the entrepreneur and is regarded as the founder of the term. He viewed the entrepreneur as a risk taker who "buy[s] at certain price and sell[s] at an uncertain price, therefore operating at a risk."

### 18th Century

In the 18th century the person with capital was differentiated from the one who needed capital. In other words, entrepreneur was distinguished from the capital provider.
Many of the inventions developed during this time as was the case with the inventions of Eli Whitney and Thomas Edison were unable to finance invention themselves. Both were capital users (entrepreneurs), not capital providers (venture capitalists.) Whitney used expropriated crown property. Edison raised capital from private sources.

A **venture capitalist** is a professional money manager who makes risk investments from a pool of equity capital to obtain a high rate of return on investments.

### 19th and 20th Centuries

In the late 19th and early 20th centuries, entrepreneurs were viewed mostly from an economic perspective. The entrepreneur "contributes his own initiative, skill and ingenuity in planning, organizing and administering the enterprise, assuming the chance of loss and gain."
Andrew Carnegie is one of the best examples of this definition, building the American steel industry on of the wonders of industrial world, primarily through his competitiveness rather than creativity.
In the middle of the 20th century, the notion of an **entrepreneur as an innovator was** established.

Innovation, the act of introducing something new, is one of the most difficult tasks for the entrepreneur.

Edward Harriman and John Pierpont Morgan are examples of this type of entrepreneur. Edward reorganized the Ontario and southern railroad through the northern pacific trust and john developed his large banking house by reorganizing and financing the nation's industries.
This ability to innovate is an instinct that distinguishes human beings from other creatures and can be observed throughout history.

**DEFINITION OF ENTREPRENEUR**

The concept of entrepreneurship from a personal perspective has been explored in this century. This exploration is reflected in the following three definitions of an entrepreneur:
In almost all definitions of entrepreneurship, there is agreement that we are talking about a kind of behavior that includes:

1. Initiative taking
2. The organizing and reorganizing or social/economic mechanisms to turn resources and situations to practical account.
3. The acceptance of risk or failure.

To an economist, an entrepreneur is one who brings resources, labor, materials, and other assets into combinations that make their value greater than before, and one who introduces changes, innovations, and a new order.
To a psychologist, such a person is typically driven by certain forces- the need to obtain something, to experiment, to accomplish or perhaps to escape the authority of others.
*Entrepreneurship* is the dynamic process of creating incremental wealth. Our definition of entrepreneurship involves four aspects:

1. Entrepreneurship involves the creation process.
2. It requires the devotion of the necessary time and effort.
3. It involves assuming the necessary risks.
4. The rewards of being an entrepreneur are independence, personal satisfaction, and monetary reward.

For the person who actually starts his or her own business there is a high failure rate due to poor sales, intense competition, lack of capital or lack of managerial ability.

**THE ENTR EPRENEURIAL DECISION PROCESS**
**(Deciding to become an entrepreneur by leaving present activity )**

Many individuals have difficulty bringing their ideas to the market and creating new venture entrepreneurship and the actual entrepreneurial decisions have resulted in several million new businesses being started throughout the world. Although no one knows the exact number in the United States.
Indeed, millions of ventures are formed despite recession, inflation, high interest rates, and lack of infrastructure, economic uncertainty and the high probability of failure

The entrepreneurial decision process entails a movement *from* something *to* something— a movement from a present life style to forming a new enterprise.

To leave a present live-style to create something new comes from a negative force--disruption. Many companies are formed by people who have retired, moved, or been fired. Another cause of disruption is completing an educational degree.

The decision to start a new company occurs when an individual perceives that forming a new enterprise is both desirable and possible.

**KEY TERMS Breakthrough innovations**

A new product with some technological change

**Business ethics**

The study of behavior and morals in a business situation

**Desirability of new venture formation**

Aspects of a situation that make it desirable to start a new company.

**Entrepreneur**

Individual who takes risks and starts something new

**Entrepreneur as an innovator**

An individual developing something unique

**Entrepreneurial decision process**

Deciding to become an entrepreneur by leaving present activity

**Entrepreneurship**

Process of creating something new and assuming the risks and rewards

**THE NATURE AND IMPORTANCE OF ENTREPRENEURSHIP Lesson 02**

**LEARNING OBJECTIVES**

1. To introduce the concept of entrepreneurship and its historical development.
2. To explain the entrepreneurial decision process.

**Desirability of New Venture Formation**

**(Aspects of a situation that make it desirable to start a new company)**

The perception that starting a new company is desirable results from an individual's culture, subculture, family, teachers and peers.
American culture places a high value on being your own boss, being a success and making money therefore, it is not surprising to find a high rate of company formation in the United States. On the other hand in some countries making money is not as valued and failure may be a disgrace. The rate of business formation in these countries is not as high. Many subcultures that shape value systems operate within a cultural framework.

Studies indicate that a high percentage of founders of companies had fathers and/or mothers who valued independence. Encouragement to form a company is also gained from teachers, who can significantly influence individuals. An area having a strong educational base is also a requirement for entrepreneurial activity. Peers are important, also, as is an area with an entrepreneurial pool and peer-meeting place.

## Possibility of New Venture Formation

**(Factors making it possible to create a new venture)**

Although the desire of new venture formation derived from the individual's culture, subculture, family, teachers and peers needs to be present before any action is taken, the second feature necessary centers around this question "What makes it possible to form a new company?"
Formal education and previous business experience give a potential entrepreneur the skills needed to form and manage a new enterprise. Although educational systems are important in providing the needed business knowledge, individual will tend to be more successful in forming in fields in which they have worked. The government also contributes by providing the infrastructure to help a new venture.
The market must be large enough and the entrepreneur must have the marketing know-how to put together the entire package.

Finally, financial resources must be readily available. Although most start-up money comes from personal savings, credit, and friends, but there is often a need for additional capital. Risk-capital availability plays an essential role in the development and growth of entrepreneurial activity.

**KEY TERMS**

**Foundation companies**

A type of company formed from research and development that usually does not go public.

**Gazelles**

Very high growth ventures.

**Government as an innovator**

A government active in commercializing technology

**High-potential ventures**.

A venture that has high growth potential and therefore receives great investor interest

**Entrepreneurship**

Entrepreneurship within an existing business structure

**Iterative synthesis**

The intersection of knowledge and social need that starts the product development process

**Lifestyle firm**

A small venture that supports the owners and usually does not grow

**Ordinary innovation**

Z new product with little technological change

**Possibility of new venture formation**

Factors making it possible to create a new venture

# ENTREPRENEURIAL PROCESS/START UPS Lesson 03

## LEARNING OBJECTIVES

1. To identify the basic types of start-up ventures.
2. To explain the role of entrepreneurship in economic development
3. To discuss the ethics and racial responsibility of

## TYPES OF START-UPS

### Life-Style Firms

A **life-style firm** exists primarily to support the owners and usually has little growth opportunity. This type of firm may grow after several years to 30 or 40 employees.

### Foundation Companies

A type of company formed from research and development that usually does not go public. This firm can grow in five to ten years from 40 to 400 employees.

### High-Potential Venture

A venture has high growth potential and therefore receives great investor interest. The company may start out like a foundation company, but its growth is far more rapid. After five to ten years the company could employ around 500 employees. These firms are also called **gazelles** and are most important for the economic development of an area

## ROLE OF ENTREPRENEURSHIP IN ECONOMIC DEVELOPMENT

The role of entrepreneurship in economic development involves initiating change in the structure of business and society. One theory of economic growth depicts innovation as the key, not only in developing new products, but also in stimulating investment interest. The new capital created expands the capacity for growth (supply side), and new spending utilizes the new capacity and output (demand side.)

In spite of the importance of investment and innovation in the economic development of an area, there is still a lack of understanding of few factors which are as follows:

- The **product-evolution process** is the process through which innovation develops and commercializes through entrepreneurial activity, which in turn stimulates economic growth. It begins with knowledge in the base technology and ends with products or services available in the marketplace.
- The critical point in the process is the intersection of knowledge and a recognized social need, called the **iterative synthesis.** This point often fails to evolve into a marketable innovation.
- Most innovations introduced in the market are **ordinary innovations**, with little uniqueness.
- **Technological innovations** refer to new products with significant technological advancements.
- **Breakthrough innovations** mean the development of new products with some technological change.

Regardless of the level of uniqueness or technology, each innovation evolves into and develops towards commercialization through one of three mechanisms: the government, entrepreneurship, or entrepreneurship. Entrepreneurship has assisted in revitalizing areas of the inner city. Individuals in inner-city areas can relate to the concept and see it as a possibility for changing their present situation.

**GOVERNMENT AS AN INNOVATOR**

A government active in commercializing technology is known as an innovative government. Commercializing technology is frequently called **technology transfer**.

However, few inventions resulting from government-sponsored research have reached the commercial market. Most of the by-products from scientific research have little application to any social need. The government lacks the business skills needed for successful commercialization. Government bureaucracy and red tape also often inhibit the timely formation of the business. Recently, federal labs have been required to commercialize some of their technology each year and some are providing entrepreneurial training

**Intrapreneurship**

Intrapreneurship refers to entrepreneurship within an existing organization or business structure. Existing businesses have the financial resources, business skills, and marketing and distribution system to commercialize innovation successfully. Often the bureaucratic structure, emphasis on short-term profits, and structured organization inhibit creativity. Some corporations have tried to establish an Entrepreneurial spirit in their organization, some in the form of strategic business units (SBUs.)

Intrapreneurship can also bridge the gap between science and the marketplace. It is the practice of using entrepreneurial skills without taking on the risks or accountability associated with entrepreneurial activities. It is practiced by employees within an established organization using a systemized business model. Employees, perhaps engaged in a special project within a larger firm are supposed to behave as entrepreneurs, even though they have the resources and capabilities of the larger firm to draw upon. Capturing the dynamic nature of entrepreneurial management (trying things until successful, learning from failures, attempting to conserve resources, etc.) adds to the potential of otherwise static organizations without exposing those employees or self employed people to the risks or accountability normally associated with entrepreneurial failure.

**Employee Intrapreneur**

An employee *Intrapreneur* is the person who focuses on innovation and creativity and who transforms a dream or an idea into a profitable venture, by operating within the organizational environment. Thus, Intrapreneurs are *inside entrepreneurs* who follow the goal of the organization.

Employees, perhaps engaged in a special project within a larger firm are supposed to behave as entrepreneurs, even though they have the resources, capabilities and security of the larger firm to draw upon. Capturing a little of the dynamic nature of entrepreneurial management (trying things until successful, learning from failures, attempting to conserve resources, etc.) adds to the potential of an otherwise static organizations without exposing those employees to the risks or accountability normally associated with entrepreneurial failure

**Entrepreneurship**

The third method for bridging the gap between the science and the marketplace is via entrepreneurship. Many entrepreneurs have difficult time bridging this gap and creating new ventures. They may often lack managerial skills, marketing capabilities, or financial resources. They frequently do not know how to interface with banks, suppliers, customers, and distributors. Yet, entrepreneurship is the most effective method for bridging the gap and creating new enterprises, these activities affect an areas economy by building the economic base and providing jobs.

**ENTREPRENEURIAL CAREERS AND EDUCATION**

Since 1985 there has been an increased interest in entrepreneurial careers fostered by factors such as increased media coverage of entrepreneurs and employment shifts.
A conceptual model for understanding entrepreneurial careers views the career stages as interacting with other stages and events in the individual's life, the life-cycle approach. This approach conceptualizes
entrepreneurial careers in nine categories.

1. Educational environment
2. The individual's personality
3. Childhood family environment
4. Employment history
5. Adult development history
6. Adult family/non-work history
7. Current work situation
8. The individual's current perspective
9. The current family situation

Although there exist a common perception that entrepreneur are less educated than the general population however studies have found entrepreneurs overall and female entrepreneurs in particular, are far more educated than the general population. However, this education sometimes does not develop the specific skills needed in the venture, especially for women entrepreneurs.

Childhood influences have been explored, particularly in terms of values and the individual's personality .The traits most frequently researched are the need for achievement, locus of control, **risk-taking**, and gender identity.
The research on the childhood family environment of the entrepreneur has had more definite results.
Entrepreneurs tend to have self-employed fathers, and many also have entrepreneurial mothers. The family plays an important role in establishing the desirability of entrepreneurship as a career.
Employment history also has an impact on entrepreneur careers in both positive and a negative sense. Entrepreneurs tend to have a higher probability of success when the venture created is in their field of experience. Negative displacement (such as dissatisfaction with various aspects of ones job) also encourages entrepreneurship.

Although no definite research has been done on the adult development history of entrepreneurs, it appears to also affect entrepreneur's careers. One's development history has somewhat more of an impact on women, since they tend to start businesses at a later stage in life.
There is a lack of data on adult family/non-work history and the available data adds little understanding towards entrepreneurial career development.
Entrepreneurs are known for their strong work values, their long workdays, and their dominant management style. They tend to fall in love with the organization and will sacrifice almost

anything in order for it to survive.
While in college, few future entrepreneurs realize that they will pursue entrepreneurship as their major life goal. Relatively few individuals will start a business immediately after graduation. Entrepreneurship education is a fast growing area in colleges and universities. While the courses vary by university, there is a great commonality, especially in the initial few courses.

The **skills required by entrepreneurs** can be classified in to three main areas:

1. *Technical skills* involve such things as writing, listening, oral presentations, coaching, and technical know-how.
2. *Business management skills* include those areas involved in starting, developing and managing any enterprise.
3. *Personal entrepreneurial skills* differentiate an entrepreneur from a manager and include inner control (discipline), risk taking, innovativeness, persistence, visionary leadership, and being change oriented.

These skills and objectives form the basis of the modular approach to an entrepreneurship curriculum. Today entrepreneurs are recognizing the need to learn some of the science of management in an MBA program in order to grow their businesses effectively in the global environment.

## ETHICS AND SOCIAL RESPONSIBILITY OF ENTREPRENEURS

The entrepreneur must establish a balance between ethical exigencies, economic expediency, and social responsibility. A managers attitudes concerning corporate responsibility tend to be supportive of laws and professional codes of ethics. Entrepreneurs have few reference persons, role models, and developed internal ethics codes. Entrepreneurs are sensitive to peers pressure and social norms in the community as well as pressures from their companies.

While **ethics** refers to the "study of whatever is right and good for humans," **business ethics** concerns itself with the investigation of business practices in light of human values. The word "ethics" stems from the Greek *êthos*, meaning custom and usage.
Development of Our Ethical Concepts Socrates, Plato, and Aristotle provide the earliest writings dealing with ethical conceptions; earlier writings involving moral codes can be found in both Judaism and Hinduism.

American attitudes on ethics result from three principle influences: Judeo-Christian heritage, a belief in individualism and opportunities based on ability rather than social status.
Research on business ethics can be broken down into four broad classifications:

1. Pedagogically-oriented inquiry
2. Theory-building without empirical testing
3. Empirical research, measuring the attitudes and ethical beliefs of students and academic faculty
4. Empirical research within business environments

## THE FUTURE OF ENTREPRENE URSHIP

In spite of the differences in definition of entrepreneurship, there are common aspects such as risk taking, creativity, independence, and rewards. Entrepreneurship is currently being embraced by educational institutions, governments, societies, and corporations. Schools are increasing their emphasis on entrepreneurship in terms of courses and academic research. In Europe many universities have started programs in entrepreneurship.

There has also been an increase in academic research, endowed chairs and centers of entrepreneurial activity. Governments have also promoted the growth of entrepreneurship. Individuals are encouraged to form new businesses and provided tax incentives, roads, and a communications system to facilitate this creative process. Some state governments are developing strategies for fostering entrepreneurial activity.

The venture capital industry has benefited from lowering of capital gains tax rates and more relaxed rules regarding pension fund investment.
Society's support of entrepreneurship is critical in providing motivation and public support. The media has played a powerful role in developing public support. Media coverage uplifts the image of the entrepreneur and growth companies. Articles have appeared in newspapers such as *New York Times*, *The Wall Street Journal*, and the *Washington Post.* Business magazines such as *Barrons*, *Business Week*, *Forbes*, and *Fortune* have provided coverage. Magazines such as *Black Enterprise*, *Entrepreneur*, *Inc.*, and *Venture* focus on issues of the entrepreneurial process. Television on both a national and local level has highlighted entrepreneurship.

Large companies will continue to have a special interest in Entrepreneurship in the future. The largest 15 companies account for over 20 percent of the total U.S. research and development. Other companies will create more new businesses through Entrepreneurship.

**KEY TERMS**

**Product-evolution process**

Process for developing and commercializing an innovation

**Risk taking**

Taking calculated chances in creating and running a venture.

**Technological innovation**

A new product with significant technological advancement

**Technology transfer**

Commercializing the technology in the laboratories into new products

 

**THE ENTREPRENEURIAL AND INTRAPRENEURIAL MIND Lesson 04**

**LEARNING OBJECTIV ES**

1. To explain the aspects of the entrepreneurial process.
2. To explain the differences between entrepreneurial and managerial domains.
3. To explain the organizational environment conducive for entrepreneurship.
4. To identify the general characteristics of an Entrepreneur.
5. To explain the process of establishing entrepreneurship in an organization.

**ENTREPR E NEURIAL PROCESS**

The **entrepreneurial process** involves finding, evaluating, and developing an opportunity by overcoming the strong forces that resist the creation of something new.

**Phase 1: Identifying and Evaluating the Opportunity**

Most good business opportunities result from an entrepreneur being alert to possibilities. Some sources are often fruitful, including consumers and business associates. Channel members of the distribution system-retailers, wholesalers or manufacturer's reps-are also helpful. Technically-oriented individuals often identify business opportunities when working on other projects. Each opportunity must be carefully screened and evaluated-this is the most critical element of the entrepreneurial process.

a. The evaluation process involves looking at
b. The creation and length of the opportunity
c. Its real and perceived value
d. Its risks and return.
e. It's fit with the skills and goals of the entrepreneur
f. Its differential advantage in its competitive environment

It is important to understand the cause of the opportunity, as the resulting opportunity may have a different market size and time dimension. The market size and the length of the **window of opportunity** are the primarily bases for determining risks and rewards. The risks reflect the market, competition, technology, and amount of capital involved. The amount of capital forms the basis for the return and rewards. The return and reward of the present opportunity needs to be viewed in light of any possible subsequent opportunities as well. The opportunity must fit the personal skills and goals of the entrepreneur. The entrepreneur must be able to put forth the necessary time and effort required for the venture to succeed. One must believe in the opportunity enough to make the necessary sacrifices.

Opportunity analysis, or an opportunity assessment plan, should focus on the opportunity and provide the basis to make the decision, including:

a. A description of the product or service
b. An assessment of the opportunity
c. Assessment of the entrepreneur and the team
d. Specifications of all the activities and resources needed
e. The source of capital to finance the initial venture

The most difficult aspect of opportunity analysis is the assessment of the opportunity.

**Phase 2: Develop a Business Plan**

A good **business plan** must be developed in order to exploit the opportunity defined. A good business plan is important in developing the opportunity and in determining the resources required, obtaining those resources and successfully managing the venture.

**Phase 3: Determine the Resources Required.**

Assessing the resources needed starts with an appraisal of the entrepreneur's present resources. Any resources that 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. Acquiring needed resources, while giving up as little control as possible, is difficult. The entrepreneur should try to maintain as large an ownership position as possible, particularly in the start-up stage. As the business develops, more funds will probably be needed, requiring more ownership be relinquished.

Alternative resource suppliers should be identified, along with their needs and desires, in order to structure a deal with the lowest cost and loss of control.

**Phase 4: Manage the Enterprise.**

The entrepreneur must employ these resources through implementation of the business plan. This involves implementing a management structure, as well as identifying a control system.

**KEY TERMS**

**Administrative domain**

The ways managers make decisions

**Business plan**

The description of the future direction of the business

**Corporate culture**

The environment of a particular organization

**Entrepreneurial domain**

The ways entrepreneurs make decisions

**Entrepreneurial process**

The process through which a new venture is created by an entrepreneur

**Entrepreneurial culture**

The environment of an entrepreneurial-oriented organization

**Entrepreneurship**

Entrepreneurship within an existing business organization

**Opportunity identification**

The process by which an entrepreneur comes up with the opportunity for a new venture

**Opportunity parameters**

Barriers to new product creation and development

**Top management commitment**

Managers in an organization strongly supporting entrepreneurship

**Traditional managers**

Managers in a non-entrepreneurial-oriented organization

**Window of opportunity**

The time period available for creating the new venture

 

## THE ENTREPRENEURIAL AND INTRAPRENEURIAL MIND (continued…) Lesson 05

**LEARNING OBJECTIVES**

1. To explain the aspects of the entrepreneurial process.
2. To explain the differences between entrepreneurial and managerial domains.
3. To explain the organizational environment conducive for entrepreneurship.
4. To identify the general characteristics of an entrepreneur.
5. To explain the process of establishing entrepreneurship in an organization.

### MANAGERIAL VERSUS ENTREPRENEURIAL DECISION MAKING

The difference between the entrepreneurial and managerial styles involves five business dimensions.

**Strategic Orientation**

The entrepreneur's strategic orientation depends on his or her perception of the opportunity. This orientation is most important when other opportunities have diminishing returns accompanied by rapid changes in technology, consumer economies, social values or political rules. When the use of planning systems is the strategic orientation, there is more pressure for the administrative domain to be operant.

**Commitment to Opportunity**

The **entrepreneurial domain**is pressured by the need for action and has a short time span in terms of opportunity commitment. The **administrative domain (***the ways mangers make decisions***)** is not only slow to act on an opportunity, but the commitment is usually for a longer time span.

**Commitment of Resources**

An entrepreneur is used to having resources committed at periodic intervals, often based on certain tasks or objectives being reached. In acquiring these resources the entrepreneur is forced to achieve significant milestones using very few resources. In the administrative domain, the commitment of resources is for the total amount needed. Administrative-oriented individuals receive personal rewards by effectively administering the resources under their control.

**Control of Resources**

The administrator is rewarded by effective resource administration and has a drive to own or accumulate as many resources as possible. The entrepreneur, under pressure of limited resources, strives to rent resources on an as-needed basis.

**Managerial Structure**

In the administrative domain, the organizational structure is formalized and hierarchical in nature. The entrepreneur employs a flat organizational structure with informal networks.

### CAUSES FOR RECENT INTEREST IN INTRAPRENEURSHIP

Interest in intrapreneurship has resulted from events occurring on social, cultural, and business levels.

There is an increasing interest in "doing your own thing." Individuals frequently desire to create something of their own. They want responsibility and want more freedom in their organizations. Frustration can develop and result in the employee becoming less productive or leaving the organization. This has recently caused more discontent in structured organizations. When meaning is not provided within the organization, individuals often search for an institution, such as entrepreneurship, that will provide it.

