Discovering NEW Business Opportunities

JOHN ENGLISH

& Babette Moate

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ALLEN & UNWIN

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Preface

Discovering New Business Opportunities has been written to show you how to identify new business ideas and sharpen your judgement about which ones are worth pursuing. The emphasis is on smaller businesses, but the principles apply equally to businesses of all sizes. You can also use the information in this book in other ways. You can use it to help you improve the commercial potential of a business opportunity. You can use it to re-evaluate a business opportunity whenever you decide to change the way you approach it. And you can use it as a framework for explaining a business opportunity to people who are in a position to help you.

The book is divided into five parts:

- Part A examines the nature of a business opportunity. It explores the key components of a successful business opportunity, how change creates business opportunities, the diversity of business opportunities and the rise of the solo business.
- Part B looks at ways to identify a viable market. It examines criteria for evaluating the potential demand for your idea, how the market will receive your idea and the competitive strength of your idea.
- Part C is concerned with anticipating the risks associated with your idea. There are boundary risks, such as legal requirements or changes in technology, that might constrain its commercial potential and establishment risks, such as financial and personal pressures, that might impede the start-up process.
- Part D is devoted to finding the right business model. It focuses on the skills and experience needed to put your idea into operation, the resources required to underpin it and the financial outcomes you can expect.

- Part E guides you through a technique for judging the commercial feasibility of a new business opportunity. It walks you through the evaluation process, provides a method for assessing commercial feasibility and offers suggestions for constructing a start-up strategy and writing a business plan.

Having a structured method with which you can assess a new business opportunity is enormously valuable. Some people believe that the leap from a new idea to market entry is only a short distance and they often don't recognise how complex, costly and time consuming the process can be. The result is that many people go into business blindly and postpone the day of reckoning until the cost of failure is very high. This is why it is important to assess the commercial feasibility of your idea very early. With the method outlined in this book you can make an early assessment and thus decide if your idea has enough commercial potential to take the plunge.

Discovering New Business Opportunities draws on many years of teaching and research into business start-ups. Former university students have inspired me to find fresh and informative approaches to learning about entrepreneurship and small business development. Hundreds of *IDEAS* workshop participants have contributed toward refining the method used in this book. I am grateful to my collaborator and co-author, Babette Moate, for her insight into contemporary business opportunities and her ruthless editing. I also thank the University of Tasmania and in particular my colleagues at the Australian Innovation Research Centre for their encouragement.

John English

Part A

BUSINESS OPPORTUNITIES

1 What is a business opportunity?

A business opportunity is an idea with compelling commercial potential. Most of us have seen or imagined ideas that we might turn into a business. Some ideas have the potential to be commercially successful and others do not. The question we answer in this book is how do we tell them apart. You will know the difference between an idea and a real business opportunity when you can confidently answer 'yes' to three BIG questions:

- Can you identify evidence of a viable market?
- Can you anticipate the risks involved?
- Do you have a business model that makes sense?

A business opportunity is not a guarantee of success but it does represent a likely prospect for creating a successful business. In the chapters that follow, we will explore how to uncover ideas for new business opportunities and how to evaluate them for their commercial potential. In this first chapter, each of the three BIG questions is explained, the ways in which change creates new business opportunities are investigated and the rise of the solo business is examined.

Identifying a viable market

The first BIG question asks if you can identify evidence of a viable market. A viable market is one in which there are good prospects for potential demand, confirmation of market approval and a sound competitive position for your idea.

Potential demand is one of the most important elements in evaluating an idea, and it is also one of the most difficult to assess because it requires some understanding of customer behaviour. It's not about forecasting sales at this early stage; it's about painting a picture of the factors that push demand. What can we learn about the relative size of the potential market? Is the potential market increasing or decreasing? Will the demand trend be stable or unstable? How long will demand for this idea last? What scope is there to extend this idea into other products or services? Chapter 3 focuses on key potential demand questions.

Market approval is important in converting potential demand into sales. It affects the rate of adoption and the extent to which the market can be penetrated. There are a variety of reasons why customers may accept or reject a new idea. Does it fulfil a genuine need? Can they easily understand the benefits? Is it compatible with their existing attitudes or patterns of use? Is it complicated for customers to consume or use it? Will it be difficult or costly to organise a way to distribute it? Chapter 4 investigates important questions about market approval.

Competitive strength is concerned with how an idea is likely to fare in the battle of the marketplace. How does it improve upon similar products or services? How do customers value it compared with competing products or services? Is it vulnerable to the negotiating leverage of customers? Is it vulnerable to the negotiating leverage of suppliers? Is it susceptible to existing, potential, direct or indirect competitors? Chapter 5 examines key questions about competitive strength.

Anticipating the risks

The second BIG question asks if you can identify the risks associated with an idea by searching for its flaws. There are a number of critical risks in the early stages of commercialising a new idea and we distinguish between boundary risks and establishment risks.

Boundary risks are dangers that are generally beyond our control but nevertheless restrict the commercial potential of an idea. They come from a variety of sources such as government, supporters of various popular causes, existing and potential vested interests and the public. Does your idea meet the various legal, safety and other regulatory requirements? Is it vulnerable to changes in technology? Does it have an effect on the environment? Is it vulnerable to any of the dominant social or economic forces in our society? To what extent could sales be limited by dependence on external factors that we cannot control? Chapter 6 looks at important questions about boundary risks.

Establishment risks represent obstacles that have the potential to affect a business opportunity during its start-up stage. The difference between these and boundary risks is that you have more control over them. You need to recognise these risks and decide which ones can be resolved or avoided and whether or not you want to face the others. Is there a plan for making the transition from an initial idea to a successful enterprise? Do you really understand your market? Will you be able to produce and deliver the product or service in the way you intend? Will you have enough cash to see you through the start-up phase? Will you be able to withstand the pressure on your personal finances, your career, your family and friends, and your emotions? Chapter 7 examines important questions about establishment risks.

Finding the right business model

The third BIG question asks if you have a business model that makes sense. A business model is your strategy for combining the skills and resources that translate your idea into a genuine business. The objective is to anticipate what skills and resources are needed, whether or not you have them or can get them and whether the financial results you expect confirm the commercial potential of the idea.

A thriving business is the result of a successful marriage between an idea with commercial potential and the skills to exploit it. These include marketing, technical, financial, operational and managerial skills. The relative importance of these skills depends upon the sophistication of the idea and the nature of the market it faces. Chapter 8 is concerned with identifying the skills needed to launch your idea and whether you can realistically provide them.

Taking advantage of a business opportunity not only depends on having the right skills but also having access to the right resources. Resources form the basic dimensions of a business plan and include financial resources, physical resources, human resources, intellectual resources and network resources. Chapter 9 focuses on identifying the resources you need to launch your idea and whether you can realistically acquire them.

In addition to the right skills and resources, an idea needs a business model that makes financial sense. A successful business model is built on a sensible forecast of sales revenue based on practical market research. It will have projected income statements that demonstrate your strategy for earning a profit. You also need to be aware of your cost structure and know how long it will take to break even. Your business model will have projected balance sheets indicating what assets you require and how they will be financed. You will also need a cash flow budget to help you manage your liquidity. Chapter 10 describes how to forecast the financial dimensions of transforming your idea into a business operation.

How change creates business opportunities

Change is nothing new and we adapt to it daily without much thought. If we stop to consider the changes taking place around us we will discover clues about emerging demand for new products and services. In the absence of change, existing businesses do well because they have proven products and services, smooth operations, established business models and loyal customers. When conditions change, however, confusion and disruption create gaps in the marketplace that open up new business opportunities. Change produces an environment that is actually loaded in favour of new players because they tend to be more flexible and adaptive than existing businesses. Keeping abreast of these changes means being informed about shifts in demographic, lifestyle, social, technological, political, regulatory and economic trends. The objective is to recognise how changes in these trends manifest themselves as new business opportunities.

Demographic trends

Demographic information is used to answer questions about population trends. For example, is the number of households in a particular area increasing or decreasing, is the population mix getting older or younger, or is household income rising or falling? The Australian Bureau of Statistics and other agencies provide demographic information on population size, age distribution, geographic distribution, family structure, employment, race and ethnicity, education, health and welfare, literacy and spending patterns. Population characteristics are closely linked to consumer purchasing behaviour. The number of people in each age group is reflected in different spending patterns including the tremendous influence children have over adult spending decisions. Gender demographics reveal the different preferences between men and women and have been used to uncover opportunities in the sale of clothing, soft drinks, non-prescription medications, toiletries, magazines and even cigarettes. Race and ethnicity demographics are used to discover opportunities in food, music, clothing and cosmetics. Population size and income levels across geographic areas are used to measure *market density* and to anticipate changes in spending power and the desire for certain lifestyles.

Marital status and the presence and ages of children, together called the *family life cycle*, are used to reveal opportunities in housing, appliances, food and beverages, automobiles and recreational products. There has been a decline in the traditional family partly due to fewer marriages, higher divorce rates and couples having fewer children. There are now more one- or two-person households than ever before. The birth rate is declining in the 15–29 year age group and rising in the 30–39 year age group. The number of one-parent families is also rising. These demographic trends are reflected in shifting family spending patterns.

The post-Second World War 'baby boom' and the progression of this generation through their lives have provided an abundant source of business opportunities. As they approach retirement, the baby boomers bring with them a strong desire to live well past the age of their parents and to maintain a healthy lifestyle in the process. Life expectancy has been increasing by about two and a half years per decade and the over-fifty population will more than double during the next thirty-five years. Seniors control 48 per cent of discretionary spending, so the combination of demographics and dollars suggests that many business opportunities will emerge in areas like home services, health services, travel, recreation and retirement counselling. At the other end of the age spectrum are more than two million Australians aged six to thirteen. They represent increasing spending power because of the trend towards older parents with higher disposable incomes and smaller families who spend more per child. These children have sophisticated tastes, are avid consumers, are heavily influenced by the media and are technologically savvy.

Lifestyle trends

Thanks to globalisation and rising incomes, consumerism plays a big part in the lifestyle of many people. Australians who want a way of life that relies on consumer goods and services will continue to generate new business opportunities. Lifestyle trends are closely aligned with consumers' motives for making purchases such as appearance, convenience, affiliation, status, safety or health.

One consequence of the modern world is that most of us feel pressed for time so we use products and services that compensate for lack of time. Nearly one-third of lunches are eaten on the run and are supplied by the fast food industry. Speed dating is having a major impact on the dating scene. More and more people are condensing a holiday into a weekend or a short trip, resulting in more spontaneous travel for shorter periods. Convenience is also an increasingly important feature of the goods and services we consume and the ways in which we buy them. Personal shoppers, home cleaning services and dog walkers are examples of businesses meeting the increased demand for convenience. Many consumers are willing to pay extra for convenience in order to save time for other pursuits. Understanding the effect of time compression on lifestyle is one of the keys to unlocking new business opportunities.

Another interesting trend is consumers' loss of trust in food authorities who keep changing the 'facts' about nutrition. We no longer trust what we read on the labels. We do not want eating to be a stressful or difficult task. We want to buy food we know is ‘authentic’. Authentic means not made in a laboratory. It means safe, it means reliable and it means trustworthy. One result of this trend is that there are consumers who are willing to pay a premium for organic produce simply to obtain peace of mind. Another consequence is consumers seeking more information about the origin of their food such as where it was grown and how was it handled.

The 1990s saw a huge change in the emphasis placed on physical fitness and healthy living. Since that time, many people have been taking responsibility for their own health by challenging the traditional authority of the doctor and seeking more information and other options. The trend towards bottled water is also driven by increased concern for health and wellbeing. However, now it has taken on symbolic values as well so we have water bars, recipes for rainwater, regional waters, branded waters and spas based on pure water locations.

New trends in shopping are emerging. The weekly shopping trip is on the decline as more people shop every day. More men are becoming grocery shoppers. Why are they are taking a greater interest in food? Is it because more men are living alone or is it a result of more women in the workforce with less time for shopping? At the same time, more women are becoming interested in renovation and shop at hardware stores. Why is this happening, what do they want, and how could these trends translate into new business opportunities?

Social trends

New business opportunities emerge from changes in our society. These include changes in value systems, accepted norms of behaviour, approaches to sexuality, religion and spirituality, the pursuit of wealth and possessions, and shifting aspirations, fears, desires and anxieties. For example, how many parents no longer allow their child to ride a bicycle without supervision because they have a nagging fear of danger lurking outside the home? This trend may not be good for sales of children’s bikes, but the upside is new business opportunities for supervised play groups, structured extracurricular activities and organised sports events.

Consumer interest in 'green' or environmentally friendly products has become pervasive. Together with growing environmental awareness comes a shift towards non-material factors that affect the ways in which consumers spend their money. Rather than focusing solely on price and quality, many buyers consider ethical, religious and other beliefs before making their spending decisions. For example, the use of sweatshop labour affects the decisions of some consumers when they buy clothing and footwear. Similarly, some consumers will only buy 'fair trade' coffee.

Women continue to gain social, political and economic power, propelled by changing values and social attitudes. These gains have been accelerated by more women entering higher education and the growth in the number of couples where both are in paid employment. Another reason for the increasing economic power of women is the decline in the manufacturing sector coupled with the rise of service industries. The qualities most often attributed to women are also those associated with the skills needed to succeed in customer-focused and service-oriented businesses. These changes have also led to opportunities for products and services that are 'feminised' or that assist women to balance the demands of career and family.

Migration to Australia and migration between different regions in Australia show no sign of slowing. The movement to coastal areas for a sea change and to country areas for a tree change is driving urbanisation in smaller communities. With shifting population comes increased demand for services and cultural change in regional areas. This is altering the lives of those who are relocating as well as the character of the regions that receive them. Migration affects language, social values, food, entertainment, housing and other spending patterns resulting in new business opportunities.

Technology trends

Technology is rapidly and comprehensively changing the world in which we live. Blogs, podcasting, YouTube and MySpace have created a whole new realm in which we can interact with each other. Social networks and data democracy based on user-generated content mean we are living more of our lives online and out of the reach of institutional gatekeepers and bureaucrats. Research suggests that Australians are early adopters of technology and willing to try new products and services. For example, the internet is now the most important booking tool for air travel, accommodation, car hire, tour operators, cruise ships, state travel centres and motoring clubs. Many new businesses such as Wotif have taken advantage of these technology trends to become Aussie icons.

One reason for the exploding role of technology is that the cost of technology has dropped dramatically compared with disposable income. New technology has created powerful opportunities for home-based electronic leisure activities such as interactive television, online gaming services and home theatres. The equipment is getting easier to install and easier to use, and wireless devices will infiltrate our lives as more products roll out with access anywhere, any place and any time. A new form of online business called a *mash-up* illustrates the business opportunities available on the internet. A mash-up uses online services and tools to combine data from several sources to create a new business. They are relatively easy to start and require fewer resources than traditional technology start-ups. For example, data from online real estate advertising has been combined with Google Maps to create a new type of real estate marketing service.

The traditional media began to lose its grip on the Australian public when we started to use the internet. Over a million Australians now read newspapers and magazines less frequently. Over two million watch less television. These changes have important consequences for advertising. As we turn our backs on the traditional media, the internet and mobile phones have emerged as important new marketing channels. Even word-of-mouth recommendations are turbo-charged by the social networks spawned in these media. These new forms of media not only provide new business opportunities but also new ways of pursuing existing businesses. Retail businesses collect our mobile phone numbers and email addresses to advertise new stock arrivals and sales. Consulting and related services are benefiting from technological changes in education and training, transport, health and medical services, and systems and hardware upgrades. The internet also provides business opportunities in network management, firewall security systems, e-commerce applications, website development, VoIP applications and business process outsourcing.

Political and regulatory trends

The role of politics in business can be pervasive. A single vote or a budget speech in parliament can change an entire industry. Regulations stem from local, state and Commonwealth governments as well as from a number of government-sanctioned authorities. Examples of political and regulatory trends include increased emphasis on the market economy, industrial relations reform, welfare reform, deregulation of the financial sector, changes to superannuation legislation and reforms in the telecommunications sector.

There is growing political acceptance that global warming is resulting in climate change accompanied by an increased interest in environmental sustainability. Drought and acute water shortages have focused the government's attention on a range of new environmental standards for home building and renovation. The resultant demand for domestic water tanks, grey water diversion systems, water-saving devices and specialised landscaping services has created new business opportunities. With increased environmental consciousness has come legislation that restricts our ability to do as we please, but it has also created new opportunities in the areas of renewable energy, air conditioning technology and building insulation products.

Another trend over recent years has been for government to gradually withdraw from the direct provision of a range of services. This results in opportunities for new businesses to take over where government left off. There is a profit to be made by providing services in areas like ancillary healthcare, respite, day care, education and transportation. For example, governments prefer to house aged people in their own homes for as long as possible. Rising Commonwealth funding of community aged-care packages pays for personal and nursing care for older people and creates new business opportunities for the providers.

Over the past two decades the world has been transformed by the growth of free trade, the advent of the internet and the deregulation of financial markets. Now business operators can think and act globally, with more access to information, goods and services, and other cultures than at any time in history. Globalisation is affecting domestic politics, international relations, business activities and consumer behaviour. It is opening up many new business opportunities for speciality and high value products in niche markets.

Economic trends

Economic trends that are commonly tracked and reported in the mainstream media include business investment, unemployment statistics, and changes in consumer confidence and retail spending. Other measures of economic activity include average wages, inflation, interest rates, building approvals, productivity and the value of the Australian dollar. When the economy is expanding, new business opportunities are more likely to emerge. When the economy is contracting, business opportunities tend to dry up as well. Consumer confidence is the key that triggers decisions to take a holiday, buy a car or renovate the house. If the economy is healthy and interest rates are low, consumers will feel confident about their future and be more likely to open their wallets. Economic trends outside Australia are also important. Asian countries are strengthening their economic clout and boosting their participation in world trade. Whether measured by GDP growth, new technology or new goods and services, there are huge changes occurring in places like Bangalore, Shanghai and Bangkok with enormous implications for new business opportunities in Australia for importing and exporting.

Trend-watching websites

The Australian Bureau of Statistics (www.abs.gov.au) is the official statistical organisation for the Commonwealth and state governments. Its main function is to collect statistical information on a wide variety of social and economic activities and to disseminate it to government and the community generally. Examples of ABS reports that can be useful for trend watchers include:

- census of population and housing
- demographic statistics and trends

- household expenditure survey
- census of retail establishments and selected service establishments
- tourist accommodation
- wholesale establishments
- manufacturing establishments.

Springwise (www.springwise.com) scans the globe for the most promising business ventures, ideas and concepts ready for adaptation, expansion, partnering, investments or cooperation. Springwise tracks more than 400 global offline and online resources as well as taking to the streets with its digital camera to capture images of new trends as they occur.

The World Future Society (www.wfs.org) is a non-profit scientific and educational association of people interested in how social and technological developments are shaping the future. It serves as a clearinghouse for ideas about the future.

Trendwatching.com (www.trendwatching.com) is an independent research firm that scans the globe for the most promising consumer trends, insights and business ideas. It claims to have a network of more than 8000 spotters on the ground in more than seventy countries.

MarketResearch.com (www.marketresearch.com) is the world's largest and continuously updated collection of market research offering more than 110 000 market research reports from over 550 leading global publishers.

Trendcentral (www.trendcentral.com) is a free daily email newsletter covering lifestyle, technology, style and entertainment, particularly for Gens X and Y.

Emerging Trend Advisor published by Find/SVP (www.guideline.com) is an American monthly email newsletter written by industry experts covering business trends. The newsletter is free to all Find/SVP clients, but non-clients can sign up for the latest newsletter online.

Gizmodo (www.gizmodo.com.au) is a technology weblog dedicated to everything related to gadgets, gizmos and cutting-edge consumer electronics. The Australian edition delivers the best of Gizmodo from the United States while adding a huge array of Australian content as well.

IBISWorld (www.ibisworld.com) is one of Australia's richest sources of business information. It provides independent, accurate, comprehensive and up-to-date research on over 500 industries, including statistics, analysis and forecasts. It also has reports on Australia's top 2000 companies and risk-rating reports on every industry.

The objective of the Copenhagen Institute for Futures Studies (www.cifs.dk/en) is to strengthen the basis for decision making in public and private organisations by creating an awareness of the future and highlighting its importance to the present. Its work ranges from statistically based analysis and the identification of global trends to analysing more subjective factors that will affect the future.

The Institute for the Future (www.iftf.org) is an independent, nonprofit research group with nearly forty years of forecasting experience. The core of its work is identifying emerging trends and discontinuities that will transform global society and the global marketplace. It provides insights into business strategy, design processes, innovation and social dilemmas.

INNOVIC (www.innovic.com.au) is a not-for-profit organisation in Victoria assisting over 1800 innovators each year to turn their new ideas, inventions and innovations into viable products and new businesses. It offers a wide range of services, free seminars and innovation resources to help you take your idea or invention through all stages of the commercialisation process.

The rise of the solo business

A solo business consists of a single operator with no employees. Solo businesses are an emerging phenomenon with an important role to play in the development of new business opportunities. The Australian Bureau of Statistics reports that out of 1 269 000 small businesses in Australia over half, or 715 000 businesses, have no employees. The contribution of solo businesses to employment and economic activity, as well as quality of life, represents a powerful new strategy for creating wealth and independence.

The rise of the solo business stems from a variety of economic, social and technological changes. A shift away from traditional employment and the notion of a job for life have loosened workers' ties to large employers. Downsizing and retrenchments have driven those affected to try new ways to sustain themselves. With work and family pressure rising, many families are seeking new ways to earn a living while balancing childcare or care for aging parents. At the same time the internet has opened enormous opportunities for new solo businesses by providing an environment in which a significant presence can be established by a single individual.

Solo businesses have a number of distinguishing characteristics. They are under the direct control of the owner and are generally independent of outside influence. Since a solo business has no employees, it relies on the resourcefulness and energy of one individual. The money to finance a solo business is usually modest and comes out of the owner's pocket together with whatever they are able to borrow. The rewards and the risks of operating a solo business belong entirely to the owner. Many solo businesses operate part time.

This quiet revolution in the way many Australians go to work has led to an enormous increase in the number of solo businesses. Examples include bookkeeping services, mail-order marketing, desktop publishing, translation services, tutoring, computer programming, graphic art, freelance writing and multi-level marketing. The big growth in solo businesses has been the Small Office Home Office, or SOHO. As a result of changes in the labour market, lifestyle choices and office technology, garages and spare bedrooms all around the country are being transformed into the new workplace.

Some people are attracted to a solo business by family and lifestyle considerations. The hours lost commuting, the long days at work and the cost and limited availability of childcare have prompted many people to review their career aspirations and what they want out of life. With an office at home they can have no overheads, they can be close at hand for the family and their working hours can be as flexible as they like. Technology is perhaps the most powerful force behind the growth in solo businesses. Relatively inexpensive and powerful computers, voicemail systems, mobile phones, fax machines, the internet and email have made the solo business functionally feasible and financially realistic.

Most solo businesses have been started by people who left a job in order to pursue their own business. The business may be related to what they did in their former job or it may not. Some people have decided to set up a solo business as a way of balancing the demands of their home life and the need to earn a living. Others have started a solo business as a result of unemployment. In some cases it was voluntary and in others it was not. Some retired and decided, by choice or necessity, that they wanted to start a business, some quit because they were dissatisfied and some were dismissed or retrenched. An unprecedented number of people have been cast adrift in mid-career as a result of corporate and public sector restructuring. Some have been lucky enough to exit with a redundancy package. Many of these individuals are using their talents, skills and experience to set up solo businesses. It is not unusual to find retrenched individuals providing the same services to their former employer, except now it is called *outsourcing*.

Do you have an idea for a solo business? If so, how will you decide if you want to go through with it? Do you know why you want to go into business? Do you know if a particular kind of business will suit you? Do you know if your idea is commercially feasible? Do you know what you will need to get started and do you have a plan for making it all happen? The type of business you choose to undertake is a highly personal matter. Factors to consider include your skills, your experience, your talents and your interests. Experience plays a big part in understanding the market and avoiding costly mistakes. If you have a particular talent then you may want a business that capitalises on it. A strong interest in a particular type of business is important because it will help to sustain you through long hours and hard work.

Solo businesses are in a perfect position to exploit the power of being small. Big businesses are usually the ones who deliver the worst customer service. They are the ones that you cannot reach on the phone and, if you do get through, they transfer you from department to department because they are not sure who is supposed to handle your query. Big businesses and their poor customer service are what makes being small so powerful. That is why there are some distinct and impressive commercial advantages to going solo.

Have you noticed that the bigger the business the slower it handles customer inquiries and complaints? Their elaborate policies, complicated procedures and layers of managerial hierarchy mean that it simply takes too long. A solo business can handle customer questions and concerns immediately. You have the power to focus on your customers' needs as soon as they occur and consequently to provide a better service than larger competitors. Have you noticed how 'policies' prevent large organisations from being flexible? If a customer isn't happy, explaining the company's policy doesn't carry much weight. A customer who is forced to deal with a policy instead of an understanding person will leave. A solo business can make policy changes immediately. If a policy is doing your customers and your business more harm than good, you can change it.

Have you noticed how difficult it can be to get personal attention from a large organisation? They leave you feeling like they don't care whether you do business with them or not. Their idea of personal attention is to send you a form letter with your name on it. Solo businesses can provide genuine individual attention because they actually know their customers personally. This is a powerful advantage because a solo business can show its customers that it cares by offering them the attention they want. The power of being small lies in the unique ability to eliminate the gap between yourself and your customer.

Starting a solo business can also be a lonely and difficult task. Some people miss the social contact that the traditional workplace provides. There is also a need for the business amenities that we often take for granted as an employee. This is why shared work spaces where like-minded people can work together are becoming increasingly popular. They help to combat the isolation and make it possible to share offices, meeting rooms, internet access, secretarial assistance and equipment like computers, fax machines, printers and copiers. The social support and business services provided by these shared work spaces are particularly important for people who are new to business.

The evaluation in the Appendix at the end of this book will help you gain an insight into self-employment as a potential career choice. If you are not clear about your strengths or what direction to pursue, then using this tool will help you to take a fresh look at your natural capabilities and how these can be used to start a solo business.

2 The diversity of business opportunities

There are several myths about the ways in which an initial idea for a new business unfolds. One myth is that there is some procedure by which you can reliably search for and discover all the good business ideas. It simply doesn't happen that way. Good ideas tend to emerge unexpectedly or you stumble upon them inadvertently. What is important is that you are able to recognise a good idea when you see it. Another myth is that a good idea will ensure success. There have been thousands of businesses, based on good ideas, that have gone broke. New ventures take a great deal of time and much effort to succeed. A good idea needs to be supported by a thoroughly researched feasibility study followed by a carefully developed business strategy before it stands a reasonable chance of becoming a successful business operation.

The most popular myth is that you must discover a unique idea or come up with a new invention involving some enormous leap of the imagination. However, there is simply no correlation between commercial success and the creative or technological brilliance on which an idea is based. In fact, the vast majority of new business ideas are no more than excellent copies of other successful operations.

The purpose of this chapter is to examine the business opportunity matrix and how you can use it to distinguish between the diverse forms of new business opportunities. The business opportunity matrix represents four different approaches to identifying new business opportunities. It distinguishes between *recognising* opportunities to sell existing products and services as opposed to *creating* opportunities with new products and services. It also distinguishes between *contested* markets in which there are already competitors as opposed to *uncontested* markets in which there are no current competitors.

Figure 2.1 The business opportunity matrix

	Contested market	**Uncontested market**
Opportunity recognition	Parallel opportunities	New market opportunities
Opportunity creation	New product or service opportunities	Radical opportunities

Opportunities in contested markets are exploited by entering an existing market space, utilising existing demand and beating the competition by using either a differentiation strategy or a low-cost strategy. Opportunities in uncontested markets are exploited by a new market space, creating new demand and capturing it before potential competitors can get a foothold. Each approach in the business opportunity matrix represents a different proposition in terms of the nature of the opportunity, the risks involved and the business model you might adopt.

Parallel opportunities consist of *recognising* the potential for *existing* products or services to be sold into an already *contested* market in competition with one or more existing businesses. A new hairdressing salon in an area that already has a salon is a parallel opportunity.

New market opportunities consist of *recognising* the potential for *existing* products or services to be sold into a new or *uncontested* market in which no competitors are currently operating. A new domestic application for an existing industrial product is a new market opportunity.

New product or service opportunities consist of *creating* a *new or modified* product or service aimed at an existing *contested* market. Organic and environmentally friendly versions of well-known products are new product opportunities.

Radical opportunities consist of *creating* an *entirely new* product or service aimed at a completely new *uncontested* market. Nanny software aimed at protecting children from inappropriate internet content is a radical opportunity—a new product providing a solution to a new problem.

Parallel opportunities

The biggest myth of all is that successful businesses come from new ideas that never existed before. In fact, the majority of new businesses compete in parallel with other businesses by selling similar products and services to the same sorts of customers. Parallel opportunities are the most straightforward types of business opportunities because the number of known factors is greatest. However they also run the greatest risk of being exposed to severe competition from the other businesses that sell the same services or products to the same customers.

Parallel start-ups make sense when existing firms are unable to meet demand or when you realise that you can offer better value to customers. You might be able to capture existing customers by offering a product in a different size, changing the distribution system to improve delivery, finding other uses for the product or offering bulk discounts. You might be able to attract customers away from competitors by repositioning your product or service, changing the promotional strategy or offering price concessions. In some cases, existing businesses have had it too good for too long and have grown complacent. In other cases, existing operators with poor quality products, high prices or poor service allow you to gain a foothold because you are more competent and determined. There are plenty of parallel opportunities in the services sector. Every doctor, accountant or lawyer who enters practice is pursuing a parallel opportunity. The same is true for other service businesses such as house painters, hairdressers or gardening services. Parallel opportunities in the services sector are easy to exploit when the capital required is low and specialist know-how is not too important. New entrants usually compete using lower prices and longer hours and gradually shift toward greater dependability and closer customer relationships. The key to success is to position your business in a way that easily distinguishes it from the others. Let's look at some examples of parallel business opportunities.

Buying an existing business

When you buy an existing business, you get what someone else has put together. You are buying the location, premises, equipment, stock, customers, staff and goodwill that have been established by the seller. This can make it much easier to get started but you could be buying a big mistake if the seller's original decision to start the business was wrong. You should be particularly concerned with the capacity of the business to earn profits. If you choose to buy one that is not doing so well, then you need to be sure that you have the knowledge and skills to turn it around.

To find businesses for sale look for newspaper advertisements, commercial real estate agents and people in the trade. You can also talk with your accountant and solicitor to see if they know of any businesses for sale. Keep an eye out for owners who may want to retire or sell for reasons like loss of interest, partnership disagreements, divorce or bad health.

Buying a going concern has the advantage that not only will you earn income immediately but you will also save the time and effort it takes to equip and stock the business yourself. A successful business will have a proven location, established relationships with suppliers and creditors, and existing employees. Buying a going concern as a package may turn out to be cheaper than trying to assemble all the bits and pieces yourself. It is also much simpler to finance a single purchase transaction and a proven track record makes it easier to persuade a lender. When you purchase an existing business, the risk of failure is significantly less than if you tried to start the same business from scratch.

There are also potential disadvantages of buying an existing business. Initially, you are stuck with any bad decisions made by the previous owner. For example, the existing stock may be unsaleable, the choice of equipment and fixtures may be outdated, some of the staff may not be suitable, or the location may prove to be poor. You could pay too much for the business if you misjudge its value and there could be unexpected expenses if the business turns out to be run-down. If the previous owner had a bad reputation, then you are likely to inherit some of the ill will felt by customers and poor staff morale.

Copying another business

Copying another business makes sense if the market has expanded and is not adequately served or if the existing operators are clearly failing to meet the needs of customers. There are a number of advantages of starting a new business over buying an existing one. It is easier to innovate when you have the flexibility to choose your target market, select the right mix of products and services, design your own competitive strategy, and decide on your own location and facilities. You can plan the business around the policies and procedures that are best for your business and you can train the staff your own way. You also avoid the expense of buying the goodwill of an existing business along with the possibility of unknown or contingent liabilities an existing operation might have. Moreover, you will not inherit any pre-existing ill will from disgruntled customers, suppliers, creditors or staff.

Copying an existing business also has some disadvantages. It takes time and energy to create an image, build patronage and work the bugs out of new systems and procedures. Meanwhile, staff must be found, contacts developed with suppliers and a marketing strategy implemented. All the while the bills have to be paid and it could be some time before you reach a break-even level of sales. Then there are the risks that unexpected competition may emerge from existing operators trying to protect their market share or that customers may be more difficult to attract than you anticipate.

Look for a successful product or service to copy. What do you see that is currently doing well and has continuing prospects for the future? Are there potential customers who would be prepared to buy something similar from you? Can you identify the key factors responsible for the success of the product or service and can you reproduce them? What are the worst features and can you improve on them?

Can you deliver the same thing for a lower cost? Make sure you do not infringe anyone's patent, copyright or licence. Ask potential customers if they would buy the product or service if you offered it.

Filling a shortage

Shortages occur when a product or service becomes unavailable or when demand significantly outstrips supply. Are you aware of any supply shortages? Can you provide a product or service that will fill the gap? Have any potential customers indicated there is a genuine shortage and they would be prepared to buy from you? You can search for shortages by asking distributors, agents and retailers what they have trouble obtaining. Similarly, ask which products and services take the longest to be delivered. Listen to potential customers when they complain about products or services they cannot conveniently source. You can also look for supply shortages caused by businesses closing down or changing their priorities by reading the business news and trade publications and by investigating businesses that are in receivership. It is important to understand the causes of a shortage to ensure that you don't get caught in the same way. Having alternative suppliers in other countries may enable you to overcome a seasonal shortage or more efficient distribution channels may enable you to solve supplier issues.

Reintroducing a product or service

It is not uncommon for a good product or service to fail because of shortcomings in marketing, production methods, logistics or some other area. Some ideas could have been ahead of their time. If you can identify the problem and eliminate it, then the potential may exist to successfully reintroduce a product or service that has disappeared.

Do you know of any interesting products or services that are no longer available? Sometimes you can discover old ideas by looking through old magazines and catalogues. Or ask around to find out about any worthwhile products or services that have disappeared and why they are no longer available. Ask potential customers what they were previously able to buy and whether they would like to buy these again.