Intrapreneurship is one method for stimulating and capitalizing on those who think that something can be done differently and better, such as Xerox Corporation's commitment to Xerox Technology Ventures.

It is important to instill the intrapreneurial spirit in an organization in order to innovate and grow.

In a large organization problems occur that thwart creativity and innovation. This growth and diversity that can result are critical, since large corporations are more efficient in a competitive market than are smaller firms. The resistance against flexibility, growth, and diversification can be overcome by developing a spirit of entrepreneurship, called **Intrapreneurship**, within the existing organization.

There are social, cultural, and business pressures for Entrepreneurship. Hyper competition has forced U.S. companies to focus on new product development and increased productivity.

Reductions in large corporation's staff are being absorbed in the workforce, particularly in small businesses. Entrepreneurial endeavors consist of four key elements.

1. **New business venturing** refers to the creation of new business within an existing organization.
2. **Organizational innovativeness** refers to product and service innovation with an emphasis on development and innovation in technology.
3. **Self-renewal** reflects the transformation of organizations through the renewal of the key ideas on which they are built.
4. **Proactiveness** includes initiative and risk taking, as well as competitive aggressiveness

**KEY TERMS**

**Administrative domain**

The ways managers make decisions

**Business plan**

The description of the future direction of the business

**Corporate culture**

The environment of a particular organization

**Entrepreneurial domain**

The ways entrepreneurs make decisions

**Entrepreneurial process**

The process through which a new venture is created by an entrepreneur

**Entrepreneurial culture**

The environment of an entrepreneurial-oriented organization

**Entrepreneurship**

Entrepreneurship within an existing business organization

**Opportunity identification**

The process by which an entrepreneur comes up with the opportunity for a new venture

**Opportunity parameters**

Barriers to new product creation and development

**Top management commitment**

Managers in an organization strongly supporting Entrepreneurship

**Traditional managers**

Managers in a non-entrepreneurial-oriented organization

**Window of opportunity**

The time period available for creating the new venture

 

**THE ENTREPRENEURIAL AND INTRAPRENEURIAL MIND (continued…) Lesson 06**

**LEARNING OBJECTIVES**

1. To explain the aspects of the entrepreneurial process.
2. To explain the differences between entrepreneurial and managerial domains.
3. To explain the organizational environment conducive for entrepreneurship.
4. To identify the general characteristics of an entrepreneur.
5. To explain the process of establishing entrepreneurship in an organization.

**CORPORATE VERSUS INTRAPRENEURIAL CULTURE**

Smaller, aggressive, entrepreneurial firms are developing more new products and becoming dominant in certain markets. Many companies are attempting to create the same spirit, culture, and rewards of entrepreneurship in their organizations.

The typical **corporate culture** has a climate and reward system that favors conservative decision making.

Emphasis is on gathering large amounts of data as the basis for a rational decision. Risky decisions are often postponed until hard facts are gathered or a consultant is hired.

Often there are so many approvals required that no individual feels personally responsible for the project.

**The guiding principles in a traditional corporate culture are**:

1. Follow instructions given
2. Do not make mistakes
3. Do not fail
4. Do not take initiative
5. Stay within your turf and protect your backside
6. This restrictive environment is not conducive to creativity, flexibility, and risk taking

**The guiding principles of intrapreneurs**

Aspects of an **Entrepreneurial culture** are quite different:

1. Develop visions, goals, and action plans
2. Be rewarded for actions taken
3. Suggest, try, and experiment
4. Create and develop
5. Take responsibility and ownership

There are differences in the norms of the two cultures.

The **traditional culture** is hierarchical in nature, with established procedures, lines of authority, and control mechanisms. These support the present corporate culture, and do not encourage new venture creation. The **culture of an intrapreneurial** firm has a flat organizational structure with networking, teamwork, sponsors, and mentors. Close working relationships help establish an atmosphere or trust that facilitates accomplishment of visions. Individuals make suggestions across functional areas, resulting in cross-fertilization of ideas. The two cultures produce different types of individuals and management styles.

**Motivation**
Traditional managers are motivated primarily by promotion and typical corporate rewards. Entrepreneurs and intrapreneurs thrive on independence and the ability to create. Intrapreneurs expect their performance to be suitably rewarded.

There are also time orientation differences.
Managers emphasize the short run, entrepreneurs the long run, and intrapreneurs somewhere in between. Intrapreneurs use a midpoint mode between delegation of managers and direct involvement of entrepreneurs.
Entrepreneurs and intrapreneurs are moderate risk takers; managers are much more cautious. Most entrepreneurs fail at least once, and Intrapreneurs learn to conceal risky projects from management until the last possible moment. Traditional managers tend to be most concerned about those at higher levels, entrepreneurs serve self and customers, and intrapreneurs add sponsors.

**CLIMATE FOR INTRAPRENEURSHIP**

In establishing an Intrapreneurial environment, certain factors and leadership characteristics need to be present.
The **first** of these is that the organization operates on the frontiers of technology. Since research and development are key sources for new product ideas, the firm must operate on the cutting edge of technology and encourage and supporting new ideas instead of discouraging them.
**Second** is experimentation, or trial and error, is encouraged. Successful new products usually do not appear fully developed; instead they evolve. A company wanting to establish an intrapreneurial spirit has to establish an environment that allows mistakes and failures. Without the opportunity to fail, few corporate intrapreneurial ventures will be developed.
**Third** an organization should make sure that there are no initial **opportunity parameters**, such as turf protection, inhibiting creativity in new product development.
**Fourth**, the resources of the firm need to be available and easily accessible. Often, insufficient funds are allocated not to creating something new but instead to solving a problem that have an immediate effect on the bottom line. Some companies, such as Xerox, 3M, and AT&T have established separate venture capital areas for funding new internal ventures.
**Fifth** a multidisciplinary team approach needs to be encouraged. One key to Intrapreneurial success is the existence of "skunkworks" involving key people. Developing the needed team work for a new venture is further complicated by the fact that a team member’s promotion within the corporation is related to performance in the current position, not in the new venture. The corporate environment must establish a long time horizon for evaluating the success of the overall program. **Sixth** the spirit of intrapreneurship cannot be forced on individuals; it must be voluntary. Most managers in a corporation are not capable of being successful intrapreneurs. Those who do emerge from this self selection process must be allowed the latitude to carry a project through to completion. An intrapreneur falls in love with the new venture and will do almost anything to ensure its success. The **seventh** characteristic is a **reward system.** The intrapreneur needs to be appropriately rewarded for the energy and effort expended on the new venture. An equity position in the new venture is one of the best motivational methods.
**Eight** a corporate environment favorable for intrapreneurship has sponsors and champions throughout the organization that supports the creative activity and resulting failures.
**Finally** the intrapreneurial activity must be whole-heartedly supported by top management.

## THE ENTREPRENEURIAL AND INTRAPRENEURIAL MIND (continued…) Lesson 07

### LEARNING OBJECTIVES

1. To explain the aspects of the entrepreneurial process.
2. To explain the differences between entrepreneurial and managerial domains.
3. To explain the organizational environment conducive for entrepreneurship.
4. To identify the general characteristics of an Entrepreneur.
5. To explain the process of establishing entrepreneurship in an organization.

### INTRAPRENEURIAL LEADERSHIP CHARACTERISTICS

There are certain individual characteristics needed for a person to be successful Entrepreneurs, including:

1. Understanding the environment
2. Being visionary and flexible
3. Creating management options
4. Encourage teamwork while employing a multi-disciplined approach
5. Encouraging open discussion
6. Building a coalition of supporters, and persisting

An Entrepreneur needs to understand all aspects of the environment. Part of this ability is reflected in individual's level of creativity. Creativity tends to decrease with age and education. The individual must be creative and have a broad understanding of the internal and external environments of the corporation. The intrapreneurial person must be a visionary leader-a person who dreams great dreams. Leadership is the ability to dream great things and communicate them in a way that people say yes to being a part of the dream. To establish a successful new venture, the intrapreneurial leader must have a dream and overcome all obstacles to achieve it. The third necessary characteristic is that the intrapreneur must be flexible and create management options. An intrapreneur is open to and encourages change. By challenging the beliefs and assumptions of the corporation, an intrapreneur can create something new in the organization structure. He or she must possess the ability to encourage teamwork and use a multi-disciplined approach. Every new company formation requires a broad range of business skills. The intrapreneur must be a good diplomat to minimize disruption. Open discussion must be encouraged to develop a good team for creating something new. Many corporate managers have forgotten that frank, open discussion is part of the learning process. A successful venture can be formed only when the team feels the freedom to disagree and to critique an idea. The degree of openness among the team depends on the degree of openness of the intrapreneur. Openness leads to a strong coalition of supporters and encouragers. The intrapreneur must encourage each team member, particularly during hard times. A good intrapreneur makes everyone a hero. Only through persistence will a new venture be created and successful commercialization result.

### ESTABLISHING INTRAPRENEURSHIP IN THE ORGANIZATION

To establish an intrapreneurial environment, the organization must implement a procedure. This can be done internally, but it is easier to use an outsider to facilitate the process. This is particularly true when the environment is very traditional. There are some steps involved in it.
**Step 1:** The first step is to secure a commitment to intrapreneurship in the organization by top, upper, and middle management. Without **top management commitment**, the organization will never be able to make the necessary changes. Once top management has committed to intrapreneurship for a sufficient length of time, the concept is introduced throughout the organization. This is effectively accomplished through seminars. General guidelines need to be

established for intrapreneurial venture development. Next, intrapreneurial leaders need to be identified, selected, and trained.

**Step 2:** Ideas and general interest areas should be identified, along with the amount of risk money that is available. The overall expectations and target results should be established, specifying time frame, profitability requirements, and impact of the organization. A mentor/sponsor system needs to be established. **Step 3***:* A company needs to use technology to make itself faster and more flexible. Technology has allowed small companies to act like they are big ones. Large companies can use technology to make them responsive and flexible. **Step 4:** The organization can use a group of managers to train and share their experiences with other members. These sessions should be conducted one day per month for a specified period of time. Information about intrapreneurship and about the company's specific activities should be well publicized. **Step 5:** The organization needs to develop ways to get closer to its customers by tapping the data base, hiring from smaller rivals, and helping the retailer. **Step 6:** An organization must learn to be more productive with fewer resources. With middle management cutbacks, more control has been given to lower levels of the organization. The span of control should be increased. **Step 7:** The organization needs to establish a strong support structure. Because they do not immediately affect the bottom line, intrapreneurial activities can be overlooked and receive little funding. These ventures require flexible, innovative behavior, with the intrapreneurs having total authority over expenditures and access to funds. **Step 8:** The support must involve trying the rewards to the performance of the intrapreneurial unit. This encourages team members to work harder and compete more effectively. The equity portion of the compensation is particularly difficult to handle. **Step 9:** The organization needs to implement an evaluation system that allows successful units to expand and unsuccessful ones to be eliminated.

**PROBLEMS AND SUCCESSFUL EFFORTS**

Intrapreneurship, also called corporate venturing, is not without problems. One study found that new ventures started within a corporation performed worse than those started independently. Independent start-ups tend to outperform corporate start-ups. There are many examples of companies that have successfully implemented intrapreneurship. 3M allows employees to devote 15 percent of their time to independent projects. After failing to recognize the potential of Wozniak's personal computer, Hewlett-Packard has taken steps to take advantage of future opportunities. Even IBM has developed the independent business unit concept. The problems of intrapreneurship are not insurmountable, and the concept can lead to new products, growth and the development of an entirely new corporate environment and culture.

**THE INDIVIDUAL ENTREPRENEUR Lesson 08**

## LEARNING OBJECTIV ES

1. To identify some key entrepreneurial feelings and motivations.
2. To identify key elements in an entrepreneur's background.
3. To discuss the importance of role models and support systems.
4. To identify the similarities and differences between male and female entrepreneurs.
5. To explain the differences between inventors and entrepreneurs.

## ENTREPR E NEURIAL FEELINGS

There is no "true entrepreneurial profile"- entrepreneurs come from many educational backgrounds, family situations, and work experiences. A potential entrepreneur may presently be a nurse, secretary, assembly line worker, sales person, mechanic, home maker, manager or engineer. A potential entrepreneur can be male or female and of any race or nationality.

### Locus of Control

One concern people have when forming is whether they will be able to sustain the drive and energy required to form something new and to manage the new enterprise and make it grow. While research results are inconsistent, internal control seems to be a characteristic of entrepreneurs.
Internal beliefs appear to differentiate entrepreneurs from the general public, but not from managers. Managers and entrepreneurs both have an internality tendency.

### Feelings about Independence and Need for Achievement.

The entrepreneur also has the **need for independence**, to do things in his or her own way and time.
Another controversial characteristic is the entrepreneur's **need for achievement**. McClelland specified three attributes as characteristics of entrepreneurs:

1. Individual responsibility for solving problems and setting and achieving goals.
2. Moderate risk taking as a function of skill.
3. Knowledge of results of decision/task accomplishment. McClelland concluded that a high need for achievement leads individuals to engage in entrepreneurial behavior, although other studies have been inconsistent.

### Risk Taking

Risk taking seems a part of the entrepreneurial process. However, it has not yet been empirically established whether risk-taking is a distinguishing characteristics of entrepreneurs.

## ENTREPR E NEURIAL BACKGRO UND AND CHARACT E RIST ICS

Only a few background characteristics have differentiated the entrepreneur from the general populace or managers.
**Childhood Family Environment** The impact of birth order and **social status** has had conflicting research results. There is strong evidence that entrepreneurs, both male and female, tend to have self-employed or entrepreneurial fathers. Having a father who is self-employed provides a strong inspiration in the example of independence and flexibility of self-employment. This feeling of independence is often further enforced by an entrepreneurial mother. The overall parental

relationship may be the most important aspect of the childhood environment in establishing the desirability of entrepreneurial activity. Parents of entrepreneurs need to be supportive and encourage independence, achievement, and responsibility. This supportive relationship appears to be most important for females. Female entrepreneurs tend to grow up in middle- to upper-class environments, where families are child-centered, and are similar to their fathers in personality.

**KEY TERMS**

**Departure points**
The activities occurring when the venture is started

**Inventor**
An individual who creates something new

**Locus of control**
An attribute indicating the sense of control that a person has over life
**Moral-support network**
Individuals who give psychological support to an entrepreneur
Entrepreneurship – MGT602 **VU**

## THE INDIVIDUAL ENTREPRENEUR (continued…) Lesson 09

### LEARNING OBJECTIVES

1. To identify some key entrepreneurial feelings and motivations.
2. To identify key elements in an entrepreneur's background.
3. To discuss the importance of role models and support systems.
4. To identify the similarities and differences between male and female entrepreneurs.
5. To explain the differences between inventors and entrepreneurs.

### ENTREPRENEURIAL BACKGROUND AND CHARACTERISTICS

#### Education

Education appears important in the upbringing of the entrepreneur, in the level of education obtained and in playing a major role in coping with problems. Although formal education is not necessary for starting a new business, it does provide a good background. In education, female entrepreneurs previously experienced some disadvantage, with few having degrees in engineering, science, or math. The ability to deal with people and communicate clearly in written and spoken work is also important.

#### Personal Values

Studies have failed to indicate that entrepreneurs can be differentiated on personal valued from managers, unsuccessful entrepreneurs, or the general public. Leadership, support, aggression, benevolence, conformity, creativity, veracity, and resource seeking may also be important. A successful entrepreneur is frequently characterized as a winner; winning may be a prerequisite for his or her actually becoming one.

#### Age

Entrepreneurial age is the age of the entrepreneur reflected in the experience. Entrepreneurial experience is one of the best predictors of success. In chronological age, most entrepreneurs start their careers between ages 22 and 55. Earlier starts in an entrepreneurial career seem to be better than later ones. Generally, male entrepreneurs start their first venture in their early 30s, while women tend to do so in their middle 30s.

#### Work History

Dissatisfaction with one's job often motivates the launching of a new venture. Previous technical and industry experience is also important once the decision to start a business is made. Experience in the following areas is particularly important: financing; product or service development; manufacturing; development of distribution channels; and preparation of a marketing plan. As the venture becomes established, managerial experience and skills become more important. Entrepreneurial experience becomes increasingly important as the complexity of the venture increases.

**MOTIVATION** While **motivations** may vary, the reason cited most often for becoming an entrepreneur independence-not wants to work for anyone else. Other motivating factors differ between male and female entrepreneurs. Money is the second reason for men's starting a venture. Job satisfaction, achievement, opportunity, and money are the second order reasons for women.

**KEY TERMS**

**Motivations**

That causes people to do something

**Need for achievement**

An individual's need to be recognized

**Need for independence**.

Being one's own boss-one of the strongest needs of an entrepreneur

**Professional-support network**

Individuals who help the entrepreneur in business activities

**Role models**

Individuals influencing an entrepreneur's career choice and style

**Social status**

The level at which an individual in viewed by society

**Work history**

The past work experiences of an individual

## THE INDIVIDUAL ENTREPRENEUR (continued…) Lesson 10

**LEARNING OBJECTIVES**

1. To identify some key entrepreneurial feelings and motivations.
2. To identify key elements in an entrepreneur's background.
3. To discuss the importance of role models and support systems.
4. To identify the similarities and differences between male and female entrepreneurs.
5. To explain the differences between inventors and entrepreneurs.

**ROLE MODELS AND SUPPORT SYSTEMS** One of the most important factors influencing entrepreneurs in their career choice is role models. **Role models** can be parents, relatives, or successful entrepreneurs in the community. Role models can also serve in a supportive capacity as mentors during and after the new venture is launched. This support system is most crucial during the start-up phase.

It is important that an entrepreneur establish connections to support resources early in the venture formation process. As contacts expand they form a network with *density* (extensiveness of ties between two individuals) and *centrality* (the total distance of the entrepreneur to all other individuals.) The strength of ties between the entrepreneur and any individual is dependent on the frequency, level, and reciprocity of the relationship. An informal network for moral and professional support benefits the entrepreneur.

**Moral-Support Network** It is important for the entrepreneur to establish a **moral support network** of family and friends. Most entrepreneurs indicate that their spouses are their biggest supporters. Friends can provide advice that is more honest than that received from others, plus encouragement, understanding, and assistance. Relatives can also be sources of moral support, particularly if they are also entrepreneurs.

**Professional-Support Network** The entrepreneur also needs advice and counsel, which can be obtained from members of a **professional support network.** A mentor-protégé relationship is an excellent way to secure the needed professional advice. The mentor is a coach, sounding board, and advocate. The individual selected needs to be an expert in the field. An entrepreneur can initiate the "mentor-finding process" by identifying and contacting a number of experts. The mentor should be periodically apprised of the progress of the business so that a relationship can gradually develop. Another source of advice is a network of business associates. Self-employed individuals who have experience in starting a business are good sources. Clients and buyers are also important as they provide word-of-mouth advertising. Suppliers are good components of the professional-support network-they help to establish credibility with creditors and customers, and provide good information on trends in the industry. Trade associations are good network additions, as they keep up with new developments and can provide overall industry data. Affiliations with individuals developed in hobbies, sporting events, civic involvements and school alumni groups are excellent sources of referrals, advice, and information. Each entrepreneur needs to establish both a moral- and a professional-support network to share problems with and gain overall support.

**MALE VERSUS FEMALE ENTREPRENEURS**

Women are now starting new ventures at three times the rate of men. Women form over 70

percent of all new businesses. Women now own over 8.5 million small businesses, an increase of over 45 percent since 1990. In some respects female entrepreneurs possess very different motivations, business skills, and occupational backgrounds. Factors in the start-up process for male and female entrepreneurs are different, especially in such areas as support systems, sources of funds, and problems. Men are motivated by the drive to control their own destinies. Women tend to be more motivated by the need for achievement arising from job frustration.
**Departure points** and reasons for starting the business are similar for both men and women. Both generally have a strong interest and experience in the area of their venture. For men, the transition to a new venture is easier when the venture is an outgrowth of a present job. Women often leave a previous occupation with a high level of frustration and enthusiasm for the new venture rather than experience.

**Start-Up Financing**
Males often have investors, bank loans, or personal loans in addition to personal funds as sources of startup capital. Women usually rely solely on personal assets or savings. Obtaining financing and lines of credit are major problems for women.

**Occupations**
Both groups tend to have experience in the field of their ventures. Men more often have experience in manufacturing, finance, or technical areas. Most women usually have administrative experience, often in service-related fields.

**Personality**
Both men and women tend to be energetic, goal-oriented, and independent. Men are often more confident and less flexible and tolerant than women.

**Backgrounds**
The backgrounds of male and female entrepreneurs tend to be similar. Women are little older when they embark on their careers. Men often have studied in technical- or business-related areas, while women tend to have liberal arts education. Many women business owners are empty nesters or single and need business insurance as well as personal life insurance.

**Support Groups**
Men usually list outside advisors as most important supporters, with spouse being second. Women list their spouse first, close friends second, and business associates third. Women usually rely more heavily on a variety of sources for support and information than men.

**Nature of the Venture**
Women are more likely to start a business in a service-related area. Men are more likely to enter manufacturing, construction, or high-technology fields.

**MINORITY ENTREPRENEURSHIP**
It is difficult to research race and ethnicity as entrepreneurial factors as the differences in behavior of various groups must be understood in the context of the environment and economic opportunities available. Most literature dealing with minority entrepreneurship has focused on the characteristics of the group under study. In terms of ownership, one study found:

- The lowest participation rate is for blacks.

- The second highest but fastest growing rate is for Hispanics.

- The highest rate is for Asians.

Studies have also found differences in education, age, family background, and age when starting the venture. Black businesses tend to be smaller and less profitable, but there are no differences in survival rates between black- and white-owned businesses. Studies have also found differences between ethnic groups in benefiting from community resources. Entrepreneurship has increased among Asians, African Americans, Hispanics, and Native Americans.

**ENTREPR E NEURS VERSUS INVENTORS**

An **inventor**, an individual who creates something for the first time, is a highly driven individual motivated by his or her own work and personal ideas. An inventor:

1. Tends to be well-educated.
2. Has family, educational, and occupational experiences that contributes to freethinking.
3. Is a problem solver.
4. Has a high level of self-confidence.
5. Is willing to take risks.
6. Has the ability to tolerate ambiguity and uncertainty.
7. A typical inventor places a high premium on being an achiever, and is not likely to view monetary benefits as a measure of success.
8. An inventor differs from an entrepreneur.
9. An entrepreneur falls in love with the new venture, while the inventor falls in love with the invention.
10. The development of a new venture based on an inventor's work often requires the expertise of an entrepreneur.