Do these products and services have the potential to become successful with changes to the marketing mix, management methods or business strategy? What kind of changes would it take and can you make them? Ask similar questions about businesses that have failed. Make sure you test the idea thoroughly because some products will have failed for very good reasons and no amount of effort will resurrect them.

Assembling a product

By setting up an assembly operation you can save customers time, effort or money. One example is assembling kits such as first aid kits or bushwalking survival kits. Another example is assembling furniture for people who are willing and happy to pay for the convenience of not having to deal with a 'flat pack'. What could you assemble that would save someone time, money or effort? Is there a market for it? Look for products for which the assembly process is cumbersome and expensive or the parts come from different locations and you are centrally located to become a convenient assembly point. Also look for products that are sold unassembled but the average person is not willing or able to follow the instructions.

Subcontracting

A subcontractor supplies a product or service that is used by another business as part of a larger offering. With the rise in outsourcing, subcontracting for services is now common. Businesses subcontract services ranging from complex technical support to routine activities such as parcel delivery and rubbish disposal. Sometimes there is an opportunity to become a secondary supplier when a large company does not want to rely on a single source of supply. What could you supply to other businesses? Contact purchasing agents in large businesses and ask them about their supply needs. What items are hard to locate, too expensive or are not delivered reliably? Check the newspapers for 'request for tender' advertisements and 'expression of interest' advertisements from organisations looking for subcontractors. Get on the mailing lists of government purchasing agencies that are required to advertise for tenders. Look through trade journals for information about supply problems in particular industries. Your goal is to identify a product or service that you can supply to other businesses as part of their overall offering.

Replacing imports

Import replacement means producing a product or service in Australia that is currently being imported from overseas. We are surrounded by all sorts of imported products that could be produced locally. Do you know of an imported item that you could produce locally? Can you match its quality and price? Can you get a cost advantage by eliminating shipping costs or tariffs? To find out what is imported into Australia subscribe to import publications and importers' catalogues. Contact purchasing agents and ask them what they are importing. Examine the products where you shop to find out where they are made. Visit the AusIndustry website (www.ausindustry.gov.au) for information about import replacement opportunities in Australia. What are your areas of expertise and how do they match up with the import replacement opportunities you have discovered? Talk to potential customers and ask them if they would be prepared to switch to a locally made item.

Exploiting abandoned markets

Exploiting abandoned markets means entering a market that has been left behind by another business. This sometimes happens because the business does not want to handle smaller orders any longer, or may be at the leading edge of technology and no longer wants to service older equipment or stock the same range of products. Other businesses may be expanding into new markets and find themselves unable to properly service their existing customers. One example of a business opportunity arising from an abandoned market is a repair service for appliances that are no longer produced. What industries or companies have made big changes as a result of new technology, new products or new ways of doing business? Have any of these changes resulted in some customers being abandoned? Are there enough customers who would continue to buy the product or service if you offered it? Make sure you know why the market was abandoned because there may have been some very good reasons for pulling out.

Becoming an agent or distributor

Agents and distributors sell the products and services of other businesses. Some businesses do not have the resources to develop and manage their own distribution channels and they look for other organisations that can fulfil this role. Other businesses simply prefer to concentrate on what they do best and outsource distribution. An *agent* contracts with producers to sell their products or services for a fee or a commission. A *distributor* buys the producers' products or services and resells them directly to consumers or wholesales them to other businesses.

Can you find producers that need the services of an agent or a distributor in your area? Can you identify a product or service that you believe you can sell directly to consumers or wholesale to other businesses? For example, have any retailers or consumers indicated the need for a product or service that you can distribute? Ask the producers of this product or service if they need someone to handle direct sales or wholesale sales. Look for new businesses that have not established their own marketing department and need marketing services. Look for producers who cannot afford to market to rural areas or specialised niche markets. Look for a producer who only wants to handle large orders but the product requires distribution in small lots. Find a group of customers or retailers who have to wait too long for delivery and will buy from you if you will carry stock for immediate delivery. Look for advertisements for agents and distributors under 'Business Opportunities' in the classified section of the newspaper.

New market opportunities

New market opportunities occur where there is the potential to sell existing products or services to new customers. The new customers may be in new geographical areas or it may be possible to service them by new distribution channels or new merchandising methods, or reach them through new or different advertising media. Since you can benefit from your own or other businesses' experience with existing products or services, new market opportunities usually involve only medium risk. Let's look at some examples of new market opportunities.

Imitating other businesses

When you observe a successful business concept consider the possibility of imitating the same idea in another place. What businesses have you seen on your travels that might work well in your own market? Have you seen any successful products or services that are not available where you live? Keep your eyes and ears open for products or services in other locations that you can introduce into your area. Talk to purchasing agents. Buy a few foreign and interstate newspapers and read the advertisements and the stories about local businesses. Check out the local *Yellow Pages* when you travel and visit some of the businesses that look interesting.

Buying a franchise

Franchising has been responsible for the spectacular growth in new market opportunities; there are now hundreds of franchise organisations and thousands of franchisees in Australia. A franchise system usually begins with a successful business at one location that is packaged so it can be duplicated in other locations. The franchisor not only provides the product or service and trademark, but also the entire business format consisting of a marketing plan and support, operating methods and manuals, training, quality control, and ongoing back-up services. In the retail sector the franchisor generally determines the inventory mix, pricing and promotional policies. Examples of products sold by franchises include auto parts, apparel, paint and hardware, electrical appliances and fast food. Franchising can also be found in such diverse service industries as motels, income tax services, business and professional services, and real estate agencies. The franchisee buys the use of the company name, the standardised operating system and sometimes a distinctive shopfront or building design. See *How to Organise and Operate a Small Business in Australia* by John English for a detailed explanation of franchising.

What kind of business could you operate as a franchisee? Have you talked with potential customers to see if they would buy the product or service? Can you buy a franchise for your area? Do your skills and experience lend themselves to this kind of franchise? You can find out about franchise systems by reading newspapers, magazines and trade journals. You can also contact franchisors directly. Visit the Franchise Council of Australia website (www.franchise.org.au) and consider attending its trade show. Keep a sharp eye out for successful franchise operations in other locations that are likely to be successful in your area. Talk to some of the franchisees and ask them what they think about the franchise system they are operating.

Importing and exporting

Importing is a source of new market opportunities in Australia. An importer brings products and services into Australia from other countries for resale to wholesalers or directly to customers. Many foreign producers are looking for local agents or distributors. The embassies of foreign countries are an excellent source of information about agency and distribution opportunities. Another source of information is the World Trade Centers Association website (www.wtca.org) or you can visit its offices in Sydney, Melbourne or Brisbane. Exporting is a source of new market opportunities in other countries. Most Australian exporters concentrate their efforts on the countries that make up the APEC region, the United States and the European Economic Community. Do you have contacts in other countries that may become distributors? Do you know of any Australian producers who need help to export their products and services?

Importing and exporting are highly specialised activities. You need to be aware of your legal obligations in both the country of origin and the destination including quarantine laws, tariffs, quotas, duties and other restrictions. You can get important information and assistance by visiting the Austrade website (www.austrade.gov.au), the AusIndustry website (www.ausindustry.gov.au) and the Australian Customs Service website (www.customs.gov.au). See *How to Organise and Operate a Small Business in Australia* by John English for more details.

Special interest groups

Adapting or tailoring a product or service to meet the needs of a special interest group can uncover a new market opportunity. A special interest group may have needs that are related to their physical characteristics such as mobility limitations or left-handedness, to their occupation or leisure pursuits, to their ethnicity such as special food requirements, or to a variety of other things. Can you find a group of people with special needs that are not being met by the marketplace? Good sources of information can be found in newspapers, magazines and research reports produced for special interest groups. Analyse the special needs of a group by studying the unique characteristics of the people involved and asking what they look for and what they have difficulty buying. Look for products and services that are either not available to the group or are not very well adapted to their needs. Look at other special interest groups with similar needs for ideas about products or services that you could adapt for your target group. Talk to members of your target group and ask them what they need and if they would buy from you.

Packaging

Packaging, repackaging or unpackaging products can be the basis for a business opportunity. For example, commodities sold in bulk may be repackaged into smaller units for individual consumers. Food sold in family-sized packages may find a new market as single serves aimed at one-person households. New regulations affecting air travellers may create a new market for mini packs of hair care and skin care products in clear containers. Alternatively, look for products that are individually packaged in small units and consider packaging them in larger units to lower the price; for example, packaging individual energy efficient light globes into house lots.

Some items can be repackaged in order to make them more attractive, more convenient, reusable or easier to store; for example, some foods are placed in resealable packaging to extend their shelf life. Other examples include bottling cleanskin wines under custom labels for restaurants or putting washing powder in dispenser packs that deliver a measured quantity and prevent waste. Look for products that are poorly packaged and think about how the packaging could be improved. Look for products that are sold without packaging and design a package that would increase sales. Look for two or more products that people generally buy or use at the same time and consider packaging them together as a single unit. Consider how unpacking or repacking might be able to address environmental concerns. What products do you think could be packaged, repackaged or unpackaged to make them more marketable? What new markets could you open up by changing the packaging for an existing product? Ask potential customers what they think about your packaging ideas.

Internet marketing

The internet is a tremendous source of new market opportunities. An internet site gives you access to markets all over the world. Sometimes the internet is more cost-effective than other marketing tools. For example, commercial artists can put their portfolio on a website and direct potential clients to it without incurring the expense of sending out an entire portfolio every time they bid for a job.

The role of a website in creating new market opportunities can vary. Some businesses have a website that is designed simply to create a marketing presence as part of an overall advertising and promotion strategy. Other businesses have a website that goes one step further by offering an online catalogue and product specifications and contact details for handling orders and customer inquiries. A complete website goes beyond general marketing and customer support to online ordering and credit card approval while the customer is online. Fully featured websites are also capable of tracking a customer’s preferences and transaction history as part of a strategy for cross promotion and on-selling.

New product or service opportunities

New product or service opportunities occur when a new product or service is developed, acquired or produced for an existing market. These may be genuine new products and services or only modest improvements. To the extent that you or others have little previous experience with a particular product or service, the risks become greater. Products and services that are totally new are very rare indeed. Instead, look for products and services that are already working in the marketplace that you can improve or expand by:

- improving quality or service
- broadening or narrowing the range of products or services offered
- improving usability, performance or safety
- changing the delivery method, packaging or unit size
- adding new features, accessories or extensions
- introducing simplifications or convenience
- simplifying repair, maintenance, replacement or cleaning
- increasing mobility, access, portability or disposability
- changing colour, material or shape
- altering size, weight or speed.

Spending a little time observing customers to see how a product or service is used may reveal opportunities for complementary services or products that can be bundled with the existing ones. Similarly, a product that is bought for its functional benefits can be transformed into a product that is sold for its aesthetic qualities in the way that budget watches were transformed from simple timepieces into fashion accessories. Let's look at some examples of product and service business opportunities.

Take advantage of switching

When customers switch from one product or service to another, additional business opportunities may also be created. For example, the switch from fixed telephone handsets to mobile phones has created a flood of add-on services and accessories such as personalised ring tones and phone covers. Can you think of any recent consumer switches that you take advantage of? Have potential customers expressed a need that is based on a market switch? You might be able to discover changes in consumer buying habits by looking at market research reports and trade association studies. You can also look for fads that are turning into permanent changes or new products that are rapidly growing in popularity. Think about changes in your own buying habits. If you think a switch has definitely occurred, look for related products or services that will complement it.

Piggybacking on growth

When the number of customers for a product or service grows, some businesses piggyback on this growth by offering additional related products or services. For example, there is a long-term trend toward personal fitness and health. Businesses offering fitness monitoring equipment, health foods and exercise apparel are piggybacking on this trend. What current trends can you identify? What products or services could you provide that fit into these trends? Have any potential customers indicated a desire to buy these products or services?

You can look for growth trends by surfing the internet and reading books, magazines and research reports on social and economic trends. Run a Google search for 'trend spotters' and see what you find. Make a list of growth trends and consider how your skills, knowledge and experience could be applied to produce a product or service that would fit into these trends. Talk to potential customers and ask them if they would purchase such a product or service.

Adding value

You add value when you buy an existing product or service and then add materials, components, processing or services. There are a number of ways to add value including putting a product through another process, combining a product with other products, offering a product as part of a package of services such as installation and maintenance, or increasing the level of service. Can you identify an existing product or service that would benefit from an additional process, more material or increased service? It may be a product or service that does not work properly or it may be unsuitable for some other reason. Locate the new elements and develop a method of adding them. Ask the target customers if they would purchase the product or service with these changes.

Improving a product or service

Improving a product or service is different from adding value. When you improve a product or service, you are creating a new product or service. The ergonomic tools designed for the building trade that help prevent repetitive strain injuries are an example. An existing product or service can be improved in different ways. For example, a product might be made bigger, smaller or more durable. Its design might be simplified so it is easier to clean. Select a product or service that interests you and analyse its strengths and weaknesses. Can you identify ways in which it could be improved? How would you make these improvements? How would it make the product or service more marketable? Can you actually produce a better product or service? Is there a market for it?

Sometimes a product can be improved by altering the material with which it is made so it becomes lighter, stronger, more flexible or cheaper to make. For example, producing fishing lures out of plastic instead of metal made them less expensive and more versatile. Products with new characteristics may appeal to a different target market. Can you think of any products that could be made with different materials? Can you think of any inferior products that could be improved with better materials? Examine existing products to determine if they might appeal to a different market by substituting materials. Alternatively, consider materials that you have in good supply and think about products that might be improved using these materials. Look for products that suffer because the materials used are too expensive or prone to big price fluctuations, difficult to use, unsafe, in short supply or produce lots of waste. Look for substitute materials that eliminate these problems.

Making new combinations

Sometimes it is possible to combine existing products or services to create a new business opportunity. One example is combining a beauty salon with a medical centre in order to offer an expanded range of beauty and cosmetic treatment services. Another example is combining the skills of several tradespeople to offer a comprehensive home maintenance and repair service. The objective is to create a combination of products or services that is more powerful than its separate parts. What combinations can you envisage? Which ones suit your skills and experience? Start with a business concept, idea, product or service that interests you. Ask yourself what could be combined with it to create something significantly better. Look for consumer groups with similar needs that could be served by combining existing products or services. Make a list of different types of businesses from the *Yellow Pages* and play with various combinations. Ask potential customers what combinations they would like to see.

Information services

One of the consequences of living in the modern world is that people are expected to process and manage an enormous amount of information. In a survey by Reuters, 49 per cent of the respondents felt they were unable to keep up with the flow of information, 43 per cent were having trouble making important decisions because of information overload, 38 per cent said they wasted valuable time trying to locate important information and 33 per cent suffered from stress-related health problems brought on by having to deal with too much information. Managing information for other people provides a huge opportunity for new businesses. Can you offer an information service providing advice, services or information in a subject area you know well? Do you have experience, knowledge or skills that you can sell to others? Do you know of potential clients that need your expertise?

Look for information service ideas in business newspapers and trade magazines, company reports and by talking directly with potential clients. Other ideas may come from the popular press, radio and television shows and community activities. The key is to identify up-to-date sources of information to which you can add value by offering a service. Examples of areas in which business customers could benefit from information services include production problems, business planning, marketing strategies, staffing issues, computer services, financial management, training, political lobbying and public relations. Examples for consumers include building and renovation planning approval processes, interior decorating, personal budgeting, purchasing major appliances, landscaping or career planning.

Radical opportunities

A radical opportunity occurs with the creation of a new product or service that is targeted at an uncontested market. It is radical because the idea is novel and it has the potential to upset the position of established products and services in the marketplace. Typically, new inventions take a long time to develop and are costly to bring to the market. The risks are extremely high but if you get it right so are the rewards. Radical opportunities require a combination of foresight and chance. Success depends on an ability to see where a new product or service might fit into a future market environment. Some radical opportunities are *pushed* by technological developments but the majority are *pulled* into existence by a market that is seeking something new. Let's look at some examples of radical business opportunities.

Inventing a new product or service

Inventing a new product or service can be the basis for an excellent business opportunity. What products or services are needed but don't exist? What customer needs could be met by a new invention? Are you familiar with any processes that you could improve by inventing a new procedure, product or service? Do you already have an idea that you could develop into an invention? Is there a market for it?

First, concentrate on products or services with which you are familiar and try to think of ideas for radical improvements. Can you think of new ways to make an existing product or service more efficient in terms of saving time, effort or money? What products and services are people asking for that do not exist? Look through magazines and research reports devoted to consumer topics and search the IPAustralia website (www.ipaustralia.gov.au) and the Google Patent Search website (www.google.com/patents) to see what has already been registered. IPAustralia can also provide you with information about how to apply for a patent for your own invention. Once a patent is granted, you have the exclusive right to produce and sell it including the right to sell a licence to someone else who wants to produce and sell it.

Buying a licence

The flip side of selling patent rights is to buy a licence to produce and market an invention patented by someone else. Is there a patent for an interesting product or service with genuine market potential that has never been produced, or has been produced but was not successfully exploited? Some patents are available under licence and there are many old patents that have expired and can be produced without a licence. A licence may be exclusive and unrestricted or it may only grant rights for a particular geographic area, a particular market or a limited period of time. Buying a licence requires specialised professional financial and legal advice.