**KEY TERMS**

**Motivations**
What causes people to do something

**Need for achievement**
An individual's need to be recognized
**Need for independence**
Being one's own boss-one of the strongest needs of an entrepreneur
**Professional-support network**
Individuals who help the entrepreneur in business activities

**Role models**
Individuals influencing an entrepreneur's career choice and style

**Social status**
The level at which an individual in viewed by society
**Work history**
The past work experiences of an individual

## INTERNATIONAL ENTREPRENEURIAL OPPORTUNITIES Lesson 11

### LEARNING OBJECTIVES

1. To identify the aspects and importance of international entrepreneurship.
2. To identify the important strategic issues in international entrepreneurship.
3. To identify the available options for entering international markets.
4. To present the problems and barriers to international entrepreneurship.

### THE NATURE OF INTERNATIONAL ENTREPRENEURSHIP

As more countries become market oriented and developed, the distinction between foreign and domestic markets is becoming less pronounced. **International entrepreneurship** is the process of an entrepreneur conducting business activities across national boundaries. It is exporting, licensing, or opening a sales office in another country. When an entrepreneur executes his or her business in more than one country, international entrepreneurship occurs.

### THE IMPORTANCE OF INTERNATIONAL BUSINESS TO THE FIRM

International business has become increasingly important to firms of all sizes. The successful entrepreneur will be someone who understands how international business differs from domestic business and is able to act accordingly.

### INTERNATIONAL VERSUS DOMESTIC ENTREPRENEURSHIP

Whether international or domestic, an entrepreneur is concerned about the same basic issues-sales, costs, and profits. What varies is the relative importance of the factors being considered. International entrepreneurial decisions are more complex due to uncontrollable factors such as the following.

#### Economics

A domestic business strategy is designed under a single economic system. Creating a business strategy for multiple countries means dealing with different levels of economic development and different distribution systems.

**Balance of Payments** A country's **balance of payments** affects the valuation of its currency. This economic variable will affect how companies do business in other countries.

**Type of System Barter**or **third-party arrangements** have been used to increase business activity with the Commonwealth of Independent States, the former U.S.S.R. There are still many difficulties in doing business in developing and transition economies due to:

a. Gaps in the knowledge of the Western system regarding business plans, marketing, and profits
b. Widely variable rates of return.
c. Non-convertibility of the ruble.
d. Differences in the accounting system.
e. Nightmarish communications.

#### Political-Legal Environment

Multiple political and legal environments create different business problems. Each element of the international business strategy can potentially be affected by multiple legal environments. Laws governing business arrangements also vary greatly in the 150 different legal systems and sets of national laws.

**Cultural Environment**
The impact of culture on entrepreneurs and strategies is significant. Understanding the local culture is necessary when developing worldwide plans.

**Technological Environment**
Technology varies significantly across countries. New products in a country are created based on the conditions and infrastructure of that country.
**Strategic Issues**
Four strategic issues are important to the international entrepreneur:

1. The allocation of responsibility between the U.S. and foreign operations.
2. The nature of the planning and control systems to be used.
3. The appropriate organizational structure for conducting international operations.
4. The degree of standardization possible.

With experience in international operations, entrepreneurs tend to change their approach to responsibility.
**Stage 1:** In the first stages the entrepreneur typically follows a highly centralized decision-making process.
**Stage 2:** When success occurs, it is no longer possible to use completely centralized decision-making process.
**Stage 3:** Decentralization is scaled back and major strategic decisions are again centralized.
To understand what is required for effective planning, reporting, and control, the entrepreneur should consider:

1. Environmental analysis.
2. Strategic planning.
3. Structure.
4. Operational planning.
5. Controlling the marketing program. The first step in identifying markets is to analyze data in the following areas:

1. Market characteristics.
2. Marketing institutions.
3. Industry conditions.
4. Legal environment.
5. Resources.
6. Political environment.

**ENTREPRENEURIAL ENTRY INTO INTERNAT IONAL BUSINESS**
The choice of entry method depends on the goals of the entrepreneur and the company's strengths and weaknesses.

**Exporting**
As a general rule, an entrepreneur starts doing international business through exporting.

- **Indirect exporting** involves a foreign purchaser in the local market or using an export management firm. For certain commodities, foreign buyers seek out sources of supply. Export management firms, another indirect method, are located in many commercial centers.
- **Direct exporting** through independent distributors or through one's own overseas sales office is another entry method. An independent foreign distributor directly contacts foreign customers and takes care of all technicalities.

Entrepreneurs who do not wish to give up control over marketing can open overseas sales offices and hire their own salespeople.

**Non equity arrangements**

Non equity arrangements allow the entrepreneur to enter a market without direct equity investment in the foreign market.

- **Licensing** involves a manufacturer giving a foreign manufacturer the right to use a patent, trademark, or technology in return for a royalty. This arrangement is most appropriate when the entrepreneur has no prospect of entering the market through exporting or direct investment. The process is usually low risk and an easy way to generate incremental income. Without careful analysis, licensing arrangements have several pitfalls.

- **Turn-key projects**

  Lesser-developed countries are able to obtain manufacturing technology without surrendering economic control through **turn-key projects.** A foreign entrepreneur builds a facility, trains the workers, and trains the management to run the installation.

  Once the operation is on line, it is turned over to local owners. Initial profits can lead to follow-up sales. Financing is often provided by the local company or government.

- **Management contracts**

  Entrepreneurs can contract their management techniques and skills, often following a turn-key project. The **management contract** allows the purchasing country to gain foreign expertise without turning ownership over to a foreigner.

**Direct Foreign Investment**

The wholly owned foreign subsidiary has been the preferred mode of ownership for direct investment.

- **Minority interests** The **minority interest** provides the firm with either a source of raw materials or a captive market for products. Entrepreneurs have used minority positions to gain a foothold in the market before making a major investment.

- **Joint ventures**

  Two firms get together and form a third company in which they share the equity.

**KEY TERMS**

**Balance of payments**
The trade status between countries
**Barter**
A method of payment using no monetary item
**Direct exporting**
Selling goods to another country by taking care of the transaction
**Diversified activity merge r**
Combination of at least two totally unrelated firms
**Exporting**
Selling goods made in one country to another country
**Horizontal merger**
Combination of at least two firms doing similar businesses at the same market level

**INTER NATIONAL ENTREPRENEURIAL OPPORTUNITIES (continued…) Lesson 12**

**LEARNING OBJECTIV ES**

1. To identify the aspects and importance of international entrepreneurship.
2. To identify the important strategic issues in international entrepreneurship.
3. To identify the available options for entering international markets.
4. To present the problems and barriers to international entrepreneurship.

**DIRECT FOREIGN INVESTME NT**

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- **Joint ventures**

Two firms get together and form a third company in which they share the equity. Joint ventures have been used by entrepreneurs in two situations:

1. When the entrepreneur wants to purchase local knowledge and an established facility.
2. When rapid entry into a market it needed. The keys to success of joint ventures have not been well understood. Reasons for forming a joint venture today are different than those in the past. Originally, joint ventures were used for trading purposes and were one of the oldest ways of transacting business. Joint ventures in the U.S. took the form of vertical joint ventures used by mining concerns and railroads. Motives for the significant increase in the use of joint ventures:

a. To share the costs and risks of an uncertain project.
b. To gain **synergy** between the two firms.
c. To obtain a competitive advantage.
d. To enter markets that pose entrance difficulties.

- **Majority interest** Another equity method is to purchase a **majority interest** in a foreign business. The majority interest allows the entrepreneur to obtain managerial control while maintaining the company's local identity. In technical sense anything over 50% of the equity of the firm is majority interest.

- **100 percent ownership**

One hundred percent ownership assures control. One form of 100 percent ownership is mergers and acquisitions, but the entrepreneur needs to have a general understanding of the benefits and problems of mergers as a strategic option. A **horizontal merger** is the combination of two firms that produce closely related projects in the same area. A **vertical merger** is the combination of firms in successive stages of production. A **product extension merger** occurs when acquiring and acquired companies have related production but do not have directly competing products. A **market extension merger** is when two firms produce the same products but sell them in different areas. A **diversified activity merger** is a conglomerate merger involving the consolidation of two unrelated firms. Mergers are a sound strategic option for an entrepreneur when synergy is present. Economies of scale are the most common reason for mergers. A second factor that causes synergy is taxation, or unused tax credits. The final factor is the benefits received in combining complementary resources.

**VU KEY TERMS**

**Indirect exporting**
Selling goods to another country through a system in the entrepreneur's home country
**International entrepreneurship**
An entrepreneur doing business across his or her national boundary

**Joint venture**
Two companies forming a third company
**Licensing**
Allowing someone else to use something of the company's
**Majority interest**
Having more than 50 percent ownership position

**INTERNATIONAL ENTREPRENEURIAL OPPORTUNITIES (continued) Lesson 13**

**LEARNING OBJECTIV ES**

1. To identify the aspects and importance of international entrepreneurship.
2. To identify the important strategic issues in international entrepreneurship.
3. To identify the available options for entering international markets.
4. To present the problems and barriers to international entrepreneurship.

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**BARRIERS TO INTER N AT IONAL TRADE**

The positive attitude toward free trade began about 1947 with the development of general trade agreements and reduction of trade barriers.

**General Agreement on Tariffs and Trade (GATT)**

GATT is a multilateral agreement with the objective of liberalizing trade by eliminating tariffs and import quotas. In each round, mutual tariff reductions are negotiated between member nations. Members can ask for investigation of violations. While GATT has helped develop more unrestricted trade, its voluntary membership gives it little authority.

**Increasing Protectionist Attitudes**

Support of free trade increased significantly in the 1980s due to the rise in protectionist pressures in many countries. The persistent U.S. trade deficit has strained the world trading system. The economic success of a country (Japan) perceived as not playing by the rules has also strained the trading system. In response many countries have established bilateral voluntary export restrictions.

**Trade Blocks and Free Trade Areas**

Groups of nations are banding together to increase investment between nations in the group and exclude others. The North American Free Trade Agreement (NAFTA) between the U.S., Canada, and Mexico reduces barriers and encourages investment. The Americas, Argentina, Brazil, Paraguay, and Uruguay have created the Mercosul trade zone, a free trade zone between the countries. The European Community (EC) is founded on the principle of supra-nationality, with member nations not being able to enter into trade agreements on their own that are inconsistent with EC regulations.

**Entrepreneur's Strategies and Trade Barriers**

**Trade barriers** pose problems for entrepreneurs who want to become involved in international business.

Trade barriers increase the costs of exporting projects to a country. Voluntary export restrictions may limit the ability to sell products in a country from production facilities outside the country. An entrepreneur may have to locate assembly or facilities in a country to conform to the local content regulations.

**KEY TERMS**

**Management contracts**
A method for doing a specific international task
**Market extension merger**
Combination of at least two firms with similar products in different geographic markets
**Minority interest**
Having less than 50 percent ownership position
**Non equity arrangements**
Doing international business through an arrangement that does not involve any investment
**Product-extension merger**
Combination of two firms with non competing products
**Synergy**
Two parties having things in common
**Third-party arrangements**
Paying for goods indirectly through another source

**Trade barriers**
Hindrances to going international business
**Turn-key projects**
Developing and operationalizing something in a foreign country
**Vertical merger**
Combination of at least two firms at different market levels

## INTERNATIONAL ENTREPRENEURIAL OPPORTUNITIES (continued…) Lesson 14

**LEARNING OBJECTIVES**

1. To explain the aspects of the entrepreneurial process.
2. To explain the differences between entrepreneurial and managerial domains.
3. To explain the organizational environment conducive for entrepreneurship.
4. To identify the general characteristics of an Entrepreneur.
5. To explain the process of establishing entrepreneurship in an organization.

**ENTREPRENEURIAL PARTNERING**

One of the best methods to enter an international market is to partner with an entrepreneur in that country. These foreign entrepreneurs know the country and culture and therefore facilitate business transactions while keeping the entrepreneur current on business, economic and political conditions. This partnering is facilitated by understanding the nature of entrepreneurship in the country. Three areas of particular interest to U.S. entrepreneurs are Europe, the Far East and transition economies.

**Europe**

1. Europe has only recently become interested in entrepreneurship.
2. Risk taking has been discouraged and business failure considered a social disgrace.
3. Several changes in the social and political climate have changed this traditional, security-conscious culture.
4. Exemplifying this new thinking are academics, especially scientists and engineers.
5. Today more individuals are emerging in both academic circles and large companies who are look for a challenge.
6. New government policies are making it easier to raise money for starting up businesses.
7. The U.K. created the Business Expansion Scheme in 1983 to provide capital to new business ventures.
8. In France several economic and social factors cause difficulties.
9. Venture capital is managed by bankers, who are risk averse.
10. Another hurdle is the French contempt for both failure and success.
11. Research in Ireland and Sweden has explored the nature of European entrepreneurship.

**The Far East**

1. Entrepreneurial success in some Asian countries has been significant because of the culture and the political and economic systems.
2. The Malaysian government has established the Malaysian Industrial Development authority to promote efforts to eradicate poverty, but has not accomplished much.

3. In Singapore, entrepreneurial success is greatly esteemed.
4. Japan's social structure discourages entrepreneurship.
5. Hong Kong is a major entrepreneurial center.

**Controlled and Transition Economies**

1. China's planned economy has not openly encouraged entrepreneurship, but a deal of entrepreneurial activity is taking place.
2. In Poland, the transitional upheaval and lack of reform has led to a thriving black market.
3. The Overseas Private Investment Corporation of the U.S. government has supported economic reforms in these countries, through services such as:
   - Selling political risk insurance.
   - Offering direct loans.
   - Providing loan guarantees.
   - Organizing overseas missions.
   - Providing investor information services.
   - Due in part to OPIC, reforms in Hungary have supported decentralization, private initiative, and market-orientation of the economy

**SOURCE S OF NEW ID EAS**

A sound idea for a new product or service, properly evaluated, is essential to successfully launch a new venture. Some of the more frequently used ideas for new entrepreneur include consumers, existing companies, distribution channels, the federal government and research and development.

**Consumers**

Potential entrepreneurs should pay close attention to the final focal point of a new product-the customer. This can be an informal or formal survey of consumers expressing their opinions. Care should be taken to ensure that the idea represents a large enough market.

**Existing Companies**

Entrepreneurs should establish a formal method for monitoring and evaluating the products and services in the market. This may uncover ways to improve on present products, resulting in new product ideas.

**Distribution Channels**

Because they are familiar with the needs of the market, channel members often have suggestions for new products. These channel members can also help in marketing the new product.

**Federal Government**

The files of the Patent Office contain numerous new product possibilities. The patents can suggest other new product ideas. Several government agencies and publications are helpful in monitoring patent applications. New product ideas can also come in response to government regulations.

**Research and Development**

The largest source for new ideas is the entrepreneur's own research and development. This can be a formal endeavor connected with one's current employment

## INTERNATIONAL ENTREPRENEURIAL OPPORTUNITIES (continued…) Lesson 15

### LEARNING OBJECTIVES

1. To explain the aspects of the entrepreneurial process.
2. To explain the differences between entrepreneurial and managerial domains.
3. To explain the organizational environment conducive for entrepreneurship.
4. To identify the general characteristics of an Entrepreneur.
5. To explain the process of establishing entrepreneurship in an organization.

### SOURCES OF NEW IDEAS

A sound idea for a new product or service, properly evaluated, is essential to successfully launch a new venture. Some of the more frequently used ideas for new entrepreneur include consumers, existing companies, distribution channels, the federal government and research and development

**Consumers**
Potential entrepreneurs should pay close attention to the final focal point of the idea for a new product or service the potential consumer. This can be an informal or formal survey of consumers expressing their opinions. Care should be taken to ensure that the idea represents a large enough market.

**Existing Companies**
Entrepreneurs should establish a formal method for monitoring and evaluating the products and services in the market. Frequently this analysis uncovers ways to improve on these offering that may result in a new product that has more market appeal.

**Distribution Channels**
Members of distribution channels are also excellent sources for new ideas because they are familiar with the needs of the market. Not only do channel members frequently have suggestions for new product, but they can also help in marketing the entrepreneur's newly developed products.

**Federal Government**
The federal government can be source of new product ideas in two ways. First the files of the Patent Office contain numerous new product possibilities. Although the patents may not be feasible new product introduction, they can suggest other marketable product ideas. Several government agencies and publications are helpful in monitoring patent applications. Second new product ideas can come in response to government regulations. For example the Occupational Safety and Health Act (OSHA), aimed at eliminating unsafe working condition in industry, mandated that first aid kits be made available in business establishments employing more than three people. The kit had to contain specific item that varied according to the company and the industry. In response to OSHA, both established and newly formed ventures marketed a wide variety of first aid kits.

**Research and Development**
The largest source for new ideas is the entrepreneur's own research and development. This can be a formal endeavor connected with one's current employment. A more formal research and development department is often better equipped and enables the entrepreneurs to conceptualize and develop successful new product ideas.

# CREATIVITY AND THE BUSINESS IDEA Lesson 16

## LEARNING OBJECTIVES

1. To identify various sources of ideas for new ventures.
2. To discuss methods available for generating new venture ideas.
3. To discuss creativity and the techniques for creative problem solving.

## METHODS OF GE NER A TI NG NE W IDEA S

Even with the wide variety of sources available, coming up with an idea to serve as the basis for the new venture can still be a difficult problem. The entrepreneur can use several methods to help generate and test new ideas, including focus groups, brain storming and problem inventory analysis.

### Focus groups

Group of individuals providing information in a structured format is called a focus group. The group of 8 to 14 participants is simulated by comments form other group members in creatively conceptualizing and developing new product idea to fulfill a market need.

### Brainstorming

A group method of obtaining new ideas and solutions is called brainstorming. The brainstorming method for generating new ideas is based on the fact that people can be stimulated to greater creativity by meeting with others an d participating with organized group experiences. Although most of the ideas generated from the group have no basis for further development, often a good idea emerges.

### Problem inventory analysis

Problem inventory analysis uses individuals in a manner that is analogous to focus groups to generate new product ideas. However instead of generating new ideas themselves, consumers are provided with a list of problems in a general product category. They are then asked to identify and discuss products in this category that have the particular problem. This method is often effective since it is easier to relate known products to suggested problems and arrive at a new product idea then to generate an entirely new idea by itself.

## CREATIVE PROBLEM SOLVING

Creative problem solving is a method for obtaining new ideas focusing on the parameters.

### Brainstorming

The first technique, brainstorming, is probably the most well known and widely used for both creative problem solving and idea generation. It is an unstructured process for generating all possible ideas about a problem within a limited time frame through the spontaneous contribution of participants. All ideas, no matter how illogical, must be recorded, with participants prohibited from criticizing or evaluating during the brainstorming session.

### Reverse brainstorming

Similar to brainstorming, but criticism is allowed and encouraged as a way to bring out possible problems with the ideas.

### Synectics

Synectics is a creative process that forces individuals to solve problems through one of four analogy mechanisms: personal, direct, symbolic and fantasy. This forces participants to consciously apply preconscious mechanisms through the use of analogies in order to solve problems.

**Gordon method**
Gordon method is a method of developing new ideas when the individuals are unaware of the problem. In this method the entrepreneur starts by mentioning a general concept associated with the problem. The group responds with expressing a number of ideas.

**Checklist method**
Developing a new idea through a list of related issues is checklist method of problem solving.

**Free association method**
Developing a new idea through a chain of word association is free association method of problem.

**Forced relationship**
Forced relationship is the process of forcing relationship among some product combination. It is technique that asks questions about objects or ideas in an effort to develop a new idea.

**Collective notebook method**
It is method in which ideas are generated by group members regularly recording ideas.

**Heuristics**
It is method of developing a new idea through a thought process progression.

**Scientific method**
This is a more structured method of problem solving, including principles and rules for concept formation, making observations and experiments, and finally validating the hypothesis.

**Value analysis**
Value analysis is developing a new idea by evaluating the worth of aspects of ideas.

**Attribute listing**
This is an idea finding technique that requires the entrepreneur to list the attributes of an item or problem and then look at each from a variety of viewpoints.

**Matrix charting**
Matrix charting is a systematic method of searching for new opportunities by listing important elements for the product area along two axis of chart and then asking questions regarding each of these elements.

**Big dream approach**
Developing a new idea by thinking about constraints is big-dream approach of problem solving.

**Parameter analysis**
Parameter analysis is developing a new idea by focusing on parameter identification and creative synthesis.

 

**KEY TERMS**

**Brainstorming**
A group method of obtaining new ideas and solutions

**Synectics**
Creative process that forces individuals to solve problems through the use of analogies

**Gordon method**
Method of developing new ideas when the individuals are unaware of nature of the problem

## CREATIVITY AND THE BUSINESS IDEA Lesson 17

**LEARNING OBJECTIV ES**

1. To discuss the aspects of the product planning and development process
2. To discuss aspects of e-commerce and starting an e-commerce business

**PRODUC T PLA N NI N G AND DEV E LOPME N T PROCES S**

Once idea emerges from idea sources or creative problem solving, they need further development and refinement in to final product or service to be offered. This refining process- the product planning and development process – is divided in to five major stages. Idea stage, concept stage, product development stage, test marketing stage and commercializing; it result in the product life cycle.

**Establishing evaluation criteria**

At each stage of product planning and development process, criteria for evaluation need to be established. These criteria should be broad, yet quantitative enough to screen the product carefully in the particular stage of development. Criteria should be developed to evaluate the new product in terms of market opportunity, competition the marketing system, financial factors and production factors. A market opportunity and adequate market demand must exist. Current competing producers, prices, and policies should be evaluated in their impact on market share. The new product should be compatible with existing management capabilities. The product should be able to be supported by and contribute to the company's financial structure. The compatibility of new product's production requirements with existing plant, machinery, and personnel should be determined. Entrepreneurs should formally evaluate an idea throughout its evolution.

**Idea Stage**

Promising new product ideas should be identified and impractical ones eliminated in the idea stage allowing maximum use of company's resources. In the systematic market evaluation checklist method, each new product idea is expressed in terms of its chief values, merits, and benefits. This technique can be used to determine which new products should be pursued. The company should also determine the need for the new product and its value to the company. Need determination should focus on the type of need, its timing, the users involved, the importance of marketing variables, and the overall market structure and characteristics. In determining the product's value to the firm, financial scheduling should be evaluated.

**Concept Stage**

In the concept stage the refined idea is tested to determine consumer acceptance without manufacturing it. One method of testing is the conversational interview in which respondents are exposed to statements that reflect attributes of the product. Features, price, and promotion should be evaluated in comparison to major competitors to indicate deficiencies or benefits. The relative advantages of the new product versus competitors should be determined.

**Product Development Stage**

In this stage, consumer reaction is determined, often through a consumer panel. The panel can be given samples of the product and competitors' products to determine consumer preference. Participants keep the record of their use of product and comment on its virtues and deficiencies. The panel of consumers is also given a sample of product and one or more competitive product simultaneously. One test product may already be on the market, whereas the other test product is new.

**Test Marketing Stage**

Although the results of product development stage provide the basis of the final marketing plan, the market test can be done to increase the certainty of successful commercialization. The last step in the evaluation process, the test marketing stage, provides actual sales results which indicate the acceptance level of consumers. Positive test results indicate the degree of probability of a successful product launch and company formation.

**E-Commerce and Business Start-Up and Growth**

**The Internet**

The Internet started in the 1970s with a U.S. Defense Department program named ARPA. In the early 1990s the concept of World Wide Web pages was developed. The Internet is a channel for the creation of profitable companies. Electronic business (e-business) is any process that a business organization conducts over a computer-mediated network. Electronic commerce (e-commerce) is any transaction completed over a computer-mediated network that involves the transfer of ownership or rights to use goods or services. Factors that facilitate the growth of e-commerce are:

1. The widespread use of personal computers.
2. The adoption of intranets in companies.
3. The acceptance of the Internet as a business communications platform.

**Starting an E-Commerce Company**

The Internet is especially important for small and medium-sized companies as it lets them minimize marketing costs while reaching broader markets. An entrepreneur starting an Internet commerce venture needs to address many of the same strategic and tactical questions as other companies plus some specific online issues. One decision is whether to run the Internet operations within the company or outsource these operations. If handled in-house, expensive equipment and software have to be maintained. There are numerous possibilities for outsourcing the Internet business. The two major components of Internet commerce are front-end and back-end operations.

- Front-end operations are encompassed in the website's functionality, such as search capabilities, shopping cart, and secure payment. Back-end operations involve integrating customer orders with distribution channels and manufacturing capabilities.

**Website**

A website is an online connection between the company and its customers and can be developed in-house or outsourced. There are several important features of every website. Each website should have search capabilities. Other functions include shopping cart, secure server connection, credit card payment, and customer feedback features. Orders and other sensitive customer information should be transferred only through secure servers. An Internet company should also obtain a merchant account, which will allow the acceptance of major credit cards.

A successful website has three characteristics: speed, speed, and speed. Short download time should be the primary concern of website developers. A website should be easy to use, customized for specific market target groups, and compatible with different browsers. If the company is targeting international markets, then translation and cultural adaptation need to be considered. Probably the most difficult aspect of setting up an online business is advertising and promoting the web pages. A company can advertise its website through search engines, banner ads, e-mail, and classifieds. Banner ads can be targeted to the exact audience of the firm. The entrepreneur should collect e-mail addresses from customers for targeted e-mail campaigns. The Internet offers many low-cost or free services for small businesses, including Internet access, unlimited e-mail accounts, online calendar, instant messaging, and online conference rooms.

**Tracking Customer Information**

Electronic databases support personal marketing targeted at individual clients. The online company can capture customers' information in many ways. The U.S. government has generally maintained a policy of noninvolvement with Internet regulation, but the Federal Trade Commission has also pressed for new laws to protect minors.

**Relationships and Endorsements by Other Companies**

The company needs to establish strong connections with other companies in the supply chain to create an end-to-end value stream. The entrepreneur should protect its innovations and its relationship with other
companies. Another type of relationship is endorsements by prominent Internet companies and associations. Participation in merchant networks can bring needed credibility.

**Doing E-Commerce as an Entrepreneurial Company**

The decision to go online should be made on a case-by-case basis. The products should be able to be delivered economically and conveniently. The product has to be interesting for a large number of people. Online operations have to bring significant cost reductions compared with brick-and-mortar operations. The company must have the ability to economically draw customers to its website. Conflict between traditional and online marketing channels can lead to a hostile, competing position of once partnering companies.

**KEY TERMS Product development stage**

In this stage, the new product is further developed into a prototype and tested

**Product life cycle**

This cycle is generally divided into four major stages: product introduction, market growth, market maturity, and sales decline

**Product planning and development process**

Generally divided into five major stages: idea stage, concept stage, product development stage, test marketing stage, test marketing stage, and commercialization stage

## LEGAL ISSUES FOR THE ENTREPRENEUR Lesson 18

**LEARNING OBJECTIVES**
1. To identify and distinguish intellectual property assets of a new venture including software websites.
2. To understand the nature of patents, the rights they provide, and the process for filing one.

**WHAT IS INTELLECTUAL PROPERTY?**

**Intellectual property** which includes patents, trademarks, copyrights, and trade secrets represent important assets of entrepreneur and should be understood even before engaging the services of an attorney. Because entrepreneurs often don't understand intellectual property, they can ignore steps that should be taken to protect these assets.

**NEED FOR A LAWYER**
All business is regulated by law. The entrepreneur needs to be aware of regulations that affect the new venture. At different stages the entrepreneur will need legal advice. The legal expertise required will vary based on factors such as type of product and organizational status. The entrepreneur should carefully evaluate his or her needs before hiring a lawyer.

**HOW TO SELECT A LAWYER Why hire a lawyer?**
The entrepreneur does not usually have the expertise to handle possible risks associated with difficult laws. An attorney is in a better position to understand all outcomes related to any legal action. The lawyer may work on a retainer basis (stated amount per month,), which provides office and consulting time. This does not include court time or other legal fees. The lawyer may be hired for a one-time fee, i.e. filing for a patent. Choosing a lawyer is like hiring an employee-The lawyer you work with should be someone to whom you can relate personally. When resources are limited, the entrepreneur may offer the lawyer stock in exchange for his or her services

**LEGAL ISSUES IN SETTING UP THE ORGANIZATION**
There are many options an entrepreneur can choose in setting up an organization. Legal advice is also needed to prepare the agreements necessary to begin a partnership, franchise, or corporation.

**PATENTS**
A **patent** is a contract between the government and an inventor. The government grants the inventor exclusivity for a specified amount of time. At the end, the government publishes the invention, and it becomes part of the public domain. The patent gives the owners a negative right, preventing anyone from making, using, or selling the invention.
**Types of Patents**

1. **Utility Patents**
   A utility patent has a term of 17 years, beginning on the date the Patent and Trademark Office (PTO) issues it. NAFTA (North American Free Trade Agreement) establishes a minimum period of 20 years from the date of filing or 17 years from the date of the grant. Patents on any invention requiring FDA approval are extended by the amount of time it takes the FDA to review the

invention. The patent grants the owner protection from anyone making, using, and/or selling the invention.

**2. Design Patents**

Covering new, original, ornamental, and unobvious designs for articles, a design patent reflects the appearance of an object. These are for a 14-year term and provide a negative right, excluding others from making an article having the same ornamental appearance. Filing fees are lower than for utility patents.

**3. Plant patents**

Plant patents are issued for 17 years on new varieties of plants.
Patents are issued by the Patent and Trademark Office (PTO.) This office also administers the Disclosure Document Program, in which the inventor files disclosure of the invention, giving recognition that he or she was the first to develop the idea. Another program is the Defensive Publication Program, which lets the inventor protect an idea by preventing anyone else from patenting this idea, but gives the public access to it.

**4. International Patents**

With the new GATT (General Agreement on Tariffs and Trade) that took effect on January 1, 1996, any application by a foreign company will be treated equally to an American firm. Previously American firms were given priority. Now the decision is totally based on when the filing companies began work on the idea. The GATT pact has been signed by 124 countries. An additional 144 are due to be included by the end of the century. China is excluded because of issues related to piracy. The pact will mandate stronger protection for entrepreneurs by requiring protection for the following terms:

1. Seven years for trademarks.
2. Twenty years for patents.
3. Fifty years for films, music, and software.

There are still some problems with international patents, such as the attitudes in China and other Southeast Asian countries toward "knock-offs."

**The Disclosure Document**

The entrepreneur should first file a **disclosure document** to establish a date of conception. To file, the entrepreneur must prepare a clear description of the invention along with photos and a cover letter. Upon receipt, the PTO stamps and returns a duplicate copy establishing evidence of conception. Before actually applying for the patent, the entrepreneur should retain a patent attorney to conduct a patent search.

**The Patent Application**

The patent application must contain a complete history and description of the invention as well as claims for its usefulness. The application is divided into sections: *The Introduction Section* contains the background and advantages of the invention and the nature of problems it overcomes. The d*escription of Invention Section,* this section contains a description of the drawings, which must comply with PTO requirements. A detailed description of the invention follows, including engineering specifications, materials, and components. In *Claims Section,* Claims are the criteria by which any infringements will be determined. Essential parts of the invention should be described in broad terms. The claims must not be so general that they hide the invention’s uniqueness. The application should contain a declaration signed by the inventor.

When the application is sent, the status of the invention becomes "*patent pending*," providing protection until the application is approved. A carefully written patent should provide protection, but is also an invitation to sue or be sued if there is any infringement.

**Patent Infringement**

Many inventions are the result of improvements in existing products. Copying and improving a product may be legal. If improvement is impossible, it may be possible to license the product from the patent holder. To ascertain the existence of a patent, the entrepreneur can now use the Internet. If there is an existing patent that might involve infringement, licensing may be considered. If there is any doubt on this issue, the entrepreneur should hire a patent attorney.

**ONL I NE PATENT ISSUES**

The question of whether patents are applicable to e-commerce has been raised lately by stamp.com and Pitney Bowes. Large corporations, like Pitney Bowes, are suing start-up companies to get compensation for their intellectual property such as research and development and patents.

**KEY TERMS**

**Intellectual property**

Any patents, trademarks, copyright, or trade secrets held by the entrepreneur

**Patent**

Grants holder protection from others making, using, or selling similar idea

**Disclosure document**

Statement to U.S. Patent and Trademark Office by inventor disclosing intent to patent idea
Entrepreneurship – MGT602 **VU**

# LEGAL ISSUES FOR THE ENTRE P RENEUR Lesson 19

## LEARNING OBJECTIV ES

1. To understand the purpose of a trademark and the procedure for filing.
2. To learn the purpose of a copyright and how to file for one.
3. To identify procedures that can protect a venture's trade secrets.
4. To understand the value of licensing to either expand a business or to start a new venture.

## TRADEMARKS

A *trademark* may be a word, symbol, design, or some combination that identifies the source of certain goods. A **trademark** can last indefinitely, as long as it continues to perform its indicated function. The trademark is given a 20-year registration with 20-year renewable terms. In the fifth to sixth year, you must file an affidavit with the PTO indicating that the patent is in commercial use. Today the law allows filing a trademark solely on the intent to use the trademark in interstate commerce. There are benefits to registering a mark that has already been in use. **Categories of trademarks**: **Coined marks** denote no relationship between the mark and the goods and afford the possibility of expansion. An **arbitrary mark** is one that has another meaning in our language. A **suggestive mark** is used to suggest certain features or characteristics of a product or service. A **descriptive mark** must have become distinctive and gained recognition before it can be registered. Registering a trademark can offer significant advantages to the entrepreneur.

### Registering the Trademark

The PTO is responsible for federal registration of trademarks. To file, the entrepreneur must complete the application form, which can be downloaded from the PTO website. Filing of the registration involves four requirements:

a. Completion of the written form.
b. A drawing of the mark.
c. Five specimens showing actual use of the mark.

d. The fee. An examining attorney at the PTO determines whether the mark is suitable for registration. Once accepted, the trademark is published in the *Trademark Official Gazette* to allow any party 30 days opposing. If no opposition is filed, the registration is issued. The entire process usually takes about 13 months.

## COPYRIGHT

A **copyright** protects original works of authorship. The protection does not protect the idea itself. It allows someone else to use the idea in a different manner. In 1980 the Computer Software Copyright Act was added to provide explanation of the nature of software protection under copyright law. Authors of software are protected in a manner similar to authors of artistic works. The idea is not eligible for protection, but the actual software program is eligible. The PTO issues registration for software source codes and object codes programs. Protection of material on the Internet has become an important issue. The New York Time recently claimed that Amazon.com couldn't use its best-seller list without its permission. Ownership of stock quotes, judicial decision, and real estate postings is also being questioned. Copyrights are registered with the

Library of Congress. All that is needed is the form, two copies of the work, and the appropriate fee sent to the Register of Copyrights. The term of the copyright is the life of the author plus 50 years. In some instances, several forms of protection may be available: trademark, patent, and copyright.

**TRADE SE CRETS** A **trade secret** is not covered by any federal law but is recognized under common laws in each state. Employees may be asked to sign a confidential information agreement. The holder of the trade secret has the right to sue any signee who breaks the agreement. Non-protected ideas could become a serious problem in the future unless the entrepreneur takes precautions. To maintain secrecy

1. Train employees to refer sensitive questions to one person.
2. Provide escorts for all office visitors.
3. Avoid discussing business in public places.
4. Control information that might be presented by employees at conferences or in journals.
5. Use simple security such as locked file cabinets and shredders.
6. Have employees and consultants sign non-disclosure agreements.
7. Debrief departing employees.
8. Avoid faxing any sensitive information.
9. Mark documents "confidential" that need to be.
10. Protection against the leaking of trade secrets is difficult to enforce, and legal action can be taken only after the secret has been revealed.

**LICENSING**

**Licensing** is an arrangement between two parties, where one party has proprietary rights protected by a patent, trademark, or copyright. This requires the licensee to pay a royalty to the holder of the proprietary rights in return for permission to copy the patent. Licensing has significant value as a marketing strategy to holders of patents.

**Procedure**

A patent license agreement specifies how the licensee would have access to the patent. Licensing a trademark usually involves an agreement where the entrepreneur operates a business using the trademark and agrees to specific requirements. The agreement must be carefully worded and should involve a lawyer. Licensing a trademark generally involves a franchising agreement. The entrepreneur operates a business using the trademark and agrees to pay a fixed sum for use of the trademark.

The franchisee also pays a royalty based on sales volume, buys supplies from the franchiser, or some combination of these. Copyrights are also popular licensed property. They involve the right to use or copy books, software, music, photos, and plays. Celebrities will often license the right to use his or her name or image in a product. Hit movies can also result in new products. Licensing is also popular around special sports events.

Licensing opportunities are plentiful but should be carefully considered and planned. A significant player in licensing is Walt Disney, which has been actively engaged in licensing for 65 years. Licensing can be valuable for a firm that lacks resources to conduct R&D to develop a product. Technology licensing entails an agreement by which a firm (licensee) acquires rights to product technology from another firm (licensor.) Two reasons for licensing are to gain competitive advantage and to improve technical skills.

**Benefits**

Licensing can increase revenues, without the risk and costly start-up investment. Licensing can also be a way to start a new venture when the idea may infringe.

**KEY TERMS**

**Disclosure document**

Statement to U.S. Patent and Trademark Office by inventor disclosing intent to patent idea Also included as a transparency master in Section VII of this manual

**Trademark**

A distinguishing word, name, or symbol used to identify a product

## LEGAL ISSUES FOR THE ENTREPRENEURS Lesson 20

### LEARNING OBJECTIVES

1. To illustrate some of the fundamental issues related to contracts.
2. To understand important issues related to insurance and product safety and liability.

### PRODUCT SAFETY AND LIABILITY

The Consumer Product Safety Act, passed in 1972, created a five-member commission that has the power to prescribe safety standards for products. The commission also has the power to identify what it considers to be substantial hazards and bar products it considers unsafe. The act was amended in 1990 to establish stricter guidelines for reporting product defects and resulting injuries and deaths. Manufacturers could be subject to fines of $1.25 million for not reporting product liability settlements or court awards. Any new product should be assessed as to whether it falls under the law. If it does, the entrepreneur has to follow appropriate procedures. Product liability problems are complex. Recent attempts to reform the legislation passed in Congress but were vetoed by the President. Claims regarding **product safety and liability** usually fall under one of these categories:

1. **Negligence** extends to all parts of the production and marketing process.
2. **Warranty**Consumers may sue when advertising overstates the benefits of a product or when the product does not perform as stated.
3. **Strict Liability**. A consumer can sue on the basis that the product was defective prior to its receipt.
4. **Misrepresentation** occurs when advertising or other information misrepresents material facts concerning the quality of the product. The best protection against product liability is to produce safe products and to warn consumers of any potential hazards.

### INSURANCE

The entrepreneur should purchase insurance in the event that problems do occur. Most firms should consider coverage in specific areas as a means of managing risk in the business.
Common types of insurance include:

1. Property insurance.
2. Casualty insurance.
3. Life insurance.
4. Worker's compensation.
5. Bonding.

Each of these types of insurance provides a means of managing risk in the new business. Some insurance, such as disability and vehicle coverage, is required by law and cannot be avoided. Life insurance of key employees is not required but may be necessary to protect the venture. The entrepreneur should consider the increasing insurance premiums in cost projections. The entrepreneur should determine what kind of insurance to purchase, how much to purchase, and from what company. Skyrocketing medical costs have significant impact on insurance premiums, especially workers' compensation. Insurance companies calculate the premium for workers' compensation as a percentage of payrolls, type of business, and prior claims. Some states are undertaking reforms in this coverage.

Promoting safety through comprehensive guidelines and being personally involved with safety will help the entrepreneur control costs. Health care coverage is an important benefit to employees and a significant cost to businesses. A self-employed entrepreneur has limited

options. If you are leaving a corporate position, consider extending your health care benefits with a COBRA, which allows you to continue on the same health policy for about three years. Individual health care policies hare available. One rule is to never rely on a handshake if the deal cannot be completed within one year.
The courts insist that a written contract exist for all transactions over $500. The safest way to conduct business deals is with a written contract. Any deal involving real estate must be in writing to be valid. Leases, rentals, and purchases all need written agreements.
Four essential items in an agreement to provide the best legal protection:

1. All parties involved should be named and their roles specified.
2. The transaction should be described in detail.
3. The exact value of the transaction should be specified.
4. Obtain signatures of the persons involved in the deal.

**KEY TERMS**
**Copyright**
Right given to prevent others from printing, copying, or publishing any original works of authorship
**Trade secret**
Protection against others revealing or disclosing information that could be damaging to business
**Licensing**
Contractual agreement giving rights to others to use intellectual property in return for a royalty or fee

**CREATING AND STARTING THE VENTURE Lesson 21**

**LEARNING OBJECTIVES**

1. To define what the business plan is, who prepares it, who reads it, and how it is evaluated.
2. To understand the scope and value of the business plan to investors, lenders, employees, suppliers, and customers.

**PLANNING AS PART OF THE BUSINESS OPERATION**

Planning is a process that never ends. In the early stages, the entrepreneur should prepare a preliminary plan. The plan will be finalized as the enterprise develops. Many different types of plans may be part of any business operation-financial, marketing, production, and sales plans. Plans may be short term or long term, or they may be strategic or operational. All of these plans have one purpose: to provide guidance and structure to management in a rapidly changing market environment.

**WHAT IS THE BUSINESS PLAN**

A **business plan** is a written document prepared by the entrepreneur that describes all the relevant external and internal elements involved in starting a new venture. It addresses both short- and long-term decision making. The business plan is like a road map for the business' development. The Internet also provides outlines for business planning. Entrepreneurs can also hire or offer equity to another person to provide expertise in preparing the business plan. In developing the business plan the entrepreneur can determine how much money will be needed from new and existing sources.

**WHO SHOULD WRITE THE PLAN**

The business plan should be prepared by the entrepreneur; however, he or she may consult many sources. Lawyers, accountants, marketing consultants, and engineers are useful supplemental sources. Other resources are the Small Business Administration, Service Core of Retired Executives, Small Business Development Centers, universities, friends, and relatives. To help determine whether to hire a consultant, the entrepreneur needs to make an objective assessment of his or her own skills.

**SCOPE AND VALUE OF THE BUSINESS PLANCWHO READS THE PLAN**

The business plan must be comprehensive enough to address the concerns of employees, investors, bankers, venture capitalists, suppliers, and customers. Three perspectives need to be considered:

The *entrepreneur* understands the new venture better than anyone. The *marketing perspective* considers the venture through the eyes of the customer. The *investor* looks for sound financial projections. The depth of the business plan depends on the size and scope of the proposed venture.

The business plan is valuable to the entrepreneur and investors because:

1. It helps determine the viability of the venture in a designated market.
2. It gives guidance in organizing planning activities.
3. It serves as an important tool in obtaining financing. Potential investors are very particular about what should be included in the plan. The process of developing a business plan also provides a self-assessment of the entrepreneur. This self-evaluation requires the entrepreneur to

think through obstacles that might prevent the venture's success. It also allows the entrepreneur to plan ways to avoid such obstacles.

**HOW DO POTENTIAL LENDERS AND INVESTORS EVALUATE THE PLAN**

Because the business plan should address the needs of all the potential evaluators, software packages and Internet samples should be used only to assist in preparation. As the entrepreneur becomes aware of who will read the plan, changes will be necessary. Suppliers may want to see a business plan before signing a contract to supply products or services. Customers may also want to review the plan before buying the product. The business plan should consider the needs of these constituencies. Potential suppliers of capital will vary in their needs and requirements in the business plan. Lenders are primarily interested in the ability of the new venture to pay back the debt and focus on the four C's of credit:

1. The entrepreneur's credit history or *character.*
2. Their ability to meet debt and interest payments (*cash flow*.)
3. The *collateral* or tangible assets being secured.
4. *Equity contribution* or the amount of personal equity that has been invested by the entrepreneur.

Investors provide large sums of capital for ownership (equity) and expect to cash out within 5 to 7 years. They will often place more emphasis on the entrepreneur's character than lenders. The venture capitalist will play an important role in management of the business and wants the entrepreneurs to be pliable and willing to accept this involvement. These investors will also demand high rates of return and will thus focus on the market and financial projections. If the entrepreneur does not consider the needs of these sources, the plan may be an internalized document without consideration of the feasibility of meeting market goals. Most external advisors and potential investors are bound by a professional code of ethics regarding disclosure.

**PRESENTING THE PLAN**

It is often necessary for an entrepreneur to orally present the business plan to investors. Typically the entrepreneur provides a short (20-30 minutes) presentation of the business plan. The entrepreneur must sell their business concept in a short time period. A venture capitalist or angel group may also ask the entrepreneur to present the plan to their partners before making a final decision.

 

## CREATING AND STARTING THE VENTURE (Continued….) Lesson 22

### LEARNING OBJECTIVES

1. To identify information needs and sources for business planning.
2. To enhance awareness of the ability of the Internet as an information resource and marketing tool
3. To present helpful questions for the entrepreneur at each stage of the planning process.
4. To understand how to monitor the business plan

### INFORMATION NEEDS

Before preparing a business plan, the entrepreneur should do a quick feasibility study to see if there are possible barriers to success. The entrepreneur should clearly define the venture's goals, which provide a framework for the business plan. The business plan must reflect reasonable goals.

**Market Information**

It is important to know the market potential for the product or service. The first step is to define the market. A well-defined target market makes it easier to project market size and market goals. To assess the total market potential, the entrepreneur can use trade associations, government reports, and published studies.