Do a search of IPAustralia and Google Patent Search to see what you can find. Look through magazines and trade journals for articles about new product ideas and attend trade shows that feature products and services that interest you. You may also want to approach companies that hold patents on products they are not currently producing as well as venture capital organisations that know about potential opportunities. Even very old patents may have been ahead of their time and represent ideas that are marketable today.

Transferring an idea

Sometimes you can take an idea that was developed for a particular purpose and transfer it into an unrelated field. Many of the ideas that were developed for NASA's space program have been transferred into commercial products for industrial and domestic applications. There are many medical products developed for humans that have been adapted for use in veterinary practice. What successful ideas or concepts can you identify that might be transferred into another type of business, market or activity? Make a list of successful ideas that you can imagine being applied in a different setting. Alternatively, look for problems in one line of business and try to identify potential solutions from other types of businesses. Ask potential customers if they would buy a product or service resulting from the transferred idea.

Special situations

Demand for a product or service may arise spontaneously as a result of a special situation. Examples include the goods and services that were suddenly in demand as a result of the Y2K fears in the late 1990s. More recently the focus on climate change and global warming has driven the development of products such as energy-efficient light globes. What current situations might spawn a new business opportunity? What goods and services could you provide to address a market created by these situations? Pay attention to what you see and hear in the media and look for sudden changes in society, the economy, legislation, politics, the environment and business activity that leave people in unfamiliar circumstances.

Part B

IDENTIFYING A VIABLE MARKET

3 Potential demand

When you first have a new idea, you will probably be very optimistic about how it will be received in the marketplace. However, it is important that the marketplace shares your enthusiasm, so this chapter is devoted to probing potential demand. Questions about potential demand are easier to ask than to answer because you need to find out how the marketplace operates. There is always a certain amount of judgement involved when there is little in the way of objective information about the factors that are important in influencing potential demand. Nevertheless, potential demand can be examined in the early stages by looking into the general behaviour of the marketplace and how related products and services are selling. The topics in this chapter are designed to help you explore the following key questions about the potential demand for your idea:

- What is the relative size of the potential market?
- Is the potential market increasing or decreasing?
- Will the pattern of demand be stable or unstable?
- What will be the commercial sustainability of this idea?
- What possibilities exist for extending this idea into related products or services?

An objective analysis of potential demand is crucial for assessing commercial feasibility. It is easy to overestimate market size and misjudge market growth and stability. These mistakes can be commercially critical, even for a good idea. An evaluation of your idea's commercial sustainability and its potential for further extensions enables you to explore potential demand even further. We will never know how many ideas have failed because their backers did not anticipate the significance and interrelationships of the potential demand factors outlined in this chapter.

Market size

Market size is the expected annual sales to all potential customers in a target market area. The target market area might be a neighbourhood or a suburb, a town or city, a region, a state, a country or the whole world. The term *market size* is sometimes misunderstood—it is not a sales forecast. Forecasting sales requires more information than is likely to be available at this early stage. What we are looking for is information about the overall size of the market even though not every customer is going to buy from us.

Unfortunately, assessing market size is too often ignored. One argument is that trying to assess market size is futile because markets are too fickle. The proponents of this approach usually rely on their 'gut feel' or assume that other people will be similarly enraptured by their idea. Another argument is that the market is so large that estimating its size doesn't matter. Typically the rationale goes something like this: 'This market is so huge that if we get only 1 per cent of it we will make a fortune'. Even if this is true, large markets also attract large established competitors with deep pockets. It is easy to overestimate the size of the market for a new idea. While top line indicators such as population are important guides, they do not reflect market-specific issues such as regulatory or social barriers.

A good first step is to review the trends discussed in Chapter 1 with a view to anticipating their impact on the market size for your idea. Consider the information you can access:

- Demographic trends tell you how many people there are in the categories that might be interested in your product.
- Lifestyle trends may provide information about consumers' motives for purchasing your product or service.

- Social or cultural trends may also help you understand consumers' motives for purchasing your product or service.
- Technology trends foreshadow the demand for certain kinds of goods and services.
- Political and regulatory trends suggest the degree of government control involved in your idea and the effect of this on demand for it.
- Economic trends affect the demand for goods and services in general and may have a specific impact on your idea in particular.

Sales can be measured in different ways including the number of units sold per customer, the number of transactions per customer or the dollar sales per customer. The number of customers can be measured in terms of individuals, household units, business units or some other customer unit. Market size is assessed by estimating how much a typical customer would purchase in a year and multiplying it by the number of potential customers in the target market area. Here is an example of how it is done:

Step 1: What is the customer unit for this idea? *Let's say households.*

Step 2: How many households are in the target market area and what are their demographics? This information is available from the Australian Bureau of Statistics. *Let's say 10 000 households.*

Step 3: What is the average annual household consumption for this type of product? Consult the Australian Bureau of Statistics' *Household Expenditure Survey. Let's say 10 units per year.*

Step 4: What is the average price that customers are willing to pay for this product? *Let's say $30 per unit.*

Step 5: What is the market size for this product in this target market area? *10 000 households × 10 units per household per year × $30 per unit = $3 000 000 per year.*

So we have worked out that the potential market for all customers is $3 000 000 per year. If you can find information about actual sales in the target market area, then there are two more steps to help you determine if there is unexploited market potential.

Step 6: What are the actual sales for this product or service in the target market area? To determine how much of the market is currently held by competitors, try consulting the Australian Bureau of Statistics' *Census of Retail Establishments and Selected Service Establishments. Let's say $1 600 000 per year.*

Step 7: What is the unexploited market potential? To determine this deduct Step 6 from Step 5: *$3 000 000 – $1 600 000 = $1 400 000 per year.* This tells us there is $1 400 000 of unexploited market potential annually in the target market area. Whether or not this turns out to be enough market potential to warrant a start-up depends on how well the business model stacks up.

Another way to estimate market size is to use an equivalent or similar substitute. Look for information about a comparable product in the same market. Alternatively, look for information about the same product in a different market. Estimating market size by making comparisons like this works well for parallel opportunities and new market opportunities. For example, the introduction of a new idea in the UK can provide clues about market size for the same idea in Australia. Similarly, sales turnover for a franchise in Newcastle can be adjusted for differences in demographics to estimate market size in Hobart.

Estimating market size for a completely new product or service is especially difficult because there is no information about similar products in comparable locations. For a new idea to succeed, you need enough customers willing to spend enough money to provide sufficient revenue to cover expenses and make a profit. Therefore, determining how many potential customers exist and their propensity to make a purchase is an essential part of discovering if your idea is commercially feasible. There is generally information about how many customers there are but very little information available about their propensity to make a purchase. Think about what customers need, the way they will use your product or service to fill this need, the number of potential customers in the target market area and how much they are prepared to pay for it. You are looking for clear-cut answers to the following questions:

- What is the need that your product or service will satisfy? Why is this need important?
- Who will buy your product or service if you can satisfy this need?
- What price would customers be prepared to pay? This will depend on the importance of the need to them and how well your idea satisfies it.
- How many potential customers are reachable and receptive in the target market area?
- What are their likely annual purchases in units and dollars?

Evaluating the size of the market is an essential part of evaluating potential demand. Will your idea appeal to just about everybody resulting in a very large market? Perhaps it will appeal to one person in every household or business resulting in a somewhat smaller market. Or is your idea targeted at a highly specialised or limited market segment such as households with children under two years of age who do not attend regular daycare? A limited market involves more risk than a larger one because small or local markets cannot sustain high development costs or complex market research making it more difficult to launch and exploit an idea. Similarly, high promotion, distribution or service costs are not usually compatible with ideas of limited market size because higher costs and fewer potential customers make for limited profits. Nevertheless, niche business opportunities are possible in small markets. Ideas in which flexibility and innovation are at a premium, close supervision and exacting quality are essential, or custom or personalised service is required, can be fertile ground for niche business opportunities.

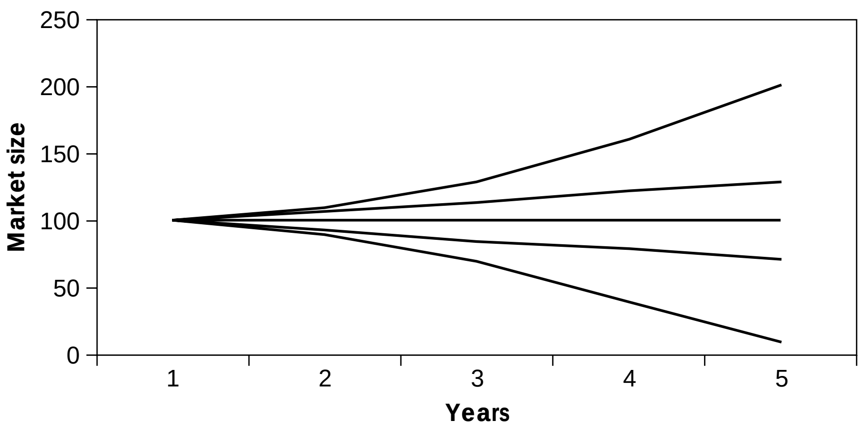
Market growth

Whereas *market size* refers to the relative potential of the current market, *market growth* refers to how market size is expected to change over the next few years. It is important to be clear about market growth because one of the biggest mistakes that new business operators make is to forecast unrealistic market growth rates. Even if substantial growth in market size is likely it does not automatically follow that you will be able to capture it.

The figure below illustrates five ways in which market growth can be characterised. The top line represents a rapidly expanding market. It is not only expanding, but the rate of growth is accelerating. This is a typical growth pattern for many technology products aimed at the domestic market such as mobile phones and DVD players. The next line also represents an expanding market, but it is taking place more slowly and the rate of growth is constant. The flat line represents a market that remains steady. It is neither increasing nor decreasing. The next line represents a slow steady decline in market size and the last line represents a market that is shrinking rapidly like the market for cassette players following the introduction of compact discs.

Over the next three to five years, do you think the market size for your idea is going to increase, remain constant or decline? An expanding market clearly implies more opportunities for new businesses and the possibility of greater financial returns. A declining market usually means the opposite. A constant market size would appear to be of low or modest risk for a new player. However, if competitors are

Figure 3.1 Market growth



a serious threat, you might struggle to capture market share unless your idea has significant competitive strength. In order to reach its fullest potential, an idea that enjoys a very large and rapidly expanding market needs to be in the hands of someone who has the expertise and the resources to fully exploit such an opportunity. It is very challenging to launch a new business in the first place and more so if you find yourself trying to keep up with a fast-growing market. Failing to meet customer orders is a sure way to lose them to the competition. If you lack the expertise or resources required, you can still profit from your idea by selling or licensing it to someone who has what it takes to capture the market and capitalise on the opportunity.

When you try to estimate market growth you face the same impediments as trying to estimate market size. For parallel business opportunities, there is usually information about existing sales and the rate of growth over time. The Australian Bureau of Statistics' *Household Expenditure Survey* and *Census of Retail Establishments and Selected Service Establishments* are two sources of information. Trade associations are another source. Much of the information about market size and growth rates in Australia is reported in magazines and newspapers. They generally quote their sources so you have an opportunity to judge the validity of the information they publish.

For new products and services or new market opportunities, estimating market growth is more complicated. Estimates can be inferred from the growth rates of comparable products or comparable markets. Alternatively, there are market research companies that specialise in end-user surveys which attempt to estimate market size and growth rates for existing products in new markets or new products in existing markets. However, this is an expensive and time-consuming process that you could easily defer until you are sure that a full-blown feasibility study is justified. For radical opportunities, an estimate of the initial market size is the critical question. Estimating the growth rate is of less importance because no one really knows until the idea is tested.

Market stability

Whereas *market size* refers to the current market and *market growth* refers to the likely future change in market size, the term *market* *stability* refers to the pattern of demand. Demand for some ideas will be relatively stable and predictable over time resulting in greater certainty about the revenue stream. For other ideas there will be variations in demand that can be foreseen with reasonable accuracy permitting forward planning for inventory and staff to cover surges and lulls. The big risks occur when demand is highly unstable and the fluctuations are unpredictable. Obviously, the ideal situation is one in which demand is highly stable and predictable. Unfortunately, this is the exception rather than the rule. Almost all products and services face fluctuations in demand to some degree. Highly unstable demand that is subject to severely unpredictable fluctuations is a risky proposition, especially for a new business or a business without other products or services to even out the revenue pattern.

A major cause of fluctuations in demand is the transition from one climatic season of the year to the next. This type of seasonality has a profound effect on businesses that sell products or services that are related to the weather. For example, a retail outlet selling barbeques will experience significantly greater sales in spring and summer resulting in an uneven revenue pattern over the year. Selling goods with complementary demand can even out revenue over the year; for example, the barbeque outlet could also sell woodstoves and fireplaces that have peak sales in winter. When seasonality is related to seasonal changes in the weather, it is usually observable and predictable.

Beyond changes in the weather, there are many man-made causes of seasonality such as religious events, cultural events, festivals and holidays which affect the businesses that depend on them. The Christmas season brings increased demand for gift items, restaurant bookings and travel services. The due date for filing tax returns creates seasonal patterns of demand for accounting services and publications on taxation. Children's shoes are stable products in which long-term variations in demand can be foreseen because birth statistics are a leading indicator of demand over several years and the seasonality of purchases, such as a peak at the beginning of the school year, is a well-established pattern.

Regular fluctuations in demand can also occur on a monthly, weekly or even hourly basis. Airlines, amusement parks, beauty salons, restaurants, car hire companies, cinemas, education centres, employment agencies, financial advisors and hotels all experience cyclical fluctuations in demand. Airlines experience fluctuations early in the morning and late in the afternoon, particularly on Mondays and Fridays. Amusement parks see increased demand on weekends and school holidays. Beauty salons experience increased demand on Fridays and Saturday mornings. A sandwich shop in an office district will have increased demand at lunchtimes on weekdays while an intimate restaurant will experience more demand in the evening on Fridays and Saturdays. Cinemas have more patrons on the weekends and on nearly all holidays. Health clubs experience demand peaks in the early morning and in the evening when most members are not working.

There are also erratic variations in demand that do not behave according to any well-defined seasonal or cyclical pattern. These are caused largely by unpredictable events such as a strike, drought, fad, threat of war or other random disturbance. Unpredictable variations sometimes occur when a large number of customers suddenly and simultaneously converge on a particular store or service provider like a supermarket or a bank. At other times customers are mysteriously absent. The important point is that some ideas are more susceptible to erratic demand instability than others.

Manufacturers can usually lessen the impact of demand instability by maintaining production at a rate equal to overall annual demand. This means production exceeds sales in the off season and inventory rises. During the busy season, sales are greater than production and inventory is sold down. This enables a manufacturer to smooth production and labour requirements associated with off-peak demand. Providers of services, however, are not so lucky. They cannot put time into inventory like products and therefore cannot even out the consequences of demand instability. This leads to more severe marketing and operational problems that not only stem from seasonal variations but are further complicated by unpredictable variations.

Sustainability

No product or service lasts forever. Some ideas have a short commercial life, whereas others enjoy a long one. An idea, like a fashion accessory, might last only a few months, compared with more than a century for the motor car. The concept of sustainability can apply to a product, a process, a service, a business, a brand, a style, a fashion or a fad. We shall illustrate the concept of sustainability using the life cycle model which characterises how a new idea moves from inspiration to exhaustion over its commercial life.

The first stage in the life cycle model is the *introduction stage.* Examples of products in the introduction stage are iris-based personal identity cards and the water stick for removing bacteria and chemicals from water. The main goal in this stage is to establish a market and build demand. Sales are usually slow until customers become aware of the new idea and its benefits. Marketing costs are typically high during this stage in order to create customer awareness and target early adopters. Similarly, the initial distribution costs are also likely to be high. High costs combined with low sales volume typically produce a period of losses and the risk of failure is high. The sooner you get through the introduction stage the better.

The next stage is the *growth stage* in which the main goals are to gain consumer preference and increase sales. Examples of products in the growth stage are third-generation mobile phones and smart cards. Sales take off as more customers become aware of the benefits but it is not usually a period of high profitability because costs are increasing as well. Getting past the break-even point is critical in order to stay in business. The growth stage is a welcome relief from the introduction stage but it is also a period of hard work, continuing stress, low returns and high risk.

The *maturity stage* is the most profitable stage in the life cycle model. The primary goals in this stage are to maintain market share, increase profitability and harvest the rewards from the idea for as long as possible. Sales increase at a slower pace and most of the marketing effort goes into encouraging competitors' customers to switch, increasing sales per customer and converting non-users into customers. Efficiency is at its peak, costs are under control and profit margins are at their best. Examples of products in the maturity stage are personal computers, credit cards and toothpaste.

The introduction stage and the growth stage are important, but the fact is they are also very high-risk stages and you want to get through them as quickly as possible. When an idea enters the maturity stage it usually generates the greatest sales and profits. This is the stage that you want to last for as long as possible and it is the key to evaluating the sustainability of a new idea. Do you think the maturity stage for your idea will last for a long time or a short time? Ideas with lasting sustainability tend to be a good base on which to launch a new business because you have more time in which to build a viable operation and a longer period in which to harvest the rewards.