**Operations Information Needs**

The entrepreneur may need information on:
1. Location
2. Manufacturing operations
3. Raw materials
4. Equipment
5. Labor skills
6. Space
7. Overhead

Each item may require some research but is needed by those who will assess the business plan.

**Financial Information Needs**

Before preparing the plan, the entrepreneur must evaluate the profitability of the venture through the following:
1. Expected sales and expense figures for the first three years
2. Cash flow figures for the first three years
3. Current balance sheets and pro forma balance sheets for the next three years
   Determination of expected sales and expenses is based on the market information gathered earlier. Estimates of cash flow will consider the ability of the new venture to meet expenses at designated times. Current balance sheet figures show the assets, liabilities, and investments made by the owner.

### USING THE INTERNET AS A RESOURCE TOOL

Thanks to technology, entrepreneurs are able to access information efficiently, expediently, and at very little cost. The **Internet** can serve as an important source of information in preparing the business plan. Information on industry analysis, competitor analysis, and measurement of market potential can be located. In addition, the Internet also provides opportunities for actually marketing the new venture's products. A web site, or home page, typically describes a firm's history, existing products, background of the founders, and other information to create a favorable image. The web site can be a vehicle for advertising or for direct marketing. Many new ventures use web pages to increase sales contacts and reach potential customers. An entrepreneur can also access competitors' web sites to gain knowledge of their strategy in the marketplace. To gather information anonymously the entrepreneur can also investigate newsgroups. All that is needed to use these sources is a small investment in hardware and software.

**WRITI NG THE BUSINESS PLA N**

The business plan should be comprehensive enough to give a potential investor a complete understanding of the venture

**Introductory Page**

The title page provides a brief summary of the business plan's contents, and should include:

1. The name and address of the company
2. The name of the entrepreneur and a telephone number
3. A paragraph describing the company and the nature of the business
4. The amount of financing needed
5. A statement of the confidentiality of the report It also sets out the basic concept that the entrepreneur is attempting to develop.

**Executive Summary**

This is prepared after the total plan is written. It should be three to four pages in length and should highlight the key points in the business plan. The summary should highlight in a concise manner the key points in the business plan. Issues that should be addressed include:

1. Brief description of the business concept
2. Any data that support the opportunity for the venture.
3. Statement of you this opportunity will be pursued.
4. Highlight some key financial results that can be achieved Because of the limited scope of the summary, the entrepreneur should ascertain what is important to the audience to whom the plan is directed.

**Environmental and Industry Analysis**

The entrepreneur should first conduct an **environmental analysis** to identify trends and changes occurring on a national and international level that may impact the new venture. Examples of environmental factors are:

Economy Culture Technology Legal concerns All of the above external factors are generally uncontrollable Next the entrepreneur should conduct an **industry analysis** that focuses on specific industry trends.

Some examples of industry factors include: Industry demand Competition The last part of this section should focus on the specific market. This would include such information as who the customer is and what the business environment is like. The market should be segmented and the target market identified

**Description of the Venture**

The description of the venture should be detailed in this section. This should begin with the mission statement or company mission**,** which describes the nature of the business and what the entrepreneur hopes to accomplish. The new venture should be described in detail, including the product, location, personnel, background of entrepreneur, and history of the venture. The emphasis placed on location is a function of the type of business. Maps that locate customers, competitors, and alternative locations can be helpful. If the building or site decision involves legal issues, the entrepreneur should hire a lawyer.

## CREATING AND STARTING THE VENTURE (Continued….) Lesson 23

### LEARNING OBJECTIV ES

1. To present examples and a step-by-step explanation of the business plan.
2. To explain how to write a business plan
3. To explain the procedure and list of document included in business plan
4. To discuss the contents of each document and how to prepare them

### WRITI NG THE BUSINESS PLAN

**Description of the Venture**
The description of the venture should be detailed in this section. This should begin with the mission statement or company mission**,** which describes the nature of the business and what the entrepreneur hopes to accomplish. The new venture should be described in detail, including the product, location, personnel, background of entrepreneur, and history of the venture. The emphasis placed on location is a function of the type of business. Maps that locate customers, competitors, and alternative locations can be helpful. If the building or site decision involves legal issues, the entrepreneur should hire a lawyer.

**Production Plan or Operations Plan**
If a new venture is a manufacturing operation, a production plan is necessary. This plan should describe the complete manufacturing process, including whether or not the process is to be subcontracted. If the manufacturing is carried out by the entrepreneur, the plan should describe the physical plant layout and machinery and equipment needed. If the venture is not manufacturing, this section would be titled *operational plan***.** The entrepreneur would need to describe the chronological steps in completing a business transaction.

**Marketing Plan**
The marketing plan describes how the products will be distributed, priced, and promoted. Potential investors regard the marketing plan as critical to the venture's success.

**Organizational Plan**
The organizational plan section should describe the venture's form of ownership. If the venture is a corporation, this should include the number of shares authorized, share options, and names and addresses of the directors and officers. It is helpful to provide an organization chart indicating the line of authority. This chart shows the investor who controls the organization and how members interact.

**Assessment of Risk**
It is important that the entrepreneur make an assessment of risk in the following manner: The entrepreneur should indicate the potential risks to the new venture. Next should be a discussion of what might happen if these risks become reality. Finally the entrepreneur should discuss the strategy to prevent, minimize, or respond to these risks. The entrepreneur should also provide alternative strategies should these risk factors occur.

**Financial Plan**
The financial plan determines the investment needed for the new venture and indicates whether the business plan is economically feasible. The entrepreneur should summarize the forecasted

sales and expenses for the first three years. Cash flow figure for three years are needed, with the first year's projections provided monthly. The projected balance sheet shows the financial condition of the business at a specific time.

**Appendix**
The appendix contains any backup material not included in the text of the document.

**Other possible documents**

Letters from customers, distributors, or subcontractors Secondary or primary research data Leases and contracts Price lists from suppliers and competitors

## CREATING AND STARTING THE VENTURE (Continued….) Lesson 24

### LEARNING OBJECTIVES

1. To present helpful questions for the entrepreneur at each stage of the planning process
2. To understand how to monitor the business plan
3. To understand the differences between business planning, strategy plans, and market planning
4. To describe the role of marketing research in determining market strategy for the marketing plan

### USING AND IMPLEMENTING THE BUSINESS PLAN

The business plan is designed to guide the entrepreneur through the first year of operations. It should contain control points to ascertain progress. Planning should be a part of any business operation. Without good planning the employees will not understand the company's goals and how they are expected to perform their jobs. Bankers say that most businesses fail because of the entrepreneur's inability to plan effectively. The entrepreneur can enhance efficient implementation of the plan by developing a schedule to measure programs and to institute contingency plans.

#### Measuring Plan Progress

Plan projections will typically be made on a 12-month schedule, but the entrepreneur should check key areas more frequently. Inventory control by controlling inventory, the firm can ensure maximum service to the customer. Production control Compare the cost figures against day-to-day operating costs.
Quality control Quality control depends on the type of production system used.
Sales control Information on units, dollars, and specific products sold should be collected.
Disbursements. The new venture should control the amount of money paid out

#### Updating the Plan

Environmental factors and internal factors can change the direction of the plan. It is important to be sensitive to changes in the company, industry, and market.

### WHY SOME BUSINESS PLANS FAIL

A poorly prepared business plan can be blamed on:

- Goals set by the entrepreneurs that are unreasonable.
- Goals those are not measurable.

To be successful

- Goals should be specific.
- They should also be measurable and should be monitored over time.

The entrepreneur who has not made a total commitment to the business will not be able to meet the venture's demands of the venture. Investors will not be positive about a venture that does not have full-time commitment. Investors will typically expect the entrepreneur to make significant financial commitment to the business. Lack of experience will result in failure unless the entrepreneur can gain knowledge or team up with someone. The entrepreneur should also document customer needs before preparing the plan

**MARKETING PLAN Purpose and Timing of the Marketing Plan**

The marketing plan establishes how the entrepreneur will effectively compete and operate in the marketplace. Marketing planning should be an annual activity focusing on decisions related to the marketing mix variables. The marketing plan section should focus on strategies for the first three years of the venture. For the first year, goals and strategies should be projected monthly. For years two and three, market results should be projected based on longer-term goals. Preparing an annual marketing plan becomes the basis for planning other aspects of the business.

**Understanding the marketing plan**

The marketing plan should answer three basic questions:

**Where have we been? -**The history of the marketplace, marketing strengths and weaknesses, and market opportunities.

**Where do we want to go (short term)? -** Marketing objectives and goals in the next twelve months.

**How do we get there? -**Specific marketing strategy that will be implemented. The marketing plan should be a guide for implementing marketing decision-making and not a superficial document. The mere organization of the thinking process involved in preparing a marketing plan can be helpful in understanding and recognizing critical issues.

## THE MARKETING PLAN Lesson 25

### LEARNING OBJECTIVES

1. To understand the differences between business planning, strategy plans, and market planning.
2. To describe the role of marketing research in determining market strategy for the marketing plan.
3. To illustrate an effective and feasible procedure for the entrepreneur to follow in engaging in a market research study.
4. To define the steps in preparing the marketing plan.
5. To explain the marketing system and its key components.
6. To illustrate different creative strategies that may be used to differentiate or position the new venture's products or services.

### PURPOSE AND TIMING OF THE MARKETING PLAN

The marketing plan establishes how the entrepreneur will effectively compete and operate in the marketplace. Marketing planning should be an annual activity focusing on decisions related to the marketing mix variables. The marketing plan section should focus on strategies for the first three years of the venture. For the first year, goals and strategies should be projected monthly. For years two and three, market results should be projected based on longer-term goals. Preparing an annual marketing plan becomes the basis for planning other aspects of the business.

### MARKET RESEARCH FOR THE NEW VENTURE

Information for developing the marketing plan may require some marketing research. Marketing research involves the gathering of data in order to determine such information as who will buy the product, what price should be charged, and what is the most effective promotion strategy. Marketing research may be conducted by the entrepreneur or by an external supplier or consultant. Market research begins with definition of objectives. Many entrepreneurs don't know what they want to accomplish from a research study.

#### Defining the Purpose or Objectives

One effective way to begin the marketing plan is to make a list of the information that will be needed to prepare the marketing plan.

**Possible objectives:**

1. Determine what people think of the product or service and if they would buy it.
2. Determine how much customers would be willing to pay for the product.
3. Determine where the customer would prefer to purchase the product.
4. Determine where the customer would expect to hear about such a product or service.

**Gathering Data from Secondary Sources** An obvious source is data that already exists, or secondary data, found in trade magazines, libraries, government agencies, and the Internet. The Internet can provide information on competitors and the industry, plus can be used for primary research. Commercial data may also be available, but the cost may be prohibitive. Free secondary information is available through:

The U.S. Bureau of Census and the Department of Commerce. State departments of commerce, chambers of commerce, and local banks. Private sources of data, such as *Predicasts*, the *Business Index*, and the SBA's *Directory of Business Development Publications*, can be found in a good business library.

A local business library can also provide access to reference sources and articles about competitors and the industry.

The entrepreneur should exhaust all possible secondary data sources, observation, and networking before beginning costly primary data research.

**Gathering Information from Primary Sources**

Information that is new is primary data. Observation is the simplest approach. Networking is an informal method to gather primary data from experts in the field, can be a valuable low-cost research method.

A recent study found that the most successful ventures were focused on information about competitors, the customer, and the industry. Less successful ventures were more focused on gathering information on general economic and demographic trends. Interviewing or surveying is the most common approach, but is more expensive. The questionnaire used by the entrepreneur should include questions designed to fulfill one or more of the objectives. Questions should be designed so they are clear and concise, without bias, and easy to answer. If the entrepreneur lacks experience, he or she should seek help in developing the questionnaire through Small Business Development Centers or a local education institution.

**Focus groups**

A focus group is a sample of 10 or 12 potential customers who participate in a discussion.

Groups discuss issues in an informal, open format.

These groups should be led by an experienced monitor.

Experimentation involves control over specific variables in the research process.

**Analyzing and Interpreting the Results**

The entrepreneur can enter the results on a computer or hand-tabulate the results. Summarizing the answers to questions will give preliminary insights. Data can then be cross-tabulated to provide more focused results.

**UNDERSTANDING THE MARKETINGPLAN**

The marketing plan should answer three basic questions:

**Where have we been? -**The history of the marketplace, marketing strengths and weaknesses, and market opportunities.

**Where do we want to go (short term)? -** Marketing objectives and goals in the next twelve months. **How do we get there? -**Specific marketing strategy that will be implemented. The marketing plan should be a guide for implementing marketing decision-making and not a superficial document. The mere organization of the thinking process involved in preparing a marketing plan can be helpful in understanding and recognizing critical issues.

**CHARACT E RIST ICS OF A MARK ETING PLA N**

An effective marketing plan should:

1. Provide a strategy to accomplish the company mission.
2. Be based on facts and valid assumptions.
3. Provide for the use of existing resources.
4. Describe an organization to implement the plan.
5. Provide for continuity.
6. Be simple and short.
7. Be flexible.
8. Specify performance criteria that can be monitored and controlled.

The marketing system identifies the major interacting components, both internal and external, that enable the firm to provide products to the marketplace. Environment factors, although largely uncontrollable, should be studied.

**Internal environmental factors** are more controllable by the entrepreneur:

**Financial resources: The** financial plan should outline the financial needs for the venture.

**Management team:** An effective management team responsibilities assigned is needed for implementing the marketing plan.

**Suppliers:** Suppliers used are generally based on a number of factors, such as price, delivery time, and quality.

**Company mission**: Every new venture should define the nature of its business and what it hopes to accomplish.

## THE MARKETING MIX Lesson 26

The actual short-term marketing decisions in the marketing plan will consist of four important marketing variables, called the **marketing mix:**

1. Product or service.
2. Pricing.
3. Distribution.
4. Promotion. Each variable should be described in detail in the strategy section of the marketing plan.

### STEPS IN PREPARING THE MARKETING PLAN

**Step 1: Defining the Business Situation**

The **situation analysis** is a review of where the company has been and considers many of the environmental factors. The entrepreneur should provide a review of past performance of the product and the company. Industry analysis should include information on market size, growth rate, suppliers, new entries, and economic conditions.

**Step 2: Defining Target Market/Opportunities and Threats**

The entrepreneur should have a good idea of who the customer or **target market** will be. The defined target market will usually represent one or more segments of the entire market. **Market segmentation** is the process of dividing the market into smaller homogeneous groups.. The process of segmenting is:

a. Decide what general market or industry you wish to pursue.
b. Divide the market into smaller groups based on characteristics of the customer.
c. Select segment or segments to target.
d. Develop marketing plan integrating the parts of the marketing mix.

**Step 3: Considering Strengths and Weaknesses**

It is important for the entrepreneur to consider its strengths and weaknesses.

**Step 4: Establishing Goals and Objectives**

Before strategy decisions can be outlined, the entrepreneur must establish realistic **marketing goals and objectives.** These answer the question "Where do we want to go?” These goals should specify such things as market share, profit, sales, market penetration, pricing policy, and advertising support. Not all goals and objectives must be quantified. It is a good idea to limit the number of goals to between six and eight.

**Step 5: Defining Marketing Strategy and Action Programs**

Strategy and action decisions respond to the question "How do we get there?" It incorporates:

**1. Product or Service**

This includes a description of the product and may include more than the physical characteristics. It involves packaging, brand name, price, warranty, image, service, features, and style.

**2. Customer Service**

- Meeting customer needs and creating loyalty involves a number of low-cost steps:
- In writing develop a statement of customer service principles. Train those employees who have direct contact with customers.
- Establish a process for evaluating customer service.
- Reward employees who are most effective in providing quality customer service.
- Make regular contact with customers.
- Invest in quality telephone equipment.
- Meet customer expectations.
- Customer service is especially important for e-businesses.

**3. Pricing.**

One of the difficult decisions is determining the appropriate price for the product. Factors such as costs, discounts, freight, and markups must be considered. Marketing research can help determine a reasonable price that consumers are willing to pay.

**4.Distribution.**

This factor provides utility or makes the product convenient to purchase when it is needed. This variable must be consistent with other marketing mix variables. Type of channel, number of intermediaries and location of members should be described. Regardless of the type of business, it is usually necessary for the new venture to have a website. The Internet will become an increasingly important medium for information and distribution. Direct mail or telemarketing may be considered. Direct mail marketing is one of the simplest and lowest in entry costs. But the direct-marketing or Internet strategies are not a guarantee for success. The entrepreneur should evaluate all possible options for distribution.

**5.Promotion.**

The entrepreneur needs to inform customers as to the product's availability using advertising media such as print, radio, or television. Usually television is too expensive unless cable television is a viable option. Larger markets can be reached using direct mail, trade magazines, or newspapers. A website may also create awareness and promote the product and services of the venture. It is possible to make use of publicity as a means of introduction. It is important that the marketing strategy and action programs be specific and detailed enough to guide the entrepreneur through the first year.

**Step 6: Coordination of the Planning Process**

The management team must coordinate the planning process. The entrepreneur may be the only person involved but may lack experience in preparing the plan. Assistance is available from many sources, such as the SBA.

**.Step 7: Designing Responsibility for Implementation**

The plan must be implemented effectively to meet all of the desired goals and objectives.

Someone must take the responsibility for implementing each decision made in the marketing plan.

**Step 8: Budgeting the Marketing Strategy**

Planning decisions must also consider the costs involved in the implementation of these decisions. This budgeting will be useful in preparing the financial plan.

**Step 9: Implementation of the Marketing Plan**

The marketing plan is meant to be a commitment to a specific strategy. A commitment to make adjustments as needed by market conditions is also valuable.

**Step 10: Monitoring Progress of Marketing Actions**

Monitoring of the plan involves tracking specific results of the marketing effort. What is monitored is dependent on the specific goals and objectives outlined.

 

## THE ORGANIZATIONAL PLAN Lesson 27

### LEARNING OBJECTIVES

1. To understand the importance of the management team in launching a new venture.
2. To understand the advantages and disadvantages of the alternative legal forms of incorporation.
3. To explain the S Corporation and limited liability company as alternative forms of incorporation.
4. To learn how to prepare a job analysis, job description, and job specification.
5. To illustrate how the board of directors or board of advisors can be used to support the management of a new venture.

### DEVELOPING THE MANAGEMENT TEAM

Potential investors are interested in the management team and its ability and commitment to the new venture. Investors usually demand that the management team not operate the business part-time while employed full time elsewhere. It is also unacceptable for the entrepreneurs to draw a large salary. The entrepreneur should consider the role of the board of directors and/or a board of advisors in supporting the management of the new venture.

### LEGAL FORMS OF BUSINESS

There are three basic legal forms and one new form of

businesses. The three basic forms are:

a. Proprietorship.

b. Partnership.

c. Corporation

A new form is the **limited liability company**, which is now possible in most states.

The entrepreneur should evaluate the pros and cons of each of the legal forms prior to submitting a business plan. He should determine the priority of several factors discussed below. It is also necessary to consider intangibles such as image to suppliers, existing clients, and prospective customers.

#### Ownership

- In the **proprietorship**, the owner has full responsibility for operations.
- In a **partnership**, there may be owners with general or with limited ownership.
- In the **corporation**, ownership is reflected by ownership of shares of stock.

#### Liability of Owners

- The proprietor and general partners are liable for all aspects of the business.
- Since the corporation is a legal entity that is taxable and absorbs liability, the owners are

liable only for the amount of their investment.

- To satisfy any outstanding debts of the business, creditors may seize personal assets of the owners in proprietorships or regular partnerships.

- In a partnership the general partners share the amount of personal liability equally, regardless of their capital contribution.
- In a limited partnership, the limited partners are liable only for their capital contributions.

**Costs of Starting a Business**

1. The more complex the organization, the more expensive it is to start.
2. The least expensive is the proprietorship, where the only costs may be for filing for a business name.
3. In a partnership a partnership agreement is needed, in addition this requires legal advice and should explicitly convey all parties' responsibilities, rights and duties.
4. A limited partnership may be more complex to form because it must comply strictly with statutory requirements.
5. The corporation can be created only by statute.
6. The owners are required to register the name and articles of incorporation and meet state statutory requirements.
7. Filing fees and an organization tax may be incurred.
8. Legal advice is necessary to meet the statutory requirements.

**Continuity of Business**

- In a sole proprietorship, the death of the owner results in the termination of the business. In a limited partnership, the death of a limited partner has no effect on the existence of the partnership. A limited partner may be replaced, depending on the partnership agreement. If a general partner in a limited partnership dies or withdraws, the limited partnership is terminated unless the partnership agreement specifies otherwise.
- In a partnership, the death or withdrawal of one of the partners results in termination of the partnership, but this can be overcome by the partnership agreement.
- Usually the partnership will buy out the withdrawn partner's share at a predetermined price.
- Another option is to have a member of the withdrawn partner's family take over as partner.
- The corporation has the most continuity, as the owner's death or withdrawal has no impact on continuity of the business, unless it is a closely held corporation.

## THE ORGANIZATIONAL PLAN (Continued ….) Lesson 28

**Transferability of Interest**

- Each of the forms of business offers different advantages as to the transferability of interest.
- In a proprietorship, the entrepreneur has the right to sell any assets.
- In the limited partnership, the limited partners can sell their interests at any time without consent of the general partners. A general partner cannot sell any interest unless specified in the partnership agreement.
- In a corporation shareholders may transfer their shares at any time.
- In the S Corporation, the transfer of interest can occur only as long as the buyer is an individual.

**Capital Requirements**

The need for capital during the early months can become one of the most critical factors in keeping a new venture alive.

- For a proprietorship, any new capital can only come from loans or by additional personal contributions. Often an entrepreneur will take a second mortgage as a source of capital. Any borrowing from an outside investor may require giving up some equity. Failure to make payments can result in foreclosure and liquidation of the business.
- In the partnership, loans may be obtained from banks or additional funds may be contributed by each partner, but both methods require change in the partnership agreement.
- In the corporation, new capital can be raised by:
    a. Stock may be sold as either voting or nonvoting.
    b. Bonds may be sold.
    c. Money may also be borrowed in the name of the corporation.

**Management Control**

- The entrepreneur will want to retain as much control as possible over the business. In the proprietorship, the entrepreneur has the most control and flexibility in making business decisions.
- In a partnership the majority usually rules unless the partnership agreement states otherwise.
- In a limited partnership the limited partners have no control over business decision. Control of day-to-day business is in the hands of management.
- Major long-term decisions may require a vote of the major stockholders.
- As the corporation increases in size, the separation of management and control is probable.

- Stockholders can indirectly affect the operation by electing someone to the board of director

**Distribution of Profits and Losses**

- Proprietors receive all profits from the business.
- In the partnership, the distribution of profits and losses depends on the partnership agreement.
- Corporations distribute profits through dividends to stockholders.

**Attractiveness for Raising Capital**

- In both the proprietorship and partnership, the ability to raise capital depends on the success of the business and personal capability of the entrepreneur.
- Because of its limitations on personal liability, the corporation is the most attractive form for raising capital.

## THE ORGANIZATIONAL PLAN (Continued ….) Lesson 29

### TAX ATTRIBUTES OF FORMS OF BUSINESS

#### A. Tax Issues for Proprietorship

For the proprietorship the IRS treats the business as the individual owner. All income is personal income and the business is not taxed as a separate entity. The proprietorship has some tax advantages compared to the corporation.

a. There is no double tax on profits.
b. There is no capital stock tax or penalty for retained earnings.

#### B. Tax Issues for Partnership.

The partnership's tax advantages and disadvantages are similar to the proprietorship. Limited partnerships can provide unique tax advantages. Both the partnership and proprietorship have a legal identity distinct from the partners, but this identity is only for accounting purposes. The income is distributed based on the partnership agreement, and the owners then report their share as personal income.

#### C. Tax Issues for Corporation

The corporation has the advantage of being able to take many deductions not otherwise available. The disadvantage is that dividends are taxed twice. This double taxation can be avoided if the income is distributed as salary. The corporation tax may also be lower than the individual rate.

### S CORPORATIONS

The **S Corporation** combines the tax advantages of the partnership and the corporation.

**1.** It is designed so that the venture income is declared as personal income on a pro rata basis.
**2.** Shareholders benefit from all of the income and the deductions of the business.

Prior to passage of the 1996 Small Business Protection Act, rules governing the S corporation were considered too rigid.

The new law provides more flexibility with regard to:

a. Number of shareholders.
b. Who can be allowed to own shares?
c. The role of trusts as stockholders.
d. The ability of S corporations to own more than 90 percent of stock of another corporation.
e. Distribution of profits.
f. Issuance of different classes of stock.
g. Rules affecting the tax basis of incurred loses.

Limited liability corporations are still more flexible than the S corporation, but conversion entails a significant cost. More than half of all S corporations have only one shareholder, which would not be possible as an LLC.

**ADVANTAGES OF AN S CORPORATION**

1. Capital gains or losses are treated as personal income.
2. Shareholders retain limited liability protection.
3. It is not subject to a minimum tax, as C corporations are.
4. Stock may be transferred to low-income-bracket family members.
5. Stock may be voting or nonvoting.
6. This form may use the cash method of accounting.
7. Corporate long-term capital gains and losses are deductible by the shareholders.

**DISADVANTAGES OF AN S CORPORATION**

1. Even with the new regulations, there are still some restrictions.
2. If the corporation earns less than $100,000, then the C Corporation would have a lower tax liability.
3. The S Corporation may not deduct most fringe benefits for shareholders.
4. The S Corporation must adopt a calendar year for tax purposes.
5. Only one class of stock, common stock is permitted.
6. The net loss of the S Corporation is limited.

**THE LIMITED LIABILITY COMPANY**

1. A popular new entity is the **limited liability company** (LLC), which offers similar advantages as the S Corporation but with more liberal tax rules under subchapter K. This form is a partnership-corporation hybrid with the following characteristics:
2. Where the corporation has shareholders, the LLC has members.
3. No shares are issued, and each member owns an interest in the business.
4. Liability does not extend beyond the member’s capital contribution.
5. Members may transfer their interest only with the unanimous written consent of the remaining members.
6. The standard acceptable term of an LLC is 30 years.
7. The laws governing formation of the LLCs differ from state to state. The LLC is similar to an S corporation, but is more flexible. A major concern with LLCs is in international business, where the context of unlimited liability is still unclear. The primary differences between the limited partnership and the LLC are that the limited partnership must have at least one general partner with unlimited liability for partnership debts. The acceptability of the LLC should grow as state statutes are clarified and international rules established. With the assistance of a tax attorney, owners should compare alternative forms of ownership.

**DESIGNING THE ORGANIZATION**

The design of the initial organization will be simple. The entrepreneur may perform all of the functions alone. He or she sometimes is unwilling to give up responsibility to others. The entrepreneur may have difficulty making the transition from a start-up to a growing well-managed business that maintains its success over a long period of time. As the workload increases the organizational structure will need to expand to include additional employees with defined roles. Interviewing and hiring procedures will need to be implemented. For many new ventures, part-time employees may be hired, raising commitment and loyalty issues.
The organization must identify the major activities required to operate effectively. The design of the organization will indicate to employees what is expected of them in five areas:
Organizational structure, which defines members’ jobs and the relationship these jobs have to one another. Rewards are in the form of bonuses, promotion, and praise. A selection criterion is the set of guidelines for selecting individuals for each position. The organization’s design can be

simple or complex.

There are two stages of development in an organization

**Stage 1:** The new venture is operated by one person, the entrepreneur, with no need for sub managers.

**Stage 2**: As the business expands, the organization may be described as Stage 2.

1. Sub managers are hired to coordinate, organize, and control aspects of the business
2. Measurement, evaluation, rewards, selection, and training become necessary.

**Stage 3** *may* exist when the firm is large enough that a third level of managers is added

As the organization evolves, the manager's decision roles become more critical The primary concern is to adapt to changes in the environment and seek new ideas. The manager will also need to respond to unexpected pressures, referred to as "putting out fires." Another role is that of allocation of resources, delegating budgets and responsibility. The final role is that of negotiator, as the entrepreneur can be the only person with the appropriate authority.

**BUILDING THE SUCCESSFUL ORGANIZATION**

Before writing the organization plan, it is helpful to prepare a job analysis. The **job analysis** serves as a guide in determining hiring procedures and **job descriptions** and specifications. As the size of the venture changes, the process becomes more complex.

The place to start is with the tasks that need to be performed to make the venture viable. After this list is made, then determine how many positions and what types of persons will be needed. Other decisions to be made early in planning process:

a. Where to advertise for employees.
b. How they will be trained.
c. How they will be compensated.

Searching for senior talent requires a different strategy. Usually networking provides the best source of candidates. Some recruiting firms are also specializing in placing senior people in start-ups. The most important issues in the business plan are the job descriptions and specifications.

# THE FINANCIAL PLAN Lesson 30

## LEARNING OBJECTIV ES

1. To understand why positive profits can still result in a negative cash flow.
2. To understand the role of budgets in preparing pro forma statements.
3. To learn how to prepare monthly pro forma cash flow, income, balance sheet, and sources and uses of funds statements for the first year of operation.
4. To explain the application and calculation of the break-even point for the new venture.
5. To illustrate the alternative software packages that can be used for preparing financial statements.

## THE FINANCIAL PLAN

**A. The financial plan provides a complete picture of:**

1. How much and when the funds are coming into the organization.
2. Where the funds are going.
3. How much cash is available?
4. The projected financial position of the firm.

**B. The financial plan provides the short-term basis for budgeting and helps prevent a common problem-lack of cash.**

**C. The financial plan must explain how the entrepreneur will meet all financial obligations and maintain its liquidity.**

**D. In general, the financial plan will need three years of projected financial data for outside investors.**

## OPERATING AND CAPITAL BUDGETS

**A. Before developing the pro forma income statement, the entrepreneur should prepare operating and capital budgets.**

1. If the entrepreneur is a sole proprietor, he or she will be responsible for the budgeting decisions.
2. In a partnership, or where employees exist, the initial budgeting process may begin with one of these individuals.
3. Final determination of budgets will ultimately rest with the owners or entrepreneurs.

**B. In the preparation of the pro forma income statement, the entrepreneur must first develop a sales budget, an estimate of the expected volume of sales by month.**

1. From sales forecasts, the entrepreneur will determine the cost of these sales.
2. Estimated ending inventory will also be included.

**C. Production or Manufacturing Budget.**

1. This budget provides a basis for projecting cash flows for the cost of goods produced.
2. The important information in this budget is the actual production required each month and the needed inventory to allow for changes in demand.
3. This budget reflects seasonal demand or marketing programs, which can increase demand and inventory.
4. The operating budget is an important document, as the pro forma income

statement will only reflect the actual costs of goods.

**D. Operating Budget.**

1. Next the entrepreneur can focus on operating costs.
2. Fixed expenses (incurred regardless of sales volume) include rent, utilities, salaries, interest, depreciation, and insurance.
3. The entrepreneur will need to calculate variable expenses, which may change from month to month depending on sales volume, such as advertising and selling expenses.

**E. Capital budgets are intended to provide a basis for evaluating expenditures that will impact the business for more than one year.**

1. A capital budget may project expenditures for new equipment, vehicles, or new facilities.
2. These decisions can include the computation of the cost of capital and the anticipated return on investment using present value methods.
3. The entrepreneur should enlist the assistance of an accountant.

## THE FINANCIAL PLAN (Continue d ….) Lesson 31

**OPERATING AND CAPITAL BUDGETS**

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**PRO FORMA INCOME STATEMENTS**

**A. Sales is the major source of revenue; since other activities relate to sales, it is usually the first item defined.**

**B. In preparing the pro forma income statement, sales by month must be calculated first.**

1. Market research, industry sales, and trial experience might provide the basis for these figures.
2. Forecasting techniques, such as a survey of buyers' intentions or expert opinions, can be used to project sales.

3. The costs for achieving increases in sales can be higher in early months.

**C. Sales revenues for an Internet start-up are often more difficult to project.**

1. A giftware Internet start-up could project the number of average hits expected per day or month based on industry data.
2. From the number of "hits" it is possible to project the number of consumers who will buy products and the average dollar amount per transaction.

**D. The pro forma income statements also provide projections of all operating expenses for each month of the first year.**

1. Selling expenses as a percentage of sales may also be higher initially.
2. Salaries and wages should reflect the number of personnel employed, as well as their roles in the organization.
3. Any unusually expenses, such as those for a key trade show, should be flagged and explained at the bottom.

**E. In addition to the first year's statement, projections should be made for years 2 and 3.**

1. Investors generally prefer to see three years of income projections.
2. Some expenses will remain stable over time, like depreciation, utilities, rent, insurance, and interest.
3. When calculating the projected operating expense, it is important to be conservative for initial planning purposes.

**F. For the Internet start-up, capital budgeting and operating expenses will involve equipment purchasing or leasing, inventory, and advertising expenses.**

**G. Many of the recent Internet start-ups have not earned a profit.**

**PRO FORM A CASH FLOW**

**A. Cash flow is not the same as profit.**

1. Profit is the result of subtracting expenses from sales.
2. Cash flow results from the difference between actual cash receipts and cash payments.
3. Cash flows only when actual payments are made or received.

**B. For an Internet start-up, the same transaction would involve the use of a credit card in which a percentage of the sale would be paid as a fee to the credit card company.**

**C. On many occasions, profitable firms fail because of lack of cash; therefore, using profit as a means of success may be deceiving.**

**D. There are two standard methods used to project cash flow.**

1. In the indirect method some adjustments are made to the net income based on the fact that actual cash may not have actual been receive or disbursed.
2. The direct method, a simple determination of cash in less cash out, gives a fast indication of the cash position of the new venture at a point in time.

**E. It is important for the entrepreneur to make monthly projections of cash, pro forma cash flow.**

1. If disbursements are greater than receipts in any time period, funds will have to be borrowed or cash reserve tapped.
2. Large positive cash flows may need to be invested in short term sources.
3. Usually the first few months of start-up will require external cash in order to cover cash outlays.

**F. The most difficult problem with projecting cash flows is determining the exact monthly receipts and disbursements.**

1. Some assumptions will need to be made and should be conservative so enough funds can be maintained to cover the negative cash months.
2. These cash flows will also assist in determining how much money will need to be borrowed.

**G. The pro forma cash flow is based on best estimates and may need to be revised to ensure accuracy.**

**H. It is useful to provide several scenarios, each based on different levels of success.**

**PRO FORM A BALANCE SHEET**

**A. The entrepreneur should also prepare a projected balance sheet depicting the condition of the business at the end of the first year.**

1. The **pro forma balance sheet** summarizes the assets, liabilities, and net worth of the entrepreneurs.
2. Every business transaction affects the balance sheet.
3. The balance sheet is a picture of the business at one moment in time and does not cover a period of time.

**B. Assets.**

- **Assets** represent everything of value that is owned by the business.
- The assets are categorized as current or fixed.
- Value is not necessary replacement cost-it is the actual cost expended for the asset.
- Current assets include cash and anything that will be converted into cash within a year.
- Fixed assets are those that will be used over a long period of time.
- Management of receivables, or money owed by customers, is important to the business' cash flow of the business.

**C. Liabilities.**

1. **Liabilities** accounts represent everything owed to creditors.
2. Current liabilities are due within a year.
3. Others are long-term debts.
4. It is often necessary to delay payments of bills in order to more effectively manage cash flow.

**D. Owners Equity.**

1. This amount represents the excess of all assets over all liabilities.
2. **Owners equity** represents the net worth of the business.
3. Any profit from the business will also be included in the net worth as retained earnings.

**BREAK-EVEN ANALYSIS**

**A. It is helpful for the entrepreneur to know when a profit may be achieved.**

1. **Break-even** analysis is a technique for determining how many units must be sold in order to break even.
2. The firm has fixed cost obligations that must be covered by sales volume in order for a company to break even.
3. The break-even point is that volume of sales at which the business will neither make a

profit nor incur a loss.

4. The break even sales point is the volume of sales needed to cover total variable and fixed expenses.

**B. The break-even formula is: B/E (Q) = TFC SP-VC/unit (marginal contribution)**

1. As long as the selling price is greater than the variable costs per unit, some contribution can be made to cover fixed costs.
2. The major weakness in calculating the break-even is determining whether a cost is fixed or variable.
3. Costs such as depreciation, salaries and wages, rent, and insurance are usually fixed.
4. Materials, selling expenses, and direct labor are most likely variable costs.

**C. When the firm produces more than one product, break-even may be calculated for each product.**

**D. The entrepreneur can try different states of nature, such as different selling prices to see the impact on break-even and profits.**

 

## PRO FORMA SOURCES AND USES OF FUNDS Lesson 32

1. To identify the types of financing available.
2. To understand the role of commercial banks in financing new ventures, the types of loans available, and bank lending decisions.
3. To discuss Small Business Administrative (SBA) loans.
4. To understand the aspects of research and development limited partnerships.
5. To discuss government grants, particularly small business innovation research grants.
6. To understand the role of private placement as a source of funds.

### AN OVERVIEW

Different sources of capital are generally used at different times in the life of the venture.

**Debt or Equity Financing**

1. **Debt financing** involves an interest-bearing instrument, usually a loan, the payment of which is only indirectly related to sales and profits.

a. Debt financing (also called asset-based financing) requires some asset be used as collateral.
b. The entrepreneur has to pay back the amount of funds borrowed plus a fee, expressed in terms of interest.
c. Short-term money is used to provide working capital.
d. Long term debt (lasting more than a year) is frequently used to purchase some asset, with part of the value of the asset being used as collateral.
e. Debt has the advantage of letting the entrepreneur retain a large ownership position and have greater return on equity.
f. If the debt is too great payments become difficult to make and growth is inhibited.

2. **Equity financing** offers the investor some form of ownership position in the venture.

a. The investor shares in the profits of the venture.
b. Key factors in choosing the type of financing are availability of funds, assets of the venture, and prevailing interest rates.
c. Usually a combination of debt and equity financing is used.

3. In a market economy all ventures will have some equity, as all are owned by someone.

a. The equity may be entirely provided by the owner or may require multiple owners.
b. This equity funding provides the basis for debt financing, which makes up the capital structure of the venture.

**Internal or External Funds**

1. The most often used type of funds is internally generated funds.

a. These funds come from sources within the company, such as profits, sale of assets, reduction in working capital, and accounts receivable.
b. The start-up years usually involve plowing all the profits back into the venture.
c. Sometimes little-used assets can be sold or leased.
d. Assets, whenever possible, should be on a rental basis, not an ownership basis.
e. One short-term internal source of funds is reducing short-term assets, or through extended payments from suppliers.
f. Another method is by collecting accounts receivable more quickly.

2. External sources.

a. Alternative sources should be evaluated by:
(I) Length of time the funds are available.
(ii) Costs involved.

(iii) Amount of control lost.
b. The more frequently used sources of funds are discussed below.

**PERSONAL FUNDS**

**A. Few new ventures are started without the personal funds of the entrepreneur.**
1. In terms of cost and control these are the least expensive.
2. They are essential in attracting outside funding.

**B. Outside investors want the entrepreneur to demonstrate financial commitment.**
1. This level of commitment is reflected in the percentage of total assets available the entrepreneur has committed.
2. An outside investor wants an entrepreneur to have committed all available assets.
3. It is not the amount but the fact that all monies available are committed that makes outside investors feel comfortable.

**FAM I LY A N D FR IE N D S**

**A. After the entrepreneur, family and friends are the next most common source of capital.**

**B. Family and friends provide a small amount of equity funding for new ventures.**
1. It is relatively easy to obtain money from family and friends.
2. However, the amount of money provided may be small.
3. If it is in the form of equity funding, the family member or friend has an ownership position in the venture.
4. If they have direct input into operations of the venture, it may have a negative effect on employees or profits.

**C. To avoid potential future problems, the entrepreneur must present the positive and negative** aspects and the nature of the risks of the investment.
1. To minimize any future problems, keep the business arrangements strictly business
2. Any loan should specify the rate of interest and the proposed repayment schedule
3. The entrepreneur should settle everything up front and in writing.
4. A formal agreement specifying details of the funding helps avoid future problems.

**D. The entrepreneur should carefully consider the impact of the investment on the family member or friend before it is accepted.**

## PRO FORMA SOURCES AND USES OF FUNDS Lesson 33

### COMMERCIAL BANKS

Commercial banks are the most frequently used source of short-term funds.

1. This is debt financing and requires some collateral, some asset with value.
2. This collateral can be business assets, personal assets, or the assets of the cosigner of the note.

### Types of Bank Loans

**1. Accounts receivable loans.**

a. Accounts receivable provide a good basis for a loan, especially if the customer base is creditworthy.
b. A bank may finance up to 80% of the value of the accounts receivable.
c. A factoring arrangement can be developed whereby the factor (bank) actually buys the accounts and collects the money.
d. If any of the receivables are not collectible, the factor sustains the loss, not the business.
e. The cost of factoring is higher than the cost of securing a loan against the accounts receivable.

**2. Inventory loans.**

a. Inventory is often a basis for a loan, particularly when inventory is liquid and can be sold easily.
b. Finished goods inventory can be financed up to 50% of value.
c. Trust receipts are a type of inventory loan used to finance floor plans of retailers such as auto dealers.
d. The bank advances a large percentage of the invoice price of the goods and is paid a pro rate basis as the inventory is sold.

**3. Equipment loans.**

a. Equipment can be used to secure longer term financing up to 3 to 10 years.
b. When new equipment is bought, 50 to 80% of value can be financed.
c. In sale-leaseback financing the entrepreneur "sells" the equipment to a lender and then leases it back.

**4.** **Real estate loans** are easily obtained to finance land, plant, or building, usually up to 75% of value.

**Cash Flow Financing** Cash flow financing -- or **conventional bank loans** --include lines of credit, installment loans, straight commercial loans, long-term loans, and character loans.

a. Lines of credit are the most frequently used.
b. The company pays a "commitment fee" at the start then pays interest on outstanding borrowed funds.

**1. Installment loans.**

a. Installment loans can be obtained by a going venture with a track record of sales and profits.
b. These funds are used to cover working capital needs, usually for 30 to 40 days.

**2. Straight commercial loans.**

a. In this hybrid of the installment loan, funds are advanced to the company for 30 to 90 days.

b. These self-liquidating loans are used for seasonal financing.

**3. Long term loans.**

a. These loans are usually only available to more mature companies.

b. Funds are available for up to 10 years with the debt repaid according to a fixed interest and principle schedule.

**4. Character loans.**

a. When the business does not have assets to support a loan, the entrepreneur may need a character loan.

b. These loans must have assets of an individual pledged as collateral, or have the loan cosigned by another

# BANK LENDING DECISIONS Lesson 34

## BANK LENDING DECISIONS

**1. Banks are very cautious in lending money, particularly to new ventures.**

a. Commercial loan decisions are made only after the loan officer does a careful review of the borrower.

b. Decisions are made based on quantifiable and subjective judgments.

**2. Bank lending decisions can be summarized by the five C's-Character, Capacity, Capital, Collateral, and Conditions.**

a. Past financial statements are reviewed in terms of key ratios and the entrepreneur's capital invested.

b. Future projections on market size, sales, and profitability are evaluated.

c. Intuitive factors-Character and Capacity-are also taken into account and become more important when there is little or no track record.

**3. The loan application format is generally a "mini" business plan.**

a. This provides the loan officer with information on the creditworthiness of the individual and the ability of the venture to repay the loan.

b. Presenting a positive business image and following procedure are important in obtaining the funds.

**4. The entrepreneur should borrow the maximum amount possible that can be repaid, as long as the prevailing interest rates and terms are satisfactory.**

a. Care must be taken to ensure that the venture will generate enough cash flow to repay the interest and principal on the loan.

b. The entrepreneur should evaluate the track record and lending policies of several banks in the area.

## SMALL BUSINESS ADMINISTRATION LOANS

**A. When an entrepreneur is unable to secure a regular commercial bank loan, an alternative is a Small Business Administration (SBA) Guaranty Loan.**

1. The SBA guarantees that 80% of the loan will be repaid to the bank by the SBA if the company can't pay.
2. This allows the bank to make loans that have higher risks.
3. This procedure is the same as for securing a bank loan, except that government forms and documentation are required.

**B. Both long and short-term loans can be guaranteed by the SBA.**

1. A maximum loan period of 15 years on existing buildings and 20 years on new construction can be obtained.
2. For inventory, equipment, or working capital, a maximum of 10 years is available, although five years is the usual.
3. Once the application has been filled out, it usually is processed within 15 days.
4. There are additional reporting requirements beyond those for a conventional bank loan.
5. Since there is no difference in interest rates charged between conventional bank loans and SBA-guaranteed loans, a commercial bank loan is usually better.
6. A good banking relationship is very valuable as the venture grows.

**C. For most SBA loans, there is no limit to the amount of loan money requested, but there is practical limit of $1 million.**

1 The vast majority of small businesses are eligible for financial assistance from the SBA.

1. As defined by the Small Business Act, a small business is independently owned and operated and not dominant in its field of operation.
2. The size limits of a small business vary from industry to industry.
3. The proceeds of the loans can be used for almost any business purpose.
4. The interest rates are negotiated between the entrepreneur and the bank, but there are subject to SBA maximums.