Sales eventually dip in the *decline stage* as the market becomes saturated, the product or service becomes obsolete, or customer preferences change. Examples of products in the decline state are typewriters, fountain pens and phone pagers. The market is shrinking, sales are shrinking and profits are shrinking. There may be some potential to reinvent or restyle the product or service or squeeze out a bit more profit by cutting costs, but the time is near when it will have to be abandoned.

It simply does not make sense to undertake a long-term financial commitment or invest in specialised assets for an idea with limited sustainability. If you decide to base a new business opportunity on a short-lived idea, then you need to be capable of a fast entry and exit in which you gather the necessary resources quickly enough to exploit it and promptly disengage when it is time to pull out. There are many short-lived ideas that have been successful, but they require specialised marketing, and operational and financial strategies to overcome the disadvantages of a brief lifespan.

Extensions

Extensions are further business opportunities that can be derived from the initial idea. If an idea can be extended into other products or services, then it has greater commercial potential. Can you see ways in which your idea might be extended into other products or services? Here are some examples:

- Baking soda has been used for years in cooking but now it is also marketed as a cleaning product and deodoriser.

- Coca-Cola varied its traditional formula to offer Cherry Coke, Vanilla Coke, caffeine-free Coke, Diet Coke and Coke Zero.
- Drink containers have gone from glass bottles to cans to plastic bottles in order to extend into more markets.
- Velcro was originally developed for NASA's space suits but has since been widely accepted by the commercial textile industry and used in everything from shoes to cable ties.
- Digital watches have gone from inexpensive timepieces to expensive fashion items.

Ideas with a high potential for extensions reduce the risk of poor ratings for market growth or market stability. Ideas with limited potential for extensions have the greatest risk if market size is small and sustainability is short-lived. Ideas with a very high prospect for extensions are sometimes capable of spawning entirely new industries and a substantial pay-off for those involved. Microsoft is a good example in the way that Windows-based software was extended from specialist work environments into home entertainment applications.

More than half of the new products and services introduced each year are extensions of another product or service. Look at your supermarket shelves and you will see lots of new products derived from existing products or brands, such as ice-cream and biscuits based on top selling chocolate bars. Another example is the owner of a child-care centre who decided to expand her business by offering family counselling and parenting courses for her clients. There were few extra costs and the extension of her services fitted perfectly with her existing business. The benefits that come from extensions include more customers, more sales to existing customers, greater marketing efficiency, greater production efficiency, lower costs and greater profits.

If there isn't much scope for extensions and you want to go ahead anyway, then there are strategies that minimise the risk. One strategy is to outsource some aspects of your business. It is usually less expensive to contract out production for a new product (or the parts thereof) to other firms with existing manufacturing facilities. Some manufacturers specialise in short-run production or packaging for other firms. Similarly, it might make sense to outsource the marketing function as well by appointing a distributor. Another strategy is to license someone else to produce and/or distribute your product or service. What might be a marginal business opportunity for you might be a profitable add-on for someone else.

4 Market approval

In the last chapter we were concerned with establishing the potential demand for a new idea. In this chapter, we go a step further by focusing on how to anticipate if potential customers will give their approval for a new idea. The two chapters are analogous to estimating how many trout there are in a stream and how well your bait will attract them. If they like the bait, then you will catch fish. If they don't like the bait, then it doesn't matter how many trout there are in the stream. Impediments always confront new ideas. An idea may be contrary to established beliefs or habits, it may be difficult to use or understand, or the need it fills may not be of great consequence. Therefore, an important part of assessing market viability is recognising these impediments and making a judgement about their effect on market approval. This chapter explores five important impediments that could affect how the market reacts to your idea and asks the following questions:

- Does it fill a genuine need?
- Will the benefits be easy to recognise?
- Is it compatible with existing attitudes and patterns of use?
- Is it complicated to consume or use?
- Will it be difficult to establish distribution channels?

Market approval is the cumulative result of numerous judgements about the benefits of an idea. Each potential customer judges a new idea in an environment that is characterised by uncertainty and limited information. This means potential customers are taking a risk every time they try a new product or service. If they approve of an idea in the first place, then they are more likely to try it. New ideas inevitably fail if the backers become so enamoured with their idea that they fail to notice when the marketplace doesn't share their enthusiasm.

A good example of mass market approval is contained in the history of photography. The introduction of the Brownie camera by Kodak founder George Eastman in 1900 transformed photography from a technically challenging, costly, professional activity to a simple, mass market product. He did not seek market approval based on the sophistication of his new technology. Instead he showed people how simple and fun it was to take pictures. Eventually polaroid photography was introduced offering the totally new benefit of on-the-spot images. More recently, digital photography replaced polaroid photography because it is less expensive and has new features such as digital storage and image manipulation which satisfy the evolving needs of computer-savvy customers. The key to commercial success over a century of modern photography has been market approval. Every time the technology evolved, the market got a better way of satisfying people's need to take pictures. They also got new products that were easy to understand, compatible with their existing mindset, simple to use and easy to buy.

Needs and wants

It is essential that you understand the basic *needs* of your potential customers. The most basic needs include things like food, shelter, affection, esteem and self-development. These are very broad needs derived from human biology and the nature of social relationships. Defining needs more specifically leads us toward a better understanding of how need affects market approval for a specific idea.

Safety: People want to protect themselves and their property from harm.

Savings: People are not only interested in the initial purchase price, but also in saving money through less frequent replacement, lower maintenance or lower operating costs.

Health: People buy products and services such as exercise bikes, vitamins, health food, sunglasses and aerobic exercise classes to protect and maintain their health.

Status: Some people buy things in order to be recognised as part of a particular group. An individual may be more concerned with the designer's name on a handbag than with the handbag itself. A young cricketer may consider the autograph on a cricket bat equally important.

Pleasure: People hire DVDs, go to football games, eat out at restaurants and buy books to derive entertainment and pleasure.

Convenience: Many products and services are purchased to make the routine chores of life easier. Examples are take-away food, house cleaning services and car washes.

It is equally important to understand that customers with the same basic need can have different *wants*. A want is a desire for a specific product or service to satisfy the underlying need. For example, you *need* to eat when you are hungry. What you *want* to eat depends on many things such as the time of day, the foods you like and what is available. It could vary enormously from a quick hamburger, a frozen microwave meal or a five-course dinner with a bottle of pinot. Consumer wants are shaped by social and cultural forces, the media and the marketing activities of individual businesses. Some customers have more wants than others. Some customers have the same wants but in a different order of priority. And customers with the same wants and the same priorities may nevertheless have a different ability or willingness to pay.

The success of any new idea depends upon its ability to fill a genuine need in an identifiable target market. There are many types of needs such as functional needs, psychological needs, economic needs, social needs and informational needs. For example, a plasma television system includes a number of functional features and benefits that are aimed at meeting the needs of television viewers:

- Large screen size offers greater detail and allows more distant viewing.

- Greater screen resolution provides clearer, and more realistic pictures.
- Surround sound immerses all of the senses in the viewing experience.
- A remote control allows for greater convenience while viewing.

Various needs have different degrees of importance ranging from essential to non-essential. For example, a home security system may fill an essential psychological need—the need to feel safe. A non-essential psychological need might be something like the need to spend a day at a beauty spa. The best ideas fill an essential need that is also highly valued, such as a baby capsule for mum's car. Other ideas may fill a need, but not necessarily one that is highly valued. And some ideas fill no needs and are simply trivial novelties that are easily forgotten.

Businesses do not create customer needs, nor do they create the social systems by which customer needs are influenced. Successful businesses, however, have an intimate understanding of what these needs are and how they can meet them. Sometimes customers cannot tell you exactly what it is they need and you will have to uncover it. At other times, customers may not even be aware of what they need and you will be faced with investing time and effort in helping them to recognise it. Ensuring that your idea meets a genuine need means doing your homework to discover that need and to find out what features and benefits customers really want to buy.

Creating a product or service that offers real benefits and tangible value means that it is fully aligned with the needs and wants of the customer. For example, global positioning systems (GPS) are aimed at the need to know where we are and where we are going. However, there are different GPS products to meet different wants. A farmer wants to steer a tractor so it ploughs in straight lines and reduces overlap when spraying. A taxi dispatcher wants to find the location of taxicabs to determine which is closest to a fare. A private car owner wants to avoid getting lost in unfamiliar territory.

A want does not become a sale unless the customer has the ability and willingness to pay for it. The farmer is typical of professional GPS users like surveyors, agronomists and professional mariners. They are prepared to pay for precision, flexibility and optimum performance to maximise their productivity. The taxi dispatcher doesn't want the same precision and is more interested in a cost-effective GPS with specific coverage so they can quickly match up the closest taxi to a customer. The car owner wants an inexpensive system that is easy to use and includes maps and navigation for any city in which they must drive. There is no GPS that meets all of these wants. Indeed, the products that meet each of their wants differ substantially according to which features and benefits each customer values most.

People have different shopping styles. There is a method used in retailing that identifies the needs that lead people to shop in different ways. It characterises customers according to the way they approach shopping in order to create an environment that will attract them. 'Economic' shoppers look for value and they are attracted by price, quality, a wide selection and an efficient operation. 'Personal' shoppers have plenty of time. They are attracted by individual attention and a warm personal relationship. 'Indifferent' shoppers are on a mission; they see shopping as a necessary nuisance and try to make it as quick and convenient as possible. They are attracted by location, parking and store hours. 'Recreational' shoppers enjoy shopping as a leisure-time activity. They are attracted by things that entertain them such as fashion shows, cooking demonstrations, attractive displays and innovative merchandising techniques. Market approval in retailing depends upon the relative value placed on each shopping style. Since these elements can be controlled or modified, retailers can focus their efforts on meeting the needs that customers value most.

Recognition

The advantages, features and benefits of a new idea have to be recognised and understood by potential customers before it will gain their approval. The cost and effort required to explain the advantages, features and benefits vary substantially from one idea to another. Will potential customers find your idea easy to understand? Can they try it out before committing themselves? Can they observe its performance before they buy it? Can it be compared with something similar with which they may have had a good or bad experience?

Are the advantages, features and benefits of your idea obvious and easily recognised? Are they only moderately evident requiring some explanation? Or are they rather obscure and likely to be difficult to explain? The implications are fairly obvious. Because obscure features and benefits are difficult and costly to communicate, the risk of not achieving market approval is higher. If you are contemplating an idea with less obvious benefits, think carefully about the marketing effort required to gain recognition. High recognition is not a guarantee of success, but it is an indication that introducing a new idea will be less costly and faster. Genuine need, compatibility and simplicity are elements that are related to high recognition. Conversely, limited need, incompatibility and complexity are related to low recognition and greater difficulty in gaining market approval.

Recognition is also about how you position your idea in the minds of your potential customers. People are bombarded with information about new products and services and they cope with this by shutting out things that are inconsistent with their prior knowledge or experience. That is why recognition depends so much on how well your idea aligns with their attitudes and beliefs. For example, the name you choose for an idea can be a critical factor in affecting potential customers' perceptions about it. You need a memorable name that conjures up images that help to position your idea in the minds of your customers. For example, names like 'DieHard' for a battery, 'Head & Shoulders' for a dandruff shampoo, 'Close-Up' for a toothpaste and 'People' for a gossip magazine project an image that is easy to recognise.

Compatibility

A dangerous assumption about any new idea is that it is so compelling that it will sell itself. People may reject a new idea for any number of irrational reasons such as 'I can't be bothered' or 'I'm fine the way I am'. They hold onto old habits and inefficient or outdated ways simply because they are not motivated to change. Other factors like emotion and culture can also enter the equation. An idea that is incompatible with the existing attitudes, perceptions and habits of those who will either purchase or use it will find difficulty gaining market approval. An idea that is consistent with existing attitudes and beliefs will have a larger market, faster market penetration and a lower cost of introduction.

How compatible is your idea with existing attitudes or methods of use? Is it highly compatible, giving market approval a strong boost? Is it moderately compatible, at least in the sense that there will be no negative effects? Or is it incompatible in ways that could block market approval altogether? Here are a few questions to test your idea for its compatibility with your intended customers:

- What is the old way of doing things?
- What will potential customers think is the relative advantage of the idea?
- Is it consistent with their values and experiences?
- Are they locked into existing ways of doing things, perhaps emotionally, financially, contractually or by their training?
- Does the idea require a change in their behaviour?
- Does the idea go against their social or cultural norms or practices?
- Does the idea deny them the ability to make important choices of their own?

Every new idea is a substitute for an older one. Customers are generally comfortable with existing products or services because they already know and understand them. Once formed, attitudes and beliefs are difficult to change. In other words, people deal with new ideas on the basis of their understanding of the familiar. If an idea diverges from existing attitudes or beliefs, market approval will be more difficult. For example, consider a new instant version of a conventional food that offers convenient storage and speedy preparation. It may fail to gain market approval if consumers assume that an instant version of their favourite food is going to taste different, contain too many preservatives or be short on nutrition.

There is also an important trade-off between compatibility and the benefits of innovation when assessing market approval. Compatibility is the way in which an idea is consistent with existing values, past experiences and perceived needs. Innovation is the way in which a new idea diverges from a previous solution to a problem and offers a better one. Even though an innovation may represent a major improvement, it can put an idea outside the normal expectations of potential buyers. The trade-off is between an idea that represents incremental change thereby maximising compatibility versus an idea for radical change that maximises the benefits of innovation. If the expectations, attitudes and beliefs of potential customers are entrenched then it is important to protect compatibility in order to maintain market approval. If, however, your idea is a radical innovation that also has universal appeal then market approval should not be significantly affected by compatibility issues.

Overlooking compatibility issues is more likely to happen if you are technically oriented and focused on the idea rather than customer oriented and focused on how customers are likely to respond to it. An idea with low compatibility requires more sophisticated marketing skills and substantial financial resources. It increases the cost and the length of the introduction period because more advertising, personal selling and other forms of communication are required to persuade potential customers to accept the idea. An idea with high compatibility is more likely to avoid customer resistance making it much easier to gain market approval.

Complexity

Complexity refers to whether a new product or service is difficult to use or consume. The amount of learning needed to use a new product directly affects market approval. The more complicated an idea, the more customers have to learn; the more customers have to learn, the more difficult it is to gain their approval. Complexity introduces an element of risk in the customer's mind. This is especially true of high-technology ideas. The technological sophistication of these products is often ahead of the technological knowledge of the people who are meant to use them. They develop a fear of the technology because they cannot understand it and they cannot make it work. Complexity not only affects ordinary consumers but industrial, commercial and government buyers as well.

It is not always easy to appreciate complexity from a customer's perspective, especially if your frame of reference is an inventor's perspective or an ideal laboratory situation. Anticipating the amount of effort needed to overcome complexity usually requires testing the new product or service by people who represent ordinary customers. What amount of effort will it take potential customers to learn to use or consume your idea? Will it be very low with virtually no learning needed? Will it be moderate so that a small amount of instruction will be enough for most users? Or will it be very high, requiring concentrated instruction or training? For example, when personal computers first became available market approval was poor. They were bought by only a few people who had the technical expertise to operate them. When less technically proficient buyers tried to use them, they were frustrated by the things they had to learn about the hardware, the operating systems and the application software. Now market approval has soared because personal computers have become more standardised, less complex from a customer's perspective and easier to use.

Complexity is increased if the process of making a purchase decision is also complicated. Some purchase decisions are more difficult than others and require more effort. Buying a mobile phone, for example, requires more effort and consideration than buying a new CD by your favourite band. Choosing between mobile phones with their different performance options, different sales packages and plans, and different facilities for integrating other products can be difficult and confusing. If a purchase is not too important to a customer then neither is the buying decision. It becomes more difficult, however, when the purchase is important and the customer has little or no previous experience in making the buying decision required. They are likely to engage in prolonged information gathering giving them numerous opportunities to defer or abandon the purchase decision because it is all too hard.

It might first appear that business customers face the same situation as ordinary consumers, but the nature of the business market is a little different. In the consumer market, purchase decisions are largely made by a single person. In the business market the purchase decision is usually made by several people. These include the buyer who is responsible for placing the order, the decider who has the power to authorise the purchase, the influencer who has the ability to affect what is ordered and the user who will actually use the product or service when it is delivered. To the extent that any one of these people looks upon the purchase decision as important, they will spend considerably more time and effort trying to evaluate it. If the purchase decision is not only important but also complex, then getting the various parties aligned in order to secure an order adds an extra degree of difficulty in gaining market approval.

Distribution

How you deliver your product or service to your customers will depend on the distribution channel you select. Your product or service needs to be located where customers can see it and buy it. This is why access to distribution is an important issue in gaining market approval. You can distribute directly to your customers or you can distribute through intermediaries. The right choice depends on the nature of your idea, the size and proximity of your market, the bargaining power of channel intermediaries and the costs involved. There are a variety of distribution channels and you need to find the one that best matches your idea with your intended customers.

A highly complex product or service in the early stages of its life cycle, or that requires lots of support, is usually a good candidate for direct distribution because it enables you to maintain contact with your customers. If you are targeting a niche market in which your customers are concentrated geographically, then direct distribution is also a good option because you don't need intermediaries. Being able to do your own distribution means you do not have to give up a slice of your profit margin to pay someone else to distribute for you. New business ideas that provide services are very close to the end user and logically call for direct distribution.

Alternatively, there may be intermediaries that are able to add more value to your idea than you can alone. They can bridge the physical separation between your business and the final customer so that your product is available at the right time and the right place. As well as physical distribution, distributors may also supply promotional programs or extra services such as extending credit. In the case of manufactured consumer goods, for example, a product is made by a manufacturer and then sold to selected wholesalers who are closer to individual markets. The wholesalers distribute the product to retailers in their respective areas. The retailers add advertising and promotion to the mix and offer the product for sale to the final consumers. Another example of value added by a distributor is a weight loss program based on a meal replacement product which uses pharmacies as a distribution channel. It is easier and less expensive to reach customers via the pharmacies than it is to create a network of weight loss centres from scratch. Moreover, pharmacists are knowledgeable about health and wellbeing issues so weight conscious customers are likely to be comfortable asking them for information and advice.

Selecting a distribution channel involves understanding how your customers want to make a purchase and choosing a channel that effectively intercepts them. An *exclusive* distribution channel grants sole rights to a wholesaler or retailer for their market area, like an automobile dealership. This limits the number of outlets carrying your product or service but it also enables you to keep fairly tight control over promotion and service. *Selective* distribution channels provide more than one outlet in a market area but the number of outlets is restricted. Some women's clothing labels, for example, are found in only a few shops, suggesting quality without the restrictions of exclusivity. *Intensive* distribution channels try to make a product available in as many places as possible. This is called *mass marketing* and lends itself to convenience goods or impulse goods such as confectionary. A low-price, high-volume idea usually calls for an intensive distribution network, whereas a big-ticket item that is purchased infrequently usually calls for more exclusive distribution and direct selling. Some ideas may need more than one distribution channel to serve different types of customers. For example, premium brand hair products sold in elite hair salons are also sold in selected retail outlets for customers who do not patronise salons.

The difficulty and cost of establishing distribution channels have a direct effect on achieving market approval. Will the optimal distribution channel for getting your idea in front of your customers be simple and inexpensive or complicated and costly? It might be tempting to think that mass merchandisers are the best channel to distribute consumer goods because they reach the largest number of people. Over time this may be the case, but mass merchandisers are not always the best distribution channel unless an idea has high recognition, high compatibility and low complexity. Sometimes a better strategy is to enter the market through more selective distribution channels in which volume requirements are lower and promotion is less expensive.

Choosing and organising distribution channels involve a number of important questions. Exactly where will customers expect to find your product or service? Who in the existing distribution channels is already dealing with your customers? How many stages must your product or service go through before it gets to the end user? What sort of mark-ups will you have to give away at each stage and will there be enough profit left for you? How much technical support, promotion or training will you need to provide? What are your competitors doing and does that tell you anything about your distribution choices? How will you be sure that everyone in the chain of distribution is going to be happy with the arrangements and give you their best effort?

Using the internet as a distribution channel offers many advantages. The internet is part of a movement toward disintermediation, or the shortening of distribution channels, by going directly to customers who were previously serviced by intermediaries. A pure internet retail business offers the benefits of direct distribution and control over promotion, support and service. Direct distribution on the internet also means you don't need to give away mark-ups in order to achieve sales and avoids the need for costly bricks-and-mortar retail space. One disadvantage is that some customers don't trust virtual businesses. Business customers in particular may have policies in which they deal only with suppliers who have a physical presence. Secure and effective websites also take time and money to build and require considerable research to ensure that customers can find you.

5 Competitive strength

In the first instance, competitive strength is driven by one of two core strategies. The first is a strategy in which customers are willing to pay a premium for an exceptional product or service that offers superior benefits. The second is a strategy in which a common product or service is produced at the lowest cost and can therefore be sold at the lowest price. Each strategy represents a different approach to achieving sustainable profit margins in the face of competition. Your ability to negotiate with customers and suppliers also affects your capacity to maintain control over profitability. This chapter examines your idea's competitive strength by focusing on the following questions:

- How is your idea different from related products or services?
- Do customers recognise the value of your idea compared with alternative products or services?
- How vulnerable is your idea to the negotiating leverage of your customers?
- How vulnerable is your idea to the negotiating leverage of your suppliers?
- How vulnerable is your idea to competition?

Differentiation and value are the two most important drivers underpinning a competitive strategy. Your negotiating leverage with customers and suppliers also determines how securely you can establish your idea in the marketplace. And your capacity to stand up to direct and indirect competition will make a major difference to your long-term success. It takes more than just a good idea to create a successful business. In order to create a strong competitive position, the marketplace must not only believe that your idea represents genuine usefulness and value, but it also needs to be capable of achieving traction in a crowded market environment.

Differentiation

You create competitive strength when your idea is different from what competitors are offering and the difference represents something of value to your customers. The contribution that differentiation makes to competitive strength depends on the extent to which your idea offers features, benefits or performance that satisfies the need or solves the problem better than the alternatives. You can also differentiate an idea in the way you distribute it. Selecting a distribution channel that gives customers easier, more convenient, less disruptive or less time-consuming access to your offering will differentiate you from your competitors. Here are a number of other ways in which an idea might be differentiated:

- **Features:** When you supplement basic functions or offer optional extras.
- **Quality:** When you enhance quality at an equivalent price.
- **Performance:** When you give better performance at an equivalent price.
- **Compliance:** When you meet and exceed the standards required.
- **Durability:** When your products or services last longer than the equivalent.
- **Reliability:** When your company or product consistently performs according to or beyond expectations.
- **Repairability:** When your products are easier to fix or to obtain replacement parts.
- **Style:** When your product looks and feels superior, including packaging.
- **Service:** When your business provides exceptional speed, accuracy, care or responsibility.

- **Simplicity:** When your products are easy to purchase, install or use.

How will your idea measure up to the alternatives? Are prospective customers going to look upon your idea as being superior, about the same, or inferior to alternative products or services? What criteria will they use to decide if your idea is better than what they currently buy? Will your idea cost less than they pay now? Will your idea make their life easier? Will your idea give them prestige or social standing? Is your idea simpler and quicker to use? Will your idea offer immediate benefits rather than making them wait? Clear-cut differentiation means that your idea is not only going to be different but also superior in some way—better, faster, cheaper, etc.—to whatever is currently offered. Little or no differentiation means that an idea is not likely to fulfil its purpose any better than the alternatives. The vast majority of undifferentiated or 'me-too' ideas fail, especially when they can be easily compared with the alternatives.

Prospective customers will compare what they can get from you with what they are getting now. To attract them, you need to offer something better. It can be anything the customer values such as a better location, a better product, better service, better technology or exclusive access. Whatever it is, there must be something about your idea that makes it distinctive, different and competitively superior to the alternatives. How does your idea differ in the customer's mind? Saying things like 'better quality' or 'new technology' is not enough because these terms don't describe the benefits that customers value. Focus on unique features and benefits that directly address the purchase decision. If you have more outlets, better parking, easier financing or quicker service for example, consider these as important differentiators. A strong distinguishing feature for a service-based idea is a customer service strategy that is more responsive than the competition.

There is a trade-off, however, between differentiation and compatibility. Differentiating your idea separates you from your competitors when the market recognises that you deliver unique benefits. But sometimes you can be too different. If your idea represents a totally new concept, it may be so incompatible with existing attitudes and beliefs that customers will not be able to make a comparison or they will reject it. For example, many people assume that electric cars are not real cars because they do not have the same range as traditional cars. In fact, they are not called 'cars'; they are called 'electric vehicles' or EVs. They are so different that they only attract buyers who are looking for a unique driving technology that helps the environment. EVs represent a product category that has differentiation written all over it, from the name of the product to the reasons why people buy it, but in this case differentiation is limiting competitive strength rather than promoting it.

Another important issue is how to protect an idea from being copied if it is genuinely unique or novel. You have a legal right to benefit from an idea that you have created. Examples of intellectual property protection include patents, design registration and copyright. In general, intellectual property protection is more important when the cost of development and testing is very high and the cost of copying is relatively low. A classic example is the drug industry in which development, trials and approval processes take many years and cost hundreds of millions of dollars. Intellectual property protection is also very important when the risk of competition is high. A short commercial life reduces the importance of intellectual property protection because the idea is likely to have run its course by the time competitors are ready to jump on the bandwagon. The same is true of ideas with limited market potential because competitors are less likely to be attracted to a small market. The lack of meaningful legal or other protection does not necessarily bar the development of a highly differentiated idea. However, in situations in which no protection is possible, you should consider carefully the risks involved before making a commitment.

Value

Value is what a customer believes to be the benefits of your idea compared with its cost. The first thing customers do when they hear about a new product or service is to compare it with the alternatives. They will buy from you if they think the value of your idea is greater than the value provided by others. Essentially, good value means the same benefits at a lower cost or greater benefits at the same cost. Cost is not just the price but also non-financial costs such as wasted time, confusion, inconvenience or unease about making a mistake. Benefits are solutions to problems such as saving money, ease of use, superior quality, greater pleasure, improved health, more fun or better convenience. Some ideas have *functional value* because they solve material problems and provide tangible benefits. Some ideas have *symbolic value* because they enhance a person's self-image, ego identification or social connections. And some ideas have *experiential value* because they provide sensory or mental stimulation.

Price is obviously a key consideration because it represents the hard cash that customers must give up in order to enjoy the benefits of a new product or service. Sometimes price has a tremendous influence on demand, but at other times it does not, so it is important to understand how the market views it. Occasionally, price itself is used as an indicator of quality and some people will pay a higher price to get the best quality, especially if they cannot easily tell the difference between products. Don't misinterpret the role price plays in creating competitive strength: it is a mistake to believe that a new idea will be widely adopted if only the price is low enough. Price reductions alone do not guarantee market approval.

Perceptions about value are dictated by the nature of the market in which a new product or service is sold. Perceived value in a very competitive market, or a market in which customers view price as a constraint, will be more sensitive than perceived value in a non-competitive market or a market in which customers use price as an indicator of quality. Let's return to our example of the electric vehicle. At the end of the 1800s there were fleets of electric taxis roaming the streets of New York and they were the dominant automotive technology before they were replaced by more expensive internal combustion vehicles. Even though it was less expensive, the electric car failed as a *value proposition*, because it didn't have the range or the power to take people out of the city for a drive in the countryside.

Unless customers believe that an idea solves their problem, they will either look for something equivalent at a lower price or something better at the same price. Your goal is to plan your idea around the features and benefits that customers value most so your new product or service becomes the 'go to' solution for their problem. Understanding what your customers value and what you can do to increase or enhance that feature or benefit will enable you to maximise competitive strength. Research has shown the following to be the top value drivers in today's market:

Differentiation: If you are not going to be the lowest cost producer and therefore the price leader then you need to add value through differentiation. Make sure the value you add represents value your customers want to pay for.

Service: Genuine customer service is so uncommon that customers will pay extra for it. Exceed their expectations and they will be your loyal customers forever.

Quality: Customers expect quality but the reality is they don't often get it. Design quality into your operation and exploit it in your marketing.

Convenience: What can you do to make your offer easily accessible? Look for all the ways in which you can make doing business with you as easy as possible.

Responsiveness: Don't make customers wait, whether it is in a physical queue, on hold, on-line or on back order. Responsiveness equals fewer hassles for customers with no time to waste.

Technology: Technology is your partner in business. Look for tools that increase responsiveness, add convenience, increase productivity and enable you to deliver exceptional customer service.

There is an emerging trend among some contemporary consumers to place value on knowledge, authenticity and fulfilment. These consumers are increasingly inquisitive, demanding to know the origin of the things they buy. They want to know how, when and where their coffee was grown, harvested, processed, packaged, transported and sold. They want to know where the wool in a garment was grown, where it was turned into fabric, who designed the garment, where it was made and that no workers were exploited in the process. Consumers want to be connoisseurs about the goods and services they buy and they are demanding the 'story' behind how they are produced and sold. They want engaging, exclusive, emotional, personal experiences and sometimes the quest for knowledge is more important than the product or service itself. These contemporary consumers define value in their own terms and they look for goods and services that fulfil their need for intrinsic experiences.

Customer negotiating leverage

Customers who are in a position to negotiate for a lower price or for more features at the same price diminish your competitive strength. Price concessions decrease your revenue, more features increase your costs and both reduce your profits. If customers are not in a position to negotiate for lower prices or for more features at the same price, then generating and protecting healthy profit margins is more straightforward. How much negotiating leverage do your customers have? If their negotiating leverage is weak then you will enjoy substantial competitive strength. If you are vulnerable to their negotiating leverage then it will diminish your competitive strength.

Customers' negotiating leverage can be driven by a variety of factors:

- **Customer concentration:** If you have many competitors and there are more sellers than customers then there will be pressure to reduce prices or offer additional services. If there are only a few competitors then you will not experience the same pressure.
- **Relative importance:** Your customers will negotiate harder if the cost of your product or service (in terms of price or volume) represents a significant part of their spending or if it is of strategic importance to them. If it is not a big item in their budget or an important item in their operation then they are not going to invest as much time and effort trying to negotiate.
- **Differentiation:** If your product or service is not genuinely different from alternatives or substitutes, or if customers are

not concerned about differences in features or quality, they will buy from any seller and insist on price concessions to buy from you. If your product or service is unique and represents genuine value then customers have no alternative but to buy from you.

- **Switching costs:** Customers who can switch from one supplier to another without incurring extra costs have greater negotiating leverage. High switching costs make it expensive to switch to you, but it also makes it expensive for customers to switch away from you.
- **Information:** The more information customers have about competitive prices, costs, features and negotiating strategies, the more leverage they have over suppliers. The less information they have, the less negotiating leverage they have when making a purchase. Similarly, if information about competing products or services is not directly comparable or if features are bundled, customers have less information with which to negotiate.
- **High fixed costs:** If you have high fixed costs then you will be anxious to make every sale in order to reach your break-even point. That gives negotiating leverage to your customer. If your cost structure consists of low fixed costs and mostly variable costs then you will not be under the same pressure to make every sale.
- **Direct competition:** If your customers can easily produce the same product or service themselves then any threat to do so means they have greater negotiating leverage. If they cannot easily do so, then your position is stronger.

If your competitive position is weak there are steps you can take to improve it. Partner with another business that has more negotiating leverage with your customers. Improve your capacity to manage the supply chain, including the removal of powerful intermediaries, by going directly to the customer. Look for ways to increase loyalty among customers such as incentives for introducing new customers. Try to move the purchase decision away from price and onto other things the customer values.

Supplier negotiating leverage

If suppliers are in a strong position to dictate the price, quality or availability of the inputs you need for your business then they diminish your competitive strength because it leads to higher costs and reduced profits. If suppliers do not have much negotiating leverage then you have greater competitive strength and you can exercise more control and achieve lower costs. Being the lowest cost producer is an important competitive advantage, especially if your product or service is not a great deal different from your competitors. How much negotiating leverage do your suppliers have? Is their negotiating leverage weak giving you strong control over your inputs or will you be vulnerable to their negotiating leverage leaving you with little control over your inputs?

Supplier negotiating leverage can be driven by a number of factors:

- **Supplier concentration:** If there are only a few suppliers then they will have greater negotiating leverage to increase prices or decrease quality and ancillary services. If, however, there are many suppliers or the source of supply is fragmented then you will find it easier to negotiate the terms of purchase.
- **Alternatives:** Suppliers have greater negotiating leverage if the product or service they provide is highly differentiated, if quality is crucial or if there are no suitable substitutes. You have greater negotiating leverage if what you need is essentially a commodity for which there are many alternatives or substitutes.
- **Volume:** Suppliers have greater negotiating leverage if your purchases are not significant relative to their total sales, or if you are not a key customer or you do not belong to a key customer buying group. If your business is large or otherwise important to them, then you have more scope to negotiate harder.
- **Switching costs:** A supplier has greater negotiating leverage if it is costly for you to switch to another supplier. You have greater negotiating leverage if switching suppliers can be done without much extra cost or inconvenience.
- **Savings:** Suppliers have negotiating leverage over non-price

elements like delivery or quality if you are dependent on them for significant cost savings. If their pricing is no different from their competitors, then you are in the driver's seat.

- **Information:** The less information you have about competitive prices, costs, features and negotiating strategies the more negotiating leverage your supplier has over you. Similarly, the more information they have about your business the more negotiating leverage they have over you. The more information you have about your supplier, and the less information they have about you, the more negotiating leverage you will have.
- **Direct competition:** If your supplier can easily produce the same product or service that you produce, then any threat to do so diminishes your negotiating leverage. This is especially critical if a supplier can achieve significant margins or economies of scale in this way. If they cannot extend their activities to compete with you then your negotiating position is stronger.

If your competitive position with a supplier is weak, there are steps you can take to improve it. You can partner with another business or a purchasing group that has greater negotiating leverage with your suppliers. You can improve your capacity to manage the supply chain, including the removal of powerful intermediaries, by going directly to the source of supply such as importing directly from an overseas supplier rather than purchasing through a local distributor. Look for ways to increase the dependency of suppliers on your business and try to learn as much as you can about suppliers' costs and methods. Occasionally, it might be worthwhile considering whether you should expand your business to include wholesale supply of the products you use in your own operation or simply buy out the supplier.

Competitors

Analysing your competitors will challenge the comforting feeling that everything about your idea is new and different. There is rarely a business opportunity in which there will be no competitors. If you believe that you have no competitors, then ask yourself why no one else has bothered to pursue your idea.