 

**SOURCES OF CAPITAL Lesson 35**

**LEARNING OBJECTIV ES**

1. To identify the types of financing available.
2. To understand the aspects of research and development limited partnerships.
3. To discuss government grants, particularly small business innovation research grants

**RESEARCH AND DEVELOPMENT LIMITED PARTNERSHIPS**

This method of financing provides funds from inventors looking for tax shelters. A typical R&D partnership arrangement is established with a sponsoring company developing the technology with funds being provided by a limited partnership of individual investors. Research and development limited partnerships are particularly good when the project involves a high degree of risk or significant expense.

**Major Elements**

The three components are the contract, the sponsoring company, and the limited partnership. The *contract* specifies the agreement between the sponsoring company and the limited partnership. The sponsoring company does not guarantee results, but performs work on a best-effort basis. The typical contract specifies that the liability for any loss be borne by the limited partners. There are some tax advantages for both the partnership and the company. This tax deduction is based on two authorizations:

1. Section 174 of the Internal Revenue Code.
2. The *Snow vs. Commissioner* case of 1974. Limited partners may deduct their investments in the R& D contract under Section 174 in the year their investments are made, significantly increasing the rate of return of the investment. The second component is the **limited partners**. The limited partners have limited liability but are not a taxable entity. Any tax benefits of the losses are passed directly to the limited partners. When the technology is successfully developed, the partners share in the profits. The *sponsoring company* acts as the **general partner** developing the technology. The sponsoring company usually has the base technology but needs to secure partners for commercial success. The company usually retains the rights to use this technology to develop other products.

**Procedure**

In the *funding stage*, a contract is established and the money invested for the proposed R&D effort. In the *development stage,* the company performs the actual research, using the funds of the limited partners. If the technology is successfully developed, the *exit stage* begins, with both parties reaping the benefits. In the typical agreement, the sponsoring company and limited partners form a new jointly owned corporation. An alternative is a royalty partnership in which a royalty based on the sale of the products is paid by the company to the limited partnership. The company and limited partners may form a joint venture to manufacture and market the product.

**Benefits and Costs Benefits**

R&D limited partnerships provide the needed funds with a minimum of equity dilution while reducing the risks. The sponsoring company's financial statements are strengthened.

**Cost s**

There is considerable time and money involved.
Most R&D limited partnerships are unsuccessful.
The restrictions placed on the technology may be substantial.
The exit from the partnership may be too complex.

**Examples**

Successful R&D limited partnerships include Syntex Corporation, Genetech, and

Trilogy Limited. R&D limited partnerships offer one alternative to funding technological development.

**GOVERNMENT GRANTS**

The **Small Business Innovation Research (SBIR) grant** program helps entrepreneurs obtain federal grant money to develop an innovative idea. The act requires all federal agencies to share a portion of the R&D funds with small businesses. This provides a uniform method of soliciting, evaluating, and selecting research proposals. Eleven agencies are involved in the program. Small businesses submit proposals directly to each agency. The agencies evaluate each proposal on a competitive basis and make awards. The SBIR grant program has three phases. **Phase I** awards are up to $50,000 for six months of feasibility-related experimental or theoretical research. **Phase II** is the principal R&D effort. Phase II awards are up to $500,000 for 24 months of further research and development. The money is to be used to develop prototype products. In **Phase III** funds from other sources, such as the private sector or regular government contracts, are needed to commercialize the developed technologies.

**Procedure**

The agencies publish solicitations describing the areas of research they will fund. The second step is submission of the proposal by a company or individual. Each agency screens the proposals it receives, and those passing are evaluated by experts. Awards are granted to those projects that have the best potential for commercialization. Any patent rights, research data, and software generated are owned by the company, not the government. The SBIR grant program is one alternative for a technically based entrepreneurial company that is independently owned and operated and employs 500 or fewer individuals.

## SOURCES OF CAPITAL Lesson 36

### PRIVATE PLACEMENT

A final source of funds is private placement with investors who may be family and friends or wealthy individuals.

**Type of Investors**

1. An investor usually takes an equity position and can influence the nature of the business to an extent.
2. The investors' degree of involvement is important for the entrepreneur to consider.
3. Some investors want to be actively involved in the business, and others are more passive.

**Private Offerings**

1. Public offerings involve much time and expense.
2. Registering the securities with the Securities and Exchange Commission (SEC) requires a number of reporting procedures once the firm has gone public.
3. This public process was established to protect unsophisticated investors.
4. A **private offering** is faster and less costly than other funding.
5. These sophisticated investors still need access to material information about the company.

**Regulation D**

1. Regulation D contains:

a. A number of broad provisions designed to simplify private offerings.
b. General definitions of what constitutes a private offering.
c. Specific operating rules-Rule 504, Rule 505, and Rule 506.

2. The entrepreneur carries the burden of proving that the exemptions granted have been met.

a. Each offering memorandum needs to be numbered and contain instructions that the document should not be disclosed.
b. The date that the investor reviews the company's information should be recorded.
c. The book documenting all specifics of the offering should be placed in the firm's permanent file.

3. Under Rule 504 a company can sell up to $500,000 of securities to any number of investors in any 12-month period.
4. Rule 505 permits the sale of $5 million of unregistered securities in the private offering in any 12-month period.

a. These can be sold to any 35 investors, and an unlimited number of accredited investors.
b. "Accredited investors" include:
(I) Institutional investors
(ii) Investors who purchase over $150,000 of the issuer's securities.
(iii) Investors whose net worth is $1 million.
(iv) Investors with incomes in excess of $200,000 in the last two years.
(v) Directors, officers, and general partners of the issuing company.
c. Rule 505 permits no general advertising.
d. Two-year financial statements must be available.
e. All companies selling private-placement securities must furnish appropriate company information to both accredited and unaccredited investors and allow any questions to be asked prior to the sale.

5. Rule 506 allows an issuing company to sell an unlimited amount of securities to 35 investors and an unlimited number of accredited investors.

In securing outside funding, the entrepreneur must disclose all information as accurately as possible.

1. If the business turns sour, both investors and regulators scrutinize the company's disclosures.
2. When a violation of security law is discovered, management can be held liable.
3. Lawsuits under securities law by damaged investors have almost no statute of limitations.
4. The entrepreneur needs to be careful to make sure all disclosures are accurate.
5. The SEC can also take administrative, civil, or criminal action, without any individual lawsuit involved.

**BOOTSTRAP FINANCING**

Bootstrap financing is particularly important at start-up and early years of the venture when capital is more expensive

**Outside capital has many costs:**

1. It takes time to rise outside capital when the company can least afford the time.
2. Outside capital often decreases a firm's drive to make money.
3. The availability of capital increases the impulse to spend.
4. Outside capital can decrease the company's flexibility and hamper the creativity of the entrepreneur.
5. Outside capital may cause more disruption and problems in the venture than without it.

In spite of these potential problems, an entrepreneur at times needs equity funding.

1. Outside capital should only be sought after all possible internal sources of funds have been explored.
2. When outside funds are obtained, the entrepreneur should not forget the basics of the business.

## CAPITAL SOURCES IN PAKISTAN Lesson 37

### PROVINCIAL LEVEL INSTITUTIONS

**1. Punjab Small Industries Corporation (PSIC)**
In the province pf Punjab PSIC was established in 1972 as an autonomous body for the promotion and development of the small-scale industries in the province. The PSIC covers the critical areas of investment promotion and provision of credits for setting up new industries and modernization of the existing ones. It also promotes the common facility center, technology transfer, guidance, handicrafts development and design facilities.
**(a) Financing and Loans**
PSIC is providing two types of loans to its clients, working capital and capital investment loans. The maximum limit of loan is RS. 7.5 Lac. There are district officers appointed for monitoring the loan recovery and in the case of unrecoverable loans, they are transferred to the revenue authorities. PSIC has managed to recover 81.6% of all loans given out. Disbursing Rs. 1768.537 million to 6339 units through its 8 regional offices ( till 31-02-2001). The debt equity ration for loan up to Rs. 7.5 Lac is 70:30.

**(b) Industrial Estates**
PSIC has developed 14 industrial estates in various areas of the Punjab. The costs of land within these industrial states have been subsidized to allow the development of the small-scale sector.

**(c) Services and Programs**
PSIC has also launched “Rural Industrialization Program” to control unemployment and strengthen the marginal household income through stimulation of industrial growth in the urban and rural areas of the Punjab. PSIC has established various types of service centers e.g. metal industries development center, Sialkot, Engineering service centers. Gujranwala, institute of pottery development, Shahdara etc

**2: Sindh Small Industries Corporation (SSIC)**

SSIC was established in 1972 having motives to indulge into promotional activities of small-scale industries in Sindh. The objectives of SSIC include financial assistance, education of craftsman, census and survey of cottage and small industries, procurement and distribution of raw materials to artisans and craftsman. SSIC was also involved in the Prime Minister’s self-employment scheme for the dispersal of the micro credits.

**(a) Industrial Estates and Colonies**

The SSIC has established 17 industrial estates in Sindh. Total number of plots developed there are 1938 and there are 302 units working utilizing 571 plots. There are six different craftsman colonies established having 92 shops.

**(b) Financing Schemes**

The SSIC also launched a credit scheme in 88,/89. The rate of markup was 7% for industrial estates and 11% for factories outside the industrial estates. The scheme was discontinued in 1993 due to shortage of funds although SSIC has created already 526 jobs and disbursed 20.6 million rupees. In October 1992, a self-employment scheme was started for locally manufactured machinery

(LMM). The loan ceiling is 1 million with the markup rate of 14%. The total amount disbursed to 171 units is rupees 98 million. The recovery rate is 47%.

**3. Small Industries Development Board (SIDB) NWFP**

The SIDP was established in 1972. It is playing a promotional role to support and assist the development of small and cottage industry in the province. The SIDB is an autonomous body, focusing on manpower training, model projects and industrial infrastructure. It has 14 regional offices in the different cities of NWFP.

**a. Training Centers**

SIDB has established carpet centers in five cities of NWFP and has trained 1327 number of trainees. The SIDB has established “Patti” training centers, textile training and “gabba” training centers which has trained 151 trainees.

**b. Development Programs and Model Projects**

SIDB has also launched various women development programs, which has trained 2062 women trainees in a number of fields of work. The SIDB is also involved in establishing other various kinds of model projects for wood working, leather goods, wool spinning, ceramic device etc. The total number of trainees trained is about 8000.

**c. Industrial Estates**

SIDB has established 9 industrial estates. There are a total of 1620 plots and the total jobs created are 4405.

**d. Financial Assistance**

SIDB is also managing different credit schemes for small industries. To date, a total number of 198 million rupees have been disbursed to 452 enterprises.
SIDB is also disbursing credit under the self-employment scheme.

**4. Directorate of Industries (Balochistan)**

The directorate of industries was formed in 1976 and it looks after all the promotional schemes for SMEs. Further more, the directorate is also involved in providing various kinds of advisory and consultancy services.

**a. Training Centers**

The directorate operates sixty-three training centers in various trades, one service center, 5 sales and display shops and one small-industries estate. Of the 63 training centers, about third are carpet centers, seven are embroidery centers and the others cover areas like tailoring, wood work, marble work, mazri and durree production.

**FINANCIAL INSTITUTIONS** In order to meet this financing requirement, a number of institutions have been formed. These are**:**

**Small Business Finance Corporation (SBFC).**
**Youth Investment Promotion Scheme (YIPS).**
**Regional Development Finance Corporation (RDFC).**
**Industrial Development Bank of Pakistan (IDBP).**

A few commercial banks such as Allied Bank Limited and First Women Bank Limited have also started schemes to provide loans to low-income clients who are generally not able to access the formal source of financing.

**Small Business Finance Corporation (SBFC)**

It was established in 1972 as a federal entity. The main aim was at the time of establishment, to assist small entrepreneurs for self-employment and setting up cottage industry. The mark up was kept lower; the majority lending was towards self-employment leaving only 2% for small industries.

**Restructuring SBFC**

The management took over in year 2000 and restructured the entire corporation. The restructuring was based on the facts that SBFC has deviated from its main aim resulting in a weak balance sheet. 70% of its credit portfolio was infected by non-performing loans. Usage of information technology was non-existing and the management was ineffective. There were 1400 employees at 96 branches. The internal control and management was highly ineffective with poor quality of human resources, poor work ethics, poor infrastructure and non-existence of training and development culture.

**Restructured SBFC**

The total number of branches has been reduced to 63 around 270 people opted for golden handshake. Separate human resource department has been setup, a separate information technology department was established to spread IT knowledge among SBFC employees, and a treasurer division has been setup in Karachi, which is responsible for management of cash and surplus funds.

**Financing Programs**

SBFC is financing various types of projects such as Gem Stones, cotton ginning, textile apparel, and marble processing etc. currently SBFC can disburse up to rupees 1.5 million for a project having total cost of five million and lend up-to 50% of the total project cost of small businesses but for that total project cost should not exceed 50 million. It can also share up to 30% of total projected cost for a medium sized industry where the total project cost does not exceed rupees 100 million.

**Regional Development Finance Corporation**

The Regional Development Finance Corporation was established in 1985 having paid up capital of Rs. 172,500 million and with the specific objective of promoting the industrialization of the less developed areas of the country. RDFC is a multi-product financial institution. It participates in money market, capital market and micro credit delivery. The head office of RDFC is located at Islamabad and a network of 14 branches carries out its operations across the country. Besides financing of medium to large sized industrial concerns RDFC has been involved in disbursing micro and small sized loans. However, over the last few years the organization has restrained from forwarding long-term project loans and currently is in the process of recovering loans from the borrowers.

**Financing Programs**

Various schemes have been initiated with credit lines from local as well as foreign sources. It has also started a micro credit scheme called the Credit for Rural Women (ICRW) under which small loans ranging from Rs. 25000 to Rs. 200,000 are disbursed to women entrepreneurs on subsidized interest rates of 10%. The total disbursements under the scheme stand at Rs. 2.5 million. RDFC was allocated a credit line of Rs. 167 million for the self-employment schemes out of which a total of Rs. 80 million was disbursed.

**Industrial Development Bank of Pakistan**

IDBP is Pakistan's one of the oldest development financing institution created with the primary objective of extending term finance for investment in the manufacturing sectors in the economy. Over the years however, the bank has emerged as an institution fostering the growth and development of SME sector stimulating industrial progress in the rural or less developed regions of the country. As a part of its services the bank offers business development assistance through providing information on potential small-scale investment projects. In this regard numerous pre-feasibility studies have been developed for identification of viable sub sectors.

**The Role of NGOs**

The NGOs are working on socio-economic sector in the development of SMEs. They are privately owned organization registered under the social welfare act. They normally work through grants, aids or donation based finances. They are having a very constructive role in the SME development. The special property of this sector is gender development. They at some places tried to replicate Grameen banks model.

**PREPARING FOR THE NEW VENTURE LAUNCH: EARLY MANAGEMENT DECISIONS (Continued….) Lesson 38**

## RECORD KEEPING

It is necessary to have good records for effective control and for tax purposes. The entrepreneur should be comfortable and able to understand what is going on in the business. With software packages, much of the record keeping can be maintained on a personal computer. The goals of a good record keeping system are to identify key incoming and outgoing revenues that can be effectively controlled.

### Sales (Incoming Revenue)

It is useful to have knowledge about sales by customer both in terms of units and dollars. The entrepreneur of a retail store might try to identify the profile of the type of customer that patronizes the store. Retailers also like to have information on specific customers. Credit card purchases can be tracked for information on the type and amount of merchandise purchased. An Internet venture can maintain purchase history data on the types of produces purchased. Customers' e-mail addresses can be requested so the customer can be notified of sales. Some Internet firms have established a free membership as a means of following up. In a service venture, records would need to be maintained on when a customer paid their monthly fee. As cash flow problems are the most significant cause of new venture failure, good payment records are necessary. Record keeping of payments can either be handled by a computer software package or a simple card file system. If payments are late beyond a reasonable time, it may be necessary to hire a collection agency, but only as a last resort.

### Expenses/Costs (Outgoing Revenue

Records of expenses are easily maintained through the checking account. It is good business practice for the entrepreneur to use checks as payment for all expenses in order to maintain records for tax purposes. Canceled checks provide proof of payment. In the early stage, it may be desirable to make all payments on time to establish credibility with suppliers. The entrepreneur should maintain information about employee either in a software program or in a card file. It may be necessary to maintain records on all assets owned by the business.

### Other Records

The entrepreneur should maintain information about employees either in a software program or in a card file. Records on all assets owned may be needed. With a good record keeping system it is easy to maintain controls over cash disbursements, inventory, and assets.

# PREPARING FOR THE NEW VENTURE LAUNCH: EARLY MANAGEMENT DECISIONS (Continued….) Lesson 39

## RECRUITING AND HIRING NEW EMPLOYEES

**The entrepreneur will generally need to establish procedures and criteria for hiring new employees.**
Advertising in local newspapers and referrals from friends and associates is most effective for entry-level positions. For senior management the most effective strategy is networking with friends and business associates. Personnel agencies may also be considered if there are no other effective options.

**Once resumes have been collected some basis of determining each candidate's strengths should be made.**
Some criteria must be used in the resume evaluation. Factors such as education, prior experience, entrepreneurial activities, and interests can be used to assess candidates. From the initial screening of resumes, a few candidates can be invited in for an interview. Most firms use an interview form with critical factors listed for evaluating the interview candidates. The goal should be to hire not only the best candidate but also someone who will perform well in the entrepreneurial environment and provide a long-term solution to the available position.

**The interview**
The interviewer should ask all of his or her questions at the beginning of the interview. It allows the interviewer to evaluate the candidate's behavior. It avoids talking too much and not listening. Upon completion of the interview, the firm should be sure to check all of the candidate's references.

**Acquiring senior talents can be critical to the venture's ability to successfully meet its growth goals.**
**Recruiting for upper management in an entrepreneurial firm**

Many executives choose to become part of the entrepreneurial process rather than continue working in structured big business. The entrepreneur should use all his or her contacts and recognize that every potential candidate is different.

## MOTIVATING AND LEADING THE TEAM

- The entrepreneur will usually be a role model for any other employees.
- It is important that the founder assume the role of leader to the management team and employees.
- Communication with managers and employees is one of the most important leadership qualities.

**PREPARING FOR THE NEW VENTURE LAUNCH: EARLY MANAGEMENT DECISIONS (Continued….) Lesson 40**

## MOTIVATING AND LEADING THE TEAM

**The entrepreneur will usually be a role model for any other employees.**
Good work ethic will go a long way toward achieving financial and emotional success. During the early stages employees need incentives to remain committed and loyal to the long run success of the new venture.

**It is important that the founder assume the role of leader to the management team and employees.**
Leadership is also influencing and inspiring others in the organization to strive to meet the mission of the venture. Below are some behaviors that can exhibit the leadership qualities necessary for the new venture. Set an example with an ethical set of values for other managers and employees. Show respect and concern for the personal well being of employees. Don’t try to do everything yourself. Recognize the diversity of employees and how they should be treated. Encourage and praise others in the organization when deserved. Provide incentives and awards for quality work effort and new ideas. Recognize the importance of employees having fun at their jobs. Be aware of the need for future strategic planning.
**Communication with managers and employees is one of the most important leadership qualities.**

## FINANCIAL CONTROL

The entrepreneur will need some knowledge of how to provide appropriate controls to ensure that projections and goals are met. Financial skills are needed for the entrepreneur to manage during early years. The cash flow statement, income statement, and balance sheet are key areas needing careful management and control. Some financial skills are necessary for the entrepreneur to manage the venture during the early years.

### Managing Cash Flow

An up-to-date assessment of cash position, such as a monthly cash flow statement, is needed. The cash flow statement may show the actual amounts next to the budgeted amounts. It is useful for adjusting the pro forma and indicating potential cash flow problems. A cash flow crisis can occur suddenly and unexpectedly. Cash flow analysis can also involve sensitivity analysis: for each monthly expected cash flow the entrepreneur can use a +/-5% that would provide a pessimistic and optimistic cash estimate. For the very new venture it may be necessary to prepare a daily cash sheet. Comparison of budgeted or expected cash flows with actual cash flows can provide an assessment of potential cash needs and indicate possible problems in the management of assets and control of costs.

### Managing Assets

In addition to cash management, other items such as accounts receivable and inventory also need to be controlled. Management of credit may include acceptance of credit cards or use of internal credit. Using outside credit cards shifts the credit risk to the outside company but increases costs. Using internal credit makes the firm responsible for collecting delinquent payments, and payment delays can create negative cash flows. The entrepreneur will need to be sensitive to major changes in accounts receivable and should always compare actual with budgeted amounts. Inventory is an expensive asset, and requires careful balance. If inventory is low and the firm cannot meet demand, sales will be lost. Carrying excess inventory can be costly. An inventory control system allows the company to monitor key figures, such as inventory turnover and percentage of customer complaints. The entrepreneur will need to determine the value of inventory and determine how it affects the cost of goods sold. Most firms use a **FIFO**(first-in, first-out) system since it reflects truer inventory and cost values. There are good arguments for the use of **LIFO** (last-in, first-out) in times of inflation. The decision to convert from a FIFO to a LIFO system is complex and requires careful evaluation. It is necessary to decide if inventory is to be grouped into categories or to cost each item individually. All inventories must be costed by searching through historical records.

An average inventory cost must be calculated. Conversion to LIFO can typically be beneficial if the following conditions exist: Rising labor, materials, and other production costs are anticipated. The business and inventory are growing. The business has some computer-assisted inventory control method capability. The business is profitable. The entrepreneur must keep careful records of inventory using perpetual inventory systems followed by a periodic physical count. Fixed assets have certain costs related to them, such as depreciation. If the entrepreneur cannot afford to buy equipment or fixed assets, leasing could be an alternative. Leasing may be a good alternative to buying depending on the terms of the lease and type of asset. Leases for automobiles may be more expensive than a purchase. However, lease payments represent an expense and can be used as a tax deduction. Leases are also valuable for equipment that becomes obsolete quickly. The entrepreneur should consider all costs associated with a lease-or-buy decision as well as the impact on cash flows.

**PREPARING FOR THE NEW VENTURE LAUNCH: EARLY MANAGEMENT DECISIONS (Continued….) Lesson 41**

**LONG-TERM VS SHORT-TERM DEBT**
The entrepreneur may need to borrow funds to finance assets and meet cash needs. Fixed assets are usually financed by long-term debt borrowed from a bank. Alternatives include borrowing from family members, having partners contribute more funds or selling corporate stock. Many of these options require the entrepreneur to give up some equity.