Direct competitors are firms that sell the same or similar products or services and *indirect* competitors are those who sell something that could act as a substitute, such as the way VoIP technology is challenging traditional telephone services. You need to identify who your potential competitors are, determine what threats they pose to your idea and find out as much as you can about their strengths and weaknesses. First, look for published information such as product brochures, press releases, annual reports and websites. Second, observe your competitors through their advertising, promotion, direct selling, pricing and trade shows. And last, look for opportunities to ask suppliers, distributors, customers or former employees about your competition. Understanding your competitors' business gives you an insight into how they operate and how you can compete with them.

Competition affects the relative risk and difficulty of pursuing a business opportunity. If the market is already highly competitive, then you need to be able to identify significant competitive strength in your idea. In contrast, business opportunities that face weak competition might be able to capture a dominant market position relatively early. Weak competition, however, does not automatically ensure easy market entry because other requirements such as distribution or regulation could become impediments. How vulnerable will your idea be to competitors? Will it be highly vulnerable making market entry costly and difficult? Or will it be relatively impervious to competitors making market entry comparatively easy and less expensive?

The following conditions make it more likely that your idea will face *direct* competition:

- Sales required for profitable operations are low.
- Product or service differentiation is low.
- Capital requirements are low.
- Customer brand loyalty is low.
- It is difficult to protect intellectual property with patents or licences.
- Important resources, such as qualified expert staff, are in plentiful supply.
- Potential control over raw materials is low.

- Ability to control distribution channels is low.
- Switching costs for customers are low.
- Government or legal barriers are low.

The opposite of any of these conditions creates barriers for new competition and extends the period during which your idea might be able to harvest profits. Moderate competition may not be a major concern for established and experienced firms, but it is generally a big concern for new or inexperienced ones.

Over the long run a large threat also comes from non-traditional competitors with different skills and resources. A threat from *indirect* competitors exists if they can offer a substitute product or service that meets the customer's requirements at a lower price or with better performance. For example, a motel room does not offer the same amenities as a five-star hotel, but it is a good substitute for customers who basically want an inexpensive bed for the night. As with direct competitors, the following conditions make the threat of substitutes greater:

- Customers' brand loyalty is low.
- Customers' propensity to substitute is high.
- Close customer relationships do not exist.
- Switching costs for customers are low.
- The price is the same or lower.

Irrespective of whether competition is direct or indirect, the following conditions are likely to make competition more intense:

- There are many equally positioned competitors chasing the same customers.
- Competitors have essentially the same marketing strategy.
- There is not much differentiation between competitors' products or services leading to intense price competition.
- Switching costs for buyers are low.
- There is not much growth in the market and the growth of one competitor can only be at the expense of another.
- High fixed costs, such as expensive or specialised equipment, make it impossible to get out of business without incurring unacceptable losses.

If your competitive strength is threatened by tough competitors then there are several things to consider. To discourage others from entering the market, you might be able to position your product or service to create better brand loyalty, rely on intellectual property protection or seek strategic alliances with distributors of similar products or services. To reduce the threat of substitutes, you might be able to increase switching costs, seek strategic alliances with the distributors of substitutes or reposition your product or service away from the substitute and emphasise the differences. To minimise the rivalry between yourself and your competitors try to avoid price competition, look for different customer segments or consider if it makes sense to buy out a competitor.

Part C

ANTICIPATING THE RISKS

6 Boundary risks

Boundary risks restrict the commercial potential of an idea because they limit the ways in which it can be exploited. Boundary risks are pervasive and they are often beyond our control. The objective of this chapter is to identify boundary risks that may affect your idea and determine if they represent a threat. You not only need to know what boundary risks affect your idea currently but also how they may evolve in the future. Looking into the future takes a little insight because it has to be intuitive and the information available to you is usually incomplete, unconnected or ambiguous. The topics in this chapter are designed to help you explore five important boundary risks:

- **Regulatory risk:** Does your idea meet legal, safety and other regulatory requirements?
- **Technology risk:** Is your idea vulnerable to changes in technology?
- **Environmental risk:** Does your idea have an effect on the environment?
- **Socio-economic risk:** Is your idea constrained by social or economic forces?
- **Dependence risk:** Will sales of your product or service depend on something that is beyond your control?

Regulatory risk is not just concerned with the law, but also includes other forms of regulation and standards as well. Technology risk is the way in which technological change may challenge the competitive position of an idea. Environmental risk and socio-economic risk require somewhat more probing because they generally reflect subtle perceptions and expectations about an idea more than its reality. Dependence risk refers to a limitation on the sales of a product or service because it depends on the purchase of another product or service first, or it needs the approval of a gatekeeper.

There is very little that you can do to change the nature of boundary risks, but you can position your idea to minimise their effect. Your task is to recognise which boundary risks apply to your idea and how, either individually or in combination, they will affect the commercial potential of your idea. You must then decide how to deal with the ones you can manage, and determine if you are prepared to live with the ones you cannot control.

Regulatory risk

There are regulations covering nearly every aspect of business including competition, financial transactions, health, safety, conservation of the environment and more. Broadly defined, regulation not only includes legal restrictions imposed by all levels of government but also restrictions imposed by government agencies like the Therapeutic Goods Administration and non-government agencies like Standards Australia, and rules imposed by industry associations like the Motor Traders Association. Regulatory risk is the danger that laws and other external requirements will have a material impact on the commercial potential of your idea. The risks from regulation are increasing, particularly with the trend towards a more intrusive, more comprehensive and more prescriptive approach by regulators. Can you comply with the laws, standards, and other regulations that apply to your idea? If your idea does not meet regulatory requirements then how can this be resolved?

Laws or regulations made by governments or other regulatory bodies can significantly increase the cost of operating a business, reduce the attractiveness of making the investment or change the competitive strength of your idea. Regulatory risk is the greatest external threat to new business opportunities. Most of us accept the need for rules to govern how businesses operate and we are accustomed to working within regulatory constraints. However, the costs and complexity of compliance have risen sharply. So have the penalties, both direct and indirect, of not complying. Anticipating regulatory conditions, interpreting them correctly and knowing how they are implemented has become a key challenge. Regulatory risk is difficult to monitor because the number and variety of laws and regulations can be overwhelming, and their complexity often makes it impossible to interpret them without costly legal advice. Sometimes it is simply not worth the cost or the effort, so you need to ask yourself a few questions:

- Can you cope with increasing regulatory complexity, new and tightened regulations, and stricter enforcement?
- Can you afford the money you will have to spend on compliance?
- Can you afford the penalties that a regulator will impose on you if you make a mistake?
- How badly will your reputation be damaged if you fail to comply with regulatory requirements?

Two regulatory issues that are important in the early stages of a new business opportunity are standards and intellectual property. Standards include things like performance standards, safety standards, material and construction specifications, and information standards. Standards Australia Ltd is the central clearing house for information on product and service standards. The Australian Consumer and Competition Commission enforces mandatory product safety standards, information standards and bans unsafe goods declared under the *Trade Practices Act.* The purpose of intellectual property law is to protect the entitlement of investors and developers to realise a commercial benefit from their work. First, you need to ensure that you are not infringing the intellectual property rights of others. Then you need to ensure that you protect your intellectual property rights.

When you establish a shop or a factory, you need to register it with the state in which it is located. At this point, you will come under a complex variety of government jurisdictions. Requirements can vary enormously from one location to another and they may involve a number of different government departments within the same jurisdiction. This is one of the more frustrating experiences in store for a new business operator and one that will require a great deal of patience. Your first stop should be the Business Licence Information Service located in your state capital. It provides one-stop advice about licences, permits, approvals and registrations. It identifies which licences you require and can print out the application forms for you. This is an important service for both new and existing business operators because it dramatically reduces wasted time and frustration.

Local government regulation

You also need to pay attention to local government zoning and building regulations. Local councils are required to prepare planning schemes for the orderly and balanced development of their areas. The effect of this is to create 'zones' for specific purposes, such as residential, industrial or commercial use. In addition, councils also control the construction and use of buildings. When you have located potential new premises, you need to ensure that you conform to the local council's planning scheme. You may even need council permission if you intend to operate from home. These are the steps you should take:

- Make an application to the council for a certificate indicating the uses to which the property may be put.
- Make an appointment to discuss your proposal with the council's planning staff. Any change in the use of a building or land will require an application to the council for its consent. If there are no building works, you can begin trading within the limits and subject to the conditions specified by the council in its consent.
- If any alterations or additions or new building works are proposed, then a development application will also be required. It is wise to discuss the council's building requirements in advance with both the building inspector and the health inspector.

- Approval may also be required for outdoor advertising, such as signs.

Regulatory agencies and organisations

Anticipating and complying with regulatory requirements is a good way to stay out of trouble. Changes to laws and other regulations are usually covered in advance by trade association and industry publications. The following is a list of important regulatory agencies and other organisations concerned with regulation together with their internet sites:

Business licences and permits

- Business Licence Information Service www.bli.net.au

Corporate governance

- Australian Institute of Company Directors www.companydirectors.com.au
- Australian Securities and Investments Commission www.asic.gov.au

Employing staff

- Australian Government Workplace Authority www.workplaceauthority.gov.au
- Human Rights and Equal Opportunity Commission www.hreoc.gov.au

Environmental issues

- Australian Government Department of the Environment, Water, Heritage and the Arts www.environment.gov.au
- Check with the departments and authorities in your state. There will probably be several.

Intellectual property

- IP Australia www.ipaustralia.gov.au

International regulations, restrictions and tariffs

- Australian Trade Commission (Austrade) www.austrade.gov.au

- Australian Customs Service www.customs.gov.au
- World Trade Centers Association www.wtca.org

Occupational health and safety

- Australian Safety and Compensation Council www.ascc.gov.au

Privacy

- Office of the Privacy Commissioner www.privacy.gov.au

Standards

- Standards Australia www.standards.org.au

Superannuation

- Australian Taxation Office www.ato.gov.au/super
- Australian Prudential Regulation Authority www.apra.gov.au

Taxation

- Australian Taxation Office www.ato.gov.au
- Check with your state government website for state taxes
- For local government taxes, check with the Australian Local Government Association www.alga.asn.au/links/obc.php

Trade practices

- Australian Competition and Consumer Commission www.accc.gov.au
- Check with your state government for Consumer Affairs and Fair Trading regulations.

Regulation in action

Here is an example of how the production and sale of a simple product, a baby's sleeping bag, can be affected by a variety of regulations. All the materials used, including the fabrics, the insulation and the zipper, have to be tested for compliance with the fire safety regulations for children's bedding and sleepwear. In order to avoid retesting every batch of materials, you need to ensure that your suppliers can continue to supply components to the same specifications. Labelling needs to comply with requirements relating to care instructions and appropriate use. You need to ensure that your product is designed so that it does not present a choking or SIDS risk to infants that could cause it to fall foul of consumer affairs departments. Some states have legislation requiring you to ensure that your contractor and any subcontractors comply with anti-sweatshop laws. If your contractor wants to be paid in cash, you need to check if these are 'reportable transactions' with the Australian Taxation Office. These are just some of the possible regulatory requirements you could face.

Technology risk

Technological change creates many new business opportunities, but it is also a significant source of risk. Technological change makes existing products and services obsolete and new technology inevitably destroys the market for older, inferior technology. Technology risk depends on the rate of technological change and the stage of market evolution. Technology risk is usually greatest in the early stages of market evolution. For example, during the high definition optical disc format war, Blu-ray Disc competed with the HD DVD format. In 2008 Toshiba, the main company supporting HD DVD, announced it would no longer develop, manufacture and market HD DVD players and recorders, forcing almost all other HD DVD supporters to switch to the Blu-ray format. As a market matures, technology risk is focused more on service delivery.

The greatest risk of technological disruption occurs when a market is mature and saturated. For example, when PCs burst onto the scene, the markets for typewriters and personal calculators soon collapsed. Computer and internet technology was the most disruptive technology of the 1990s and a major driver in the tremendous growth of new businesses in Australia. It reduced the cost of organising and operating a business, smashed competitive barriers, opened up new markets and led to the creation of entirely new business models. However, despite these positive contributions the hype surrounding the benefits of this new technology was not always matched by the reality. Sometimes the technology was not mature, the infrastructure was not in place or it was simply too complicated to be easily installed and used.

For some high-tech businesses it is the technology itself that is the curse. Many high-tech ideas fail because the developer falls in love with their technology and ignores the market that the technology is intended to serve. They mistakenly assume that customers will find the new technology as enticing and irresistible as they do. Customers, however, are interested in how your idea meets their needs, not the technological brilliance that produced it and they will not pay for technology that they do not need just because you offer it. Recognising changes in technology is the easy part. Predicting the social, economic and behavioural forces that will actually drive people to use it is the difficult part.

Another risk is the way in which technology has shortened the sustainable life span of new ideas. Whereas fifty years ago a new woodworking tool had a life of around twenty years and a new children's game might last for fifteen years, today they can only be expected to last for about five years.

Will the technology on which your idea is based be reasonably stable, will it be subject to some technological disruption, or is it likely to be replaced by new technology very soon? If the technology on which your idea is based is subject to significant disruptive developments, then you stand a greater risk of being leapfrogged by competitors when the new technology emerges.

Despite the risks inherent in embracing technological change, there is a bigger risk in not embracing it. Businesses that fail to adopt new technology will be under increasing competitive pressure from businesses that do. Technology is an essential ingredient for many new ideas and the marginal cost of technological capability is small. Technology is going to be cheaper, simpler to use, and will play a role in almost every aspect of a new business opportunity.

Environmental risk

Neither business nor society previously paid much attention to the environmental issues associated with new business opportunities. However, that has now changed and many laws have been enacted to protect the environment. Families are spending more time and effort monitoring the environmental effects of goods that enter their homes. Examples of their concerns include the toxic effects of the materials in furniture and carpets, the chemicals and pesticides used in food, the water and energy efficiency of major appliances, and the packaging used on everyday products. Concerns about the environment are going to intensify and the regulations spawned by environmental issues will have a substantial impact on the commercial potential of new business opportunities. Will your idea have a positive effect on the environment, no effect on the environment, or will it violate environmental regulations or have dangerous environmental consequences?

Concern for the environment has opened up huge markets for ecologically sound ideas such as renewable energy products, water-saving products, ecotourism, organic food and fibre production, and the sale or licensing of related intellectual property. The same concerns have also reignited interest in old products such as cloth nappies. New business opportunities that are committed to sustainable development are likely to gain a commercial edge because of the benefits to their reputation and brand. In contrast, violating environmental regulations or guidelines could result in a complete ban on a product or a public backlash. Even if no evidence of a violation is present, existing environmental regulations might require extensive and expensive testing causing costly delays and changes.

Be wary of ideas that could have real or perceived environmental consequences. Society's growing environmental consciousness is fuelled by the availability of information about who is doing what and the implications of their actions. Businesses will increasingly be judged on their 'triple bottom line' which takes into account their economic, social and environmental performance. There is huge interest in issues such as *intergenerational equity*, which means we try to leave the planet for future generations in as good or better shape than it is today, *sustainable development*, which is economic development that is in harmony with the natural environment, and *eco-footprinting*, which means we use only our fair share of limited resources. The growing concern about these issues is driving new environmental legislation and regulation.

For more than three decades businesses have been subject to government pollution regulations—specified standards to which they must comply or be penalised. This is called the *command-and-control* approach to environmental regulation and it has been criticised for its high cost, inflexibility and diminishing effectiveness. More recently, *negotiated agreements* have been used to gain commitments by business to the regulator's environmental goals. They are usually negotiated by an industry association and government against a backdrop of threatened legislation. Initially, they were not very effective, so the trend has shifted to government setting more specific targets linked with other policies such as tax incentives.

There is increasing pressure for businesses to gain ISO 14001 certification, the international standard that specifies the requirements for an environmental management system. Some of the reasons for gaining certification include recognition for regulatory compliance, access to markets and enhanced environmental reputation. Some countries require ISO 14001 certification for exporting businesses. Some companies require ISO 14001 certification for their suppliers and subcontractors. Some customers look for ISO 14001 certification before they will make a purchase.

Socio-economic risk

Social values and social change not only produce opportunities, they also produce risks. Social values are the result of behaviours, beliefs and actions we have learned from other members of our society. For example, prevailing attitudes towards gambling, alcohol, drugs and explicit publications push legislators to pass laws to protect young people. Other issues, such as consumerism, equality of race and gender, health, moral issues, ethical questions and a host of other social issues produce intense feelings among different sections of Australian society. New ideas that challenge established social values incur greater risk of rejection by the marketplace, regulation by government, adverse publicity and protests by special interest groups.

An example of a new idea with social risk is the proposal for human implants of radio frequency identification devices (RFIDS). Chip tracking is reliable and made possible by global positioning and RFID scanning technology. Inexpensive implant devices and quick implantation procedures have made the technology effective and affordable. It can be used for a variety of functions from surveillance to identification. For example, it can be used with children and the elderly as a tracking device, for debit and credit card identification, and to access personal medical records.

Implants would enable parents to keep track of their kids' whereabouts and inform retailers of parentally approved purchases. Medical staff would have instant information about a child's medical history including chronic conditions and allergies. However, despite these advantages, opinion is divided on the ethics of human microchip implants. The idea of implanting a chip in a person that is capable of tracking their movements and actions evokes strong feelings. It might be okay for the family pet, but not for the kids! What if the chips could be hacked? What about the erosion of civil liberties and loss of privacy? Why are there laws restricting human RFID implants in some countries? The social risk of commercialising human RFID implants is very high indeed.