**MANAGING COSTS AND PROFITS**
An interim income statement helps to compare the actual with the budgeted amount for that period. The most effective use of the interim income statement is to establish cost standards and compare the actual with the budgeted amount for that time period. Costs are budgeted based on percentages of net sales. These percentages can be compared with actual percentages to see where tighter cost controls may be necessary. This lets the entrepreneur manage and control costs before it is too late. In later years, it is also helpful to look back on the first year of operation and make comparisons month-to-month. When expenses or costs are much higher than budgeted, the entrepreneur may need to determine the exact cause. Comparison of actual and budgeted expenses can be misleading for ventures with multiple products or services. For financial reporting purposes, the income statement summarizes expenses across all products and services. This does not indicate the marketing cost for each product nor should the most profitable product. Allocating expenses over product lines be done as effectively as possible to avoid arbitrary allocation of costs.

**TAXES**
The entrepreneur will be required to withhold federal and state taxes for employees and make deposits to the appropriate agency. Federal taxes, state taxes, social security, and Medicare are withheld from employees' salaries and are deposited later. The entrepreneur should be careful not to use these funds. The new venture may also be required to pay state and federal unemployment taxes. Federal and state governments will require the entrepreneur to file end-of-the-year returns of the business.

**RATIO ANALYSIS** Calculations of **financial ratios** can also be valuable as an analytical and control mechanism. These ratios serve as a measure of the financial strengths and weaknesses of the venture, but should be used with caution. There are industry rules of thumb that the entrepreneur can use to interpret the financial data.

*Liquidity Ratios Current ratio* is commonly used to measure the short-term solvency of the venture or its ability to meet its short-term debts. The current liabilities must be covered from cash or its equivalent. The formula is:

$$\textbf{Current ratio} = \frac{\textbf{current assets}}{\textbf{current liabilities}}$$

While a ratio of 2:1 is generally considered favorable the entrepreneur should also compare this ratio with
industry standards.

*Acid test ratio* is a more rigorous test of the short-term liquidity of the venture.

It eliminates inventory, which is the least liquid current asset.
The formula is:

$$\textbf{Acid test ratio} = \frac{\textbf{current assets - inventory}}{\textbf{current liabilities}}$$

Usually a 1:1 ratio would be considered favorable.

*Activity Ratios*

*Average collection period* indicates the average number of days it takes to convert accounts receivable into cash.
This ratio helps gauge the liquidity of accounts receivable or the ability of the venture to collect from its customers.
The formula:

$$\textbf{Average collection period} = \frac{\textbf{accounts receivable}}{\textbf{average daily sales}}$$

This result needs to be compared to industry standards.

*Inventory turnover* measures the efficiency of the venture in managing and selling its inventory. A high turnover is a favorable sign indicating the venture is able to sell its inventory quickly.

$$\textbf{Inventory turnover} = \frac{\textbf{cost of goods sold}}{\textbf{inventory}}$$

*Debt ratio* helps the entrepreneur assess the firm's ability to meet all its obligations. It is also a measure of risk because debt also consists of a fixed commitment.
The calculation:

$$\textbf{Debt ratio} = \frac{\textbf{total liabilities}}{\textbf{total assets}}$$

*Debt to equity* ratio assesses the firm's capital structure. It provides a measure of risk by considering the funds invested by creditors and investors. The higher the percentage of debt, the greater the degree of risk to any of the creditors the calculation:

$$\textbf{Debt to equity ratio} = \frac{\textbf{total liabilities}}{\textbf{stockholder's equity}}$$

*Profitability Ratios* *Net profit margin* represents the venture's ability to translate sales into profits. You can also use gross profit as another measure of profitability. It is important to know what is reasonable in the particular industry as well as to measure these ratios over time. The calculation:

$$\textbf{Net profit margin} = \frac{\textbf{net profit}}{\textbf{net sales}}$$

*Return on investment* measures the ability of the venture to manage its total investment in assets. By substituting stockholders' equity for assets, you can also calculate a return on equity.

The calculation:

**Return on = <u>net profit</u>**
**investment total assets**

The result of this calculation will also need to be compared to industry data. As the firm grows it will be important to use these ratios in conjunction with all other financial statements to provide an understanding of how the firm is performing.

**RAPID GROWTH AND MANAGEMENT CONTROLS**

Rapid growth may result in management problems. Before rapid growth occurs, the new venture is usually operating with a small staff and limited budget. Rapid growth may also dilute the leadership abilities of the entrepreneur. The entrepreneur's unwillingness to delegate responsibility can lead to delays in decision-making. The entrepreneur can avoid these problems through preparation and sensitivity. It may be necessary to limit the venture's growth if the future financial well being of the venture means a more controlled growth rate. The limits to the growth of any venture will depend on the availability of a market, capital, and management talent. Too rapid growth can stretch these limits and lead to serious financial problems.

## CREATING AWARENESS OF THE NEW VENTURE

In the early stages, the entrepreneur should focus on developing awareness of the products offered through:

1. Publicity
2. Internet Advertising
3. Trade Shows
4. Selecting an Advertising Agency

**PREPARING FOR THE NEW VENTURE LAUNCH: EARLY MANAGEMENT DECISIONS (Continued….) Lesson 42**

## CREATING AWARENESS OF THE NEW VENTURE

In the early stages, the entrepreneur should focus on developing awareness of the products offered.

**Publicity** is free advertising provided by a media outlet. Many local media encourage entrepreneurs to participate in their programs. The entrepreneur can increase the opportunity for getting exposure by preparing a news release and sending it to as many media sources as possible. For radio or TV, the entrepreneur should identify programs that may encourage local entrepreneurs to participate. Free publicity can only introduce the company. Advertising can be focused on specific customers.

### Internet Advertising

The Internet is an excellent medium to create awareness and to effectively support early launch strategies. Creating a website is the most important first stage. The website should indicate: Background of the company. Its products, officers, address, telephone and fax numbers. Contact names for potential sales. Direct sales from the website may also be available. Significant advertising is needed to create interest and awareness of the existence of the website. It is important to change the content of the website as necessary. The entrepreneur may also consider using a banner ad, small rectangular ads similar to billboard ads that appear on browser websites.

### Trade Shows

Every industry has a trade or professional association that sponsors annual trade shows. Although creating a booth can be very expensive, trade shows are where hundreds of thousands of people observe or identify trends in their industry. There is strong evidence to indicate that the cost per sale from a trade show is significantly less than the cost per sale from a personal sales call.

### Selecting an Advertising Agency

Advertising agencies can provide many promotional services. The advertising agency is an independent business organization composed of creative and business people who develop, prepare, and place advertising in media for its customers. The agency can provide assistance in marketing research. It is important to determine whether the agency can fulfill all of the needs of the new venture. A checklist of items that the entrepreneur may consider in evaluating an agency is useful. The agency should support the marketing program and assist the entrepreneur in getting the product effectively launched.

## HIRING EXPERTS

If the entrepreneur has no expertise in financial analysis, marketing research, or promotion, he or she should hire outside experts. There are accountants, financial experts, and advertising agencies that cater to new ventures.

## NEW VENTURE EXPANSION STRATEGIES AND ISSUES Lesson 43

**LEARNING OBJECTIVES**

1. To explain the methods for expanding the venture.
2. To discuss the types of joint ventures and their uses.
3. To discuss the concepts of acquisitions and mergers.
4. To discuss the appropriateness and uses of leveraged buyouts.
5. To discuss the different types of franchises.
6. To identify the steps in evaluating a franchise opportunity.

### JOINT VENTURES

**with the increase in business risks, hyper-competition, and failures, joint ventures have increased.** A **joint venture** is a separate entity involving two or more participants as partners. They involve a wide range of partners, including universities, businesses, and the public sector.

**Historical Perspective**
Joint ventures are not new. In the U.S. joint ventures were first used for large-scale projects in mining and railroads in the 1800s.The largest joint venture in the 1900s was the formation of ARAMCO by four oil companies to develop crude oil reserves in the Middle East. Domestic joint ventures are often vertical arrangements made between competitors allowing economies of scale. The increase in the number of joint ventures has been significantly throughout the 1990s.

**Types of Joint Ventures**
The most common type is that between two or more private-sector companies. Some joint ventures are formed to do cooperative research. Another type of joint research for research development is the not-for-profit research organization. Industry-university agreements for the purpose of doing research are also increasing. Two problems have kept this type venture from increasing even faster. A profit corporation wants to obtain tangible results-such as a patent-from its research investment, and universities want to share in the returns. The corporation usually wants to retain all proprietary data while university researchers want to make the knowledge available. Joint ventures between universities and corporations take many forms, depending on the parties involved and the subject of the research. International joint ventures are increasing rapidly due to their relative advantages. Both companies can share in the earnings and growth. The joint venture can have a low cash requirement. Also, the joint venture provides ready access to new international markets. Such a venture causes less drain on a company's managerial and financial resources than wholly owned subsidiary. There are drawbacks in establishing international joint ventures. The business objectives of the partners can be quite different. Cultural differences can create managerial difficulties. Government policies sometimes can have a negative impact on the venture. The benefits usually outweigh the drawbacks.

**Factors in Joint Venture Success**
One critical factor for success is the accurate assessment of the parties involved and how best to manage the new entity. A second factor involves the symmetry between the partners. Another factor is that the expectations about the results of the joint venture must be reasonable. The final factor is the timing. **A joint venture should be considered as one of many options for supplementing the resources of the firm.**

**ACQUISITIONS** An **acquisition** is the purchase of a company or a part of it in such a way that the acquired company is completely absorbed and no longer exists. Acquisitions can provide an excellent way to grow a business and enter new markets. A key issue is agreeing on a price. Often the structure of the deal can be more important to the parties than the actual price. A prime concern is to ensure that the acquisition fits into the overall direction of the strategic plan.

**Advantages of an Acquisition**

1. Established business.
2. The acquired firm has an established image and track record.
3. The entrepreneur would only need to continue the existing strategy to be successful.
4. Location is already established.
5. Established marketing structure
6. An important factor that affects the value of a firm is its existing marketing channel and sales structure. With this structure already in place, the entrepreneur can concentrate on expanding to new target markets.
7. The total cost of acquiring a business could be lower than trying to buy a franchise.
8. Existing employees
9. The employees of an existing business can be important assets. They know the business and can help the business continue. Employees already have established relationships with customers, suppliers, and channel members.
10. More opportunity to be creative-More time can be spent assessing opportunities to expand or strengthen the business.

## NEW VENTURE EXPANSION STRATEGIES AND ISSUES (Continued….) Lesson 44

### LEARNING OBJECTIVES

1. To explain the methods for expanding the venture.
2. To discuss the types of joint ventures and their uses.
3. To discuss the concepts of acquisitions and mergers.
4. To discuss the appropriateness and uses of leveraged buyouts.
5. To discuss the different types of franchises.
6. To identify the steps in evaluating a franchise opportunity.

### DISADVANTAGES OF AN ACQUISITION

- Marginal success record
  Most ventures for sale have an erratic, or even unprofitable, record. It is important to review the records and meet important constituents to assess the future potential.
- Overconfidence in ability
  Even though the entrepreneur brings new ideas, the venture may never be successful for reasons not possible to resolve
- Key employee loss
  Often when a business changes hands key employees also leave. In a service business, it is difficult to separate the actual service from the person who performs it. Incentives can sometimes be used to assure that key employees will remain with the business.
- Overvalued If the entrepreneur has to pay too much for a business, the return on investment will not be acceptable. The entrepreneur will need to establish a reasonable payback to justify the investment.

### DETERMINING THE PRICE FOR AN ACQUISITION

Some of the key factors used in determining price for an acquisition are assets, owner’s equity, earnings, stock value, customer base, personnel and image. The price paid should provide the opportunity to get a reasonable payback and good return on the investment.

**Valuation Approaches**

- Ratios measuring profitability, activity, and liquidity can also be helpful in evaluation. Using the **asset** *valuation method*, the entrepreneur values the underlying worth of the business based on its assets.

a. The figure obtained using book value should be only a starting point, as it reflects the accounting practices of the company.
b. In adjusted book value the stated book value is adjusted to reflect the actual market value.
c. Another method is to determine the amount that could be realized if the assets were sold or liquidated.
d. The final method is the replacement value-the current cost of replacing the tangible assets.

- Another way of evaluating a firm is to calculate the prospective **cash flow** from the business.

a. Positive cash flow is cash received from the operation of the business.
b. A negative cash flow, signifying the company is losing money, can have tax advantages.

c. Final cash flow value, the terminal value, is a source of cash when the entrepreneur sells the business.

**Earnings** *valuation* capitalizes earnings of a company by multiplying earnings by the appropriate factor (the price earnings multiple.)

a. The question of earnings involves determining the appropriate earnings period as well as the type of earnings.

b. The earnings period can be either historical earnings or future earnings.

c. Earnings before interest and taxes (EBIT) are the most frequently used.

d. It is appropriate to select a price earnings multiple of a publicly traded stock similar to the company being evaluated. The valuation of a business is important in determining the feasibility of the acquisition.

**SYNERGY**

Synergy is "the whole is greater than the sum of the parts." With reference to the venture synergy refers to the phenomenon in which two or more discrete influences or organizations acting together create an effect greater than that predicted by knowing only the separate effects of the individual organizations.

**An acquisition should positively impact the bottom line.**

Lack of synergy is a frequent cause of the acquisition failing to meet goals. Evaluation should consider the upside potential, downside risks, and vulnerability to changes in markets and technology. Some of the warning signs include poor corporate communications, poorly prepared financial statements, and few new products.

**The evaluation process begins with financial analysis.**

Past operating results indicate the potential for future performance. Areas of weakness, such as too much leverage, should be carefully evaluated.

**In considering a firm's product lines study the past, present, and future.**

The life cycle and present market share of each of the present products should be evaluated. Also consider the compatibility of the firm's product lines. A method for evaluating the product line is the S or life-cycle curve plotting sales and margins for each product over time.

**The future of the firm's products and market position is affected by its research and development.**

In addition to the absolute dollar amount of R&D spending, it is important to determine whether expenditures are directed by the firm's long-range plans. The output and success of new products developed should be compared with the expenditures.

**The entrepreneur should evaluate the firm's entire marketing program and capabilities.**

Care should be taken in evaluating the established distribution system, sales force, and manufacturer's representatives. The entrepreneur can also gain insight by look at the company's marketing research efforts.

**The nature of the manufacturing process is important in deciding whether to acquire a particular firm.**

The entrepreneur should rate the management and key personnel of the candidate firm.

**Specific Valuation Method**

***Step 1****:* Compound the current revenue level forward to yield a revenue level at time of liquidity.

***Step 2****:* Multiply the future revenue level times the expected after-tax profit margin to produce an expected earnings level.

***Step 3****:* Multiply the estimated earnings level at time of liquidity times the expected price/earnings ratio to give a future market valuation. *Step 4:* Calculate the present value factor. *Step 5:* Divide the future company value by the present value factor to give a present value. *Step 6*: Divide the required capital by the present company value to obtain a minimum ownership for the investment required.

**Structuring the Deal**

The deal structure involves the parties, the assets, the payment form, and the timing of the payment.

There are two means of acquisitions. The entrepreneur may directly purchase the firm's entire stock using funds from an outside lender. Another option is a bootstrap purchase, acquiring a small amount of the firm for cash then purchasing the remainder by a long-term note.

**Locating Acquisition Candidates**

There are professional business **brokers**, operating similarly to a real estate broker that represents the seller.

Accountants, attorneys, bankers, business associates, and consultants may be aware of good candidates. It is also possible to find opportunities in the classified sections of the newspaper or trade magazine.

**Analyzing Candidates**

The entrepreneur should gather as much information as possible, read it carefully, consult with advisors, consider the situation, and then make a constructive decision. A profile containing acquisition criteria and prospect data can guide initial screening. Once the prospect passes the initial checklist, more rigorous analysis can evaluate the acquisition.

**MERGERS**

A **merger** is a transaction involving two or more companies in which only one company survives. Acquisitions are so similar to mergers, that the terms are often used interchangeably. A key concern in any merger or acquisition is the legality of the purchase. The Department of Justice frequently issues guidelines for horizontal, vertical, and conglomerate mergers. Merger motivations range from survival to protection to diversification to growth. A merger requires sound planning by the entrepreneur. Merger objectives must be spelled out with the resulting gains for the owners of both companies delineated. The entrepreneur must evaluate the other company's management and resources to ensure that the weaknesses of one do not compound those of the other. The entrepreneur should establish a climate of mutual trust. The same methods for valuing the entrepreneur's company can be used to determine the value of a merger candidate. The process involves looking at the synergistic product/market position, the new market position, and undervalued financial strength. A common procedure is to estimate the present value of discounted cash flows and the expected after-tax earnings attributable to the merger.

## ENTREPRENEURSHIP & PAKISTAN Lesson 45

**LEARNING OBJECTIV ES**

1. To look at the history of entrepreneurship in Pakistan
2. To understand the nature of policies in industrialization.
3. To understand the profile of a typical entrepreneur in Pakistan.
4. To learn the purpose of new policies induction.
5. To identify different fields of entrepreneurship...
6. To understand the value of Pakistani entrepreneur in the region.
7. To illustrate some of the fundamental issues related to woman entrepreneurs...
8. To understand development made in woman entrepreneurship.
9. To look at the over all scenario of entrepreneurship in Pakistan.
10. Future of entrepreneurship in Pakistan.

**ENTREPRENEURS IN PAKISTAN**

Salient Features of Entrepreneurs in Pakistan are:

**Age Pattern**

"The mean age of entrepreneur was found to be 42 years and of their enterprises 12 years. It is comparable to the Korean age pattern (46)".

**Corporate status**

*Sole owner:* He works with his own hands combines the entrepreneur function of initiating the business making investments, taking decisions and performing managerial functions". *Heritage:* "Caste played an important role in certain industries and on the other hand heritage is dominant. But overall it is much diversified."

**Educational Level**

"Differing from industry to industry 60% have school education and 30% have college or better education only 10% have professional or graduation level".

**Skills Level**

Majority is skilled in family business Most of training is as a family member. Technically they are very skilled in heredity business. New generation has professional education

**Sizes and Investment**

"Majority started in a small way with less than 10 workers and 1/2 to 2/3 of the firms started with less than 50,000 investments"

**Growth**

"The growth was fast in case of small firms than in large firms".

**Profitability**

"Rate of profit is higher in case of small industries in comparison with the large industries."

**The Industrial History of Pakistan**

Pakistan's industrial history has been dominated by a single-minded emphasis on industry and that is of large-scale enterprises.

The fall out of that development strategy was formally adopted in the 60’s as conscious policy step in the start of second policy plan period (1960-1965) has been large scale industrial holdings, accounting for much of the country’s assets and capital. The feeling among the masses is that a few families control 70 to 80 percent of the country’s assets, led to political rebellion. That rebellion also culminated in the dismemberment of the eastern part of the country. The primary causes for that tragedy, were basically economic in nature. The upheaval also generated a parallel economic thought, exclusive to the peculiarities of Pakistan’s economy. That economic thought advocated across the board nationalization of economic assets as a vehicle for ensuring social justice in the society. The fall out of that strategy was two pronged:

1. Inefficient labor
2. Shaken Business Confidence

The reaction to that policy mix in the early 1980’s was revert back to the Ayubian model of economic development. The model was characterized by**:**

1. Promotion of large-scale units
2. Expansion of large-scale enterprises
3 Banking sector turned to cater to large loans

The IMF conditions and poor recovery rate of huge borrowings played a major role in creating a negative point for the progress curve. These constraints further pushed the economy towards recession, industry towards sickness and individual units towards default. All these factors precipitated the rethinking of a strategy to revive the growth of economy.

It was due to non involvement of banks that medium scale and small-scale enterprises has got the attention of the stakeholders i.e. the economic managers and the private sector. The development of SMEs suits the current situation on account of the following factors.

1. Low overhead cost, low level of financing
2. Lesser pressure on the banking system
3 Employment generation
4 Entrepreneurial developments
5 Vendor based development
6 Development of large-scale industry on firm basis
7 A more just distribution of resources and profits

The pre-requisites for the development of SME sector rest heavily on an infrastructure tuned to support such developments that include:

- A banking system customized for SME development.
- One window operation

Currently, our banking system continues to be the large sector banker. Despite talk of SME development under the auspices of SMEDA and development of SME Bank and Khushali Bank, the financial sector’s general response has been influenced by the security issue, i.e. against which asset the bank would be advancing loans to the small and medium scale business entity. In the absence of a customized banking setup, the development in the SME sector so far has been evolutionary and not the result of any conscious activities.
The growth of Pakistani entrepreneurship in good in region and can be compared with INDIA,

Sri Lanka and Malaysia I respect of following

| | Rising stars% | Lost opportunity% |
|---|---|---|
| Pakistan | 60.4 | 10 |
| Sri Lanka | 57.1 | 38.7 |
| India | 52.3 | 29.3 |
| Malaysia | 59.6 | 27.7 |

**GENDER DEVELOPMENT STATUS WOMAN AS AN ENTREPRENEUR IN PAKISTAN**

Each of the two genders of any society constitutes roughly half of the population, and Pakistan is no exception. People of both genders embody not only labor force, but also knowledge and creativity, which may be mobilized, to achieve economic ends. Discarding either of the genders, therefore, implies foregoing the potential benefits, which arise from mobilizing the respective human resources for development.

Pakistani women have been engaged in the production process for ages. Their participation in the economic activities in the modern society has also progressed beyond agriculture into the local market economy. Women are increasingly migrating to urban areas for employment in a range of cottage industries, such as carpet weaving, textiles and handicrafts. In search for wage employment, women are moving into small business and self-employment ventures thereby creating many formal and informal opportunities for work.

Women entrepreneurship in the formalized sense, however, remains a new concept. Our current strategies also tend to focus on increasing women’s participation in the labor force. The business environment for women in Pakistan reflects a complex interplay of many factors made up of social, cultural, traditional and religious elements. These have taken shape over many centuries; are anchored in patriarchal system and are clearly manifested in the lower of women. The form of constitutional structures, policy documents, regulatory arrangements and institutional mechanisms is contemporary rather than traditional, so it is cosmetically impartial.

Yet the gender bias is rigid and deep-rooted as it draws legitimacy from the perpetuation of a traditional mind-set, established rituals and a firm belief system. It has conclusively been shown that women business owners encounter more obstacles, and face more risks, financially, socially, economically, culturally and legally than male business owners face.

The Government of Pakistan is well aware of the potential of the women in our society and the contribution they can make towards economic development. Women are continuously being encouraged to enter the business stream of the country and are being provided incentives. However, there still is a strong dearth of focused initiatives that need to be taken by existing business facilitation institutions.

The new scenario is giving rise to woman as entrepreneur as they have opened their own chamber of commerce. The woman bank is in Place and we can see lot of women coming up in-services sector, apparel, education and many such occupation.