At a broad level, a social group consists of a large number of people who have something in common like their social class, ethnicity or religious affiliation and who have similar values. Looking at such broad groups offers some insight into social risk, but it is generally more useful to examine smaller groups who are interested in specific areas such as sport, music or food. While broad social values and beliefs tend to shift slowly, changes within narrower groups occur more quickly. For example, the music industry regularly experiences rapid shifts in tastes as music enthusiasts discover new artists.

The economy is also a dominant force in our society. Since new business opportunities depend on customers who spend their money, it makes sense that economic conditions will play an important role. Will the current economic environment and its direction be friendly or hostile to your idea? For example, starting a real estate agency at the beginning of an economic downturn may be a risky proposition because house sales are likely to slow down. On the other hand, sales of lipstick are known to rise in a recession. Some economic risks are the result of structural changes that result from the permanent shift of resources from one sector of the economy to another, as shown by the slow down in manufacturing activity and the increase in mining activity. Other economic risks result from trying to operate counter to the prevailing trend of changes in the business cycle.

The business cycle consists of periods of economic expansion and periods of economic contraction. Expansionary phases are characterised by more jobs, higher incomes and increased consumer spending. If the economy grows too quickly, however, then inflation rises and consumers' purchasing power declines in real terms. A slowdown in consumer spending and the resulting economic contraction can lead to a period of recession. The business cycle has been through many periods of expansion and contraction, but the nature of the business cycle changes a little each time making it difficult to predict in advance. The three biggest economic risks for new business opportunities are changes in consumer and business confidence, inflation and interest rates.

Consumer and business confidence drives economic activity. The more confident people are about the future, the more they will buy, and the greater economic activity will be. When they lose confidence, they curtail purchases and economic activity slows down. Consumer confidence is measured by the Westpac–Melbourne Institute Consumer Sentiment Index. The causes of change in consumer and business confidence are the same things that affect the purchasing power of consumers and businesses:

- Taxation—especially the rates for income tax and GST and their impact on consumer disposable income and business profits.
- Economic growth—importance of overall growth and of growth by sector to show any unevenness across the economy.
- Employment—especially average weekly earnings and the rate of unemployment.
- Inflation—and its effect on prices to consumers and costs to businesses for various categories of goods and services.
- Interest rates—particularly the cost of mortgage finance for consumers and the cost of borrowing for businesses.
- Government spending—including priorities in sectors that most affect consumer disposable income and profits for businesses.
- Exchange rate of the Australian dollar—both its effect on export demand by overseas customers and its effect on the cost of imported goods and services in Australia.

- Business cycle—the stage of the business cycle and the short-term business outlook.

When inflation stays at an acceptable level, prices remain stable and consumers and businesses are more likely to be confident. The goal of the Reserve Bank of Australia is to try to keep the average inflation rate at around 2 to 3 per cent over the course of the business cycle. Inflation is regularly reported by the Australian Bureau of Statistics. However, there are actually three different measures of inflation. The Headline Consumer Price Index (CPI) measures quarterly changes in the retail prices of around 80 000 goods and services that represent a high proportion of spending by households. The Underlying CPI is similar to the CPI except that it excludes 20 000 items that have volatile prices such as fresh food items and petrol. The underlying CPI is regarded as a better indicator of the core rate of inflation. The Implicit Price Deflation Index (IPDI) is a more general measure of inflation that includes business goods and services as well as consumer goods and services. When demand is high, prices will rise unless there is a corresponding increase in supply. Higher prices mean that consumers are getting less for their dollar and they will be unable to sustain their purchasing in real terms without going into debt. In other words, high inflation damages consumer confidence and saps the demand for new products and services.

Changes in the level of interest rates affect how much consumers and businesses are prepared to borrow. For example, the housing market contracts when mortgage rates increase, as do purchases of other household goods and services on credit. Similarly, an increase in interest rates affects firms' willingness to borrow money for new investment and increases the cost of the loans they have already.

Dependence risk

Dependence risk occurs when an idea must rely upon some other product, process, service, system, person or organisation to make sales. Does demand for your idea depend on some other link in the supply chain? Dependence means loss of control over sales. The effect of personal computers on the sales of printers is an example. Ownership or intended ownership of a PC clearly determines the value that a consumer gets from a printer, so manufacturers of printers depend largely on the sales of PCs and those who recommend which printer to buy. Any change in the sales of PCs will have a knock-on effect for printers that the manufacturers cannot control.

Dependence risk is high if you have to rely on something or someone that you cannot control to generate sales. If dependence risk is low then you will have greater control over your marketing strategy and more scope to exploit your business opportunity. There are ways to minimise dependence risk. For example, provide free training and sales kits to the front-line staff of retailers if you want to encourage better in-store promotion for your product. Or, approach the maker of a product on which you are dependent for sales about forming a strategic alliance whereby you bundle your products together.

Dependence risk also includes the risk of control by gatekeepers or other vested interests who can influence sales even though they don't actually purchase or use the product themselves. Traditionally, gatekeepers have stood guard over us in order to provide guidance and protection. Their job is usually to say 'no' and they say 'no' a lot. In business, we are faced with gatekeepers who try to decide things like what should be produced, what should be sold, how it should be sold, what customers should buy and sometimes who has the right to be a customer. If your idea depends on a gatekeeper for sales then you need to look for ways to circumvent them. This doesn't mean you can avoid controls or regulatory issues altogether, but without gatekeepers you will have more opportunity to create whatever products or services you want and sell them to whomever you wish. A new generation of business operators is making it their mission to find ways to circumvent gatekeepers and their controls. They view any system without a gatekeeper as an opportunity.

It may not be realistic to expect all the gatekeepers to vanish, but traditional gatekeeping systems are going through a period of tremendous change. The first gatekeepers to go were the employment gatekeepers as more and more people found ways to make their living without ever having to be employed. Writers, graphic artists, musicians, photographers, computer specialists and thousands of other micro-business operators are making a living without having an employer to control their pay cheque. The old-fashioned electricity and telecommunications monopolies are being dismantled and opened up to greater competition and new business opportunities. Making money on the internet is becoming more appealing—more and more websites are springing to life allowing businesses to go directly to their customers and avoid the gatekeepers. Getting free of the gatekeepers is not only a source of new business opportunities but also a powerful way of avoiding dependence risk.

7 Establishment risks

Establishment risks are inherent in all new business opportunities, so if you want to go ahead with your idea then you need to know what they are, whether or not it is worthwhile incurring them and, if so, how you can manage them. Risk is relative and decisions about what kinds of risks to take and how much risk you want to bear need to be made in light of the possible rewards. You have some degree of control over establishment risks because you can manage them more easily than you can manage boundary risks.

Establishment risks can hamper the start-up stage of your idea. So it is important to identify these risks and to make sure they do not damage the commercial potential of your idea. Analysing establishment risks enables you to gain an insight into what is possible and what is not at an early stage in the development of your idea.

In this chapter, we explore five key establishment risks:

- **Planning risk:** Do you have a start-up plan?
- **Marketing risk:** Do you really understand the market for your idea?
- **Deliverables risk:** Can you deliver the goods?
- **Liquidity risk:** Can you find the money to get started?
- **Personal risk:** Are you prepared to take the personal risk?

Planning risk is concerned with your preparation for the start-up process. Marketing risk focuses on how much you really know about customers and how much work is needed to be sure that the market information you have is complete. Deliverables risk questions if your idea is physically possible. Liquidity risk is about finding the initial investment required to get underway and maintaining cash flow thereafter. Personal risk examines the stress and uncertainty involved in establishing a new business and its potential impact on your personal life.

Planning risk

To minimise planning risk, you need to seriously organise how you will go about commercialising your idea. This means developing a business plan. A business plan contains a strategy for the development and operation of a business opportunity. It is a blueprint for making the transition from an initial idea to a successful enterprise. It is the result of research, deliberation and a vision about the results you expect to achieve. It represents concrete tactics for creating competitive strength and exploiting it. A business plan identifies the characteristics of the market and the marketing strategies you will employ to capture it. It includes plans for the facilities, staff and procedures to operate the business, together with forecasts of the resulting profits and cash flow. It is not unusual for a realistic business plan to take several months to complete.

Planning is important because it helps you work smarter rather than harder. It keeps you future oriented and motivates you to achieve the results you want. Moreover, the process of completing a business plan enables you to determine what commitment you are prepared to make to the business. Planning significantly increases your chances for survival and prosperity by focusing your attention on the following areas in which new business operators sometimes get lost:

Realism: It is easy to become excessively optimistic about a new idea. Planning helps to prevent you from viewing the future in ways that the facts do not support. Sometimes the big pay-off is that a genuine planning exercise might save you from yourself by persuading you to abandon a bad idea while your mistakes are still only on paper.

The need for outside advice: Planning enables you to recognise problems that call for outside sources of information and assistance.

Recognising change: The nature of markets and consumer needs can change rapidly. Planning cannot predict change, but it helps you to recognise it and to construct your business strategy accordingly.

Balancing growth: New businesses tend to grow either too fast for their capital base or too slow to maintain cash flow. Planning helps you to achieve smooth growth and to avoid unexpected crises.

Results orientation: A business plan enables you to monitor your results against a set of goals and performance standards.

Obtaining finance: When someone puts money into your business they want to know what to expect. A business plan not only enables you to plan your capital needs in advance, but it also provides the information that an investor or lender needs to evaluate your request for finance.

Most of the books that have been written about business planning are designed for cash-hungry start-up situations in which a 100-page document is needed to pry money out of a tight-fisted venture capital organisation. That kind of business plan is simply irrelevant to the vast majority of new business opportunities. There are also a number of other myths about business planning. The first myth is that a business plan is some sort of guarantee of success. The reality is that no matter what you do there is always going to be a risk of failure. However, the chance of success increases with the quality of planning. The second myth is that new business operators do not have the time to engage in planning or cannot afford the expense. The evidence suggests that many do plan and that their rate of success is greater. The third myth is that planning is essentially the same process for all firms whether they are new or established. The reality is that planning for a new business opportunity needs to be different. When designing the business plan for your idea:

- Stick to a short planning period of one or two years.
- Do your planning in conjunction with your accountant.
- Write it down, but don't make it long or complicated.
- Make sure that your plan includes specific goals.
- Go for a rolling plan that you regularly review and update.

The fourth myth is that you don't need to do a business plan yourself because you can pay someone else to do it for you. The reality is that the business plan is a reflection of your vision and your aspirations. You can ask your accountant for advice and you can engage a consultant to get specialised expertise, but you cannot expect them to make a strong personal commitment to planning your business. If you do not do the business plan yourself, then it is not really your plan. If it is not your plan, then how can you be sure that it will work?

Marketing risk

Marketing risk exists when you do not fully understand the characteristics of your target market and the means by which you will reach it. Without customers, there is no commercial potential, and without satisfying a genuine need or want, there will be no customers. The risk is that you may not have the information you need, at the time you need it, to determine whether or not your idea will ultimately succeed or fail in the marketplace. No matter how big you think the market may be, competitors are already satisfying customers' needs in some way. Can you identify an unmistakable market segment in which you can offer customers a clear and compelling benefit at a price they will be willing to pay? Will they recognise that the benefits you are offering are different and superior in some way—better, faster, cheaper, more convenient—to the alternatives? How will you communicate with them to tell them about your offer? How do you know they will pay attention?

Failing to do your market research is the most likely way to increase your marketing risk. Whether your market research is likely to be simple, inexpensive and within your capabilities and resources, or whether it is likely to be difficult and costly, a substantial element of risk will be present until you can fully understand the market and develop a strategy to capture it. What sort of market information should you be looking for? Exactly who are your potential customers and what is the problem they need to solve? How often does the problem occur, what causes it, and is it getting worse? How many potential customers are there in your target market area and what is their capacity to pay? What other solutions are offered by competitors and what proportion of potential customers would actually buy from you? Which market segments are similar in their characteristics, big enough to be attractive, and accessible through promotion and distribution? The goal is to align the nature of your idea and the ability of your business opportunity to deliver exactly the right benefits to the best market segment you can target.

Even the best market research can be misleading, so you need to judge it carefully. Some people will tell you what they think you want to hear. Some people will tell you price is important when, in fact, they will trade price for something else like convenience. How can people tell you what they want if they don't know it exists? And even if they do know something about their problem or need, they may not be able to describe it. Make sure your market research method is appropriate; for example, a survey cannot tell you how well people come to grips with new technology when they first use it, but a focus group can actually try it out while you observe them. Keep in mind that your own biases might lead you to misinterpret the results of your market research if your needs and wants are different from those of your intended customers. Do you really know what people want from your idea? Have you asked them or are you projecting your own needs and desires on them? If the results of your market research give you negative feedback about your idea, will you listen to it or ignore it? Are you willing to kill your pet project if the market research does not support your idea?

Market research also helps you to choose the best marketing strategy for your target market. An *undifferentiated* marketing strategy is one in which you target all market segments in the same way. This is a useful strategy for products and services for which there is a universal need and it lends itself to mass marketing because there is little difference from one market segment to another. Alternatively, a *concentrated* marketing strategy is one in which you select just one market segment and specialise in being the best at meeting its needs. You are targeting fewer customers but you are trying to capture a large proportion of them. A third marketing strategy is a *differentiated* marketing strategy in which you have different marketing tactics for different market segments. For example, the way a dairy product is promoted to mothers of growing children will be different from the way it is promoted to young women. For the mothers the nutritional value of the product is important, while the low levels of fat and sugar are more important when it is promoted to the young women. Or you might choose a *custom* marketing strategy in which you satisfy each customer's unique set of needs. Typically, this strategy is used to enable each customer to 'build' their own solution such as selecting a coordinated colour scheme for the furniture, floor coverings and walls in a home makeover.

Internet marketing

Another important market risk is how you use the internet. Traditionally, most businesses have relied on newspaper, radio and television advertising to promote themselves. Advertising attempts to *push* a message out to the largest possible audience in the hope of catching the attention of a few potential customers. While push advertising will continue to have some success, the advertising and promotion landscape is changing. People have been bombarded with irrelevant advertising messages for too long and they are turning to the internet and away from the traditional media. Online customers can choose what sites to visit and what information to *pull* onto their screen. The internet provides them with broad and deep access to detailed information about the products and services that really interest them. This has resulted in a tremendous shift in power from businesses to their customers and it constitutes an important marketing risk for those who ignore it.

There is a lot of misinformation about internet marketing and it is not always easy to separate the hype from the reality. The first step is to determine if internet marketing genuinely suits your business strategy. While the vast majority of businesses do benefit from developing and maintaining an internet site, it is important to recognise that this form of marketing does not apply to every business. If your customers already buy products or get information via the internet, then you need to be there as well. If, on the other hand, your customers get most of their information from other sources such as trade catalogues or the *Yellow Pages*, then you may be better off concentrating your efforts in those media.

There is a myth that the internet automatically levels the playing field between smaller businesses and their larger competitors. A professional-looking internet site can make your business look good, but unless it is well designed and operated you run the risk that it will actually make you look technically and commercially incompetent. An internet site cannot be left to sit idly in cyberspace; it requires constant attention. If it is not regularly updated with new and interesting information, it becomes stale and potential customers will think it looks more like a faded billboard. Can you commit to adding new content every month? Do you have the time and money to support it properly? If you're not willing to do this yourself, can you afford to hire someone to do it for you?

Another myth says that if you create an internet site people will automatically come flocking to it. Don't expect people to find your internet site on their own. You need to encourage traffic through active promotion on the internet as well as via your other marketing media. You need to register your internet site with all the major search engines, exchange links or banner ads with other sites that have complementary services or products, and feature your domain name in all of your marketing literature. If your idea is for a specialised product or service aimed at a niche market, then advertising on a weblog run by an informed commentator can be an effective way to attract people with a particular interest.

Deliverables risk

There are two parts to deliverables risk. The first part relates to the performance of your product or service and whether it will be fit for the purpose you intend. The second part relates to whether you can organise the business in order to exploit it. Is your idea physically deliverable? Have you worked through the sequence of steps that will translate your idea into a tangible product or service? Do you know what sort of skills and resources it will take to deliver your product or service into the hands of your customers? Is it going to be relatively straightforward or is it going to be a real challenge to deliver the goods?

Will your idea perform precisely as it is intended or are there potential problems that could emerge? For a product, you need to consider things like operating characteristics, features, flexibility, durability, conforming to standards, serviceability, aesthetics and quality. For example, a garment must be comfortable to wear through the full range of movement and withstand multiple cycles of cleaning without shrinkage, fading or perishing. For a service, performance includes timeliness, courtesy, consistency, convenience, completeness and accuracy. If there is unfinished development work to do then the risk is much greater that unforeseen problems will occur. Ideas that involve difficult or complicated development need a substantial commitment of time, energy and resources. Thus there will be a greater risk that costs will blow out or that the idea may not be deliverable as it was originally envisaged. The amount of development required usually increases with the technical complexity of an idea, incompatibility with existing patterns of customer behaviour or the operational complexity of the business itself.

Deliverables risk also includes the possibility that you may not be able to bring together the skilled people, the right equipment, the right processes, and the right controls to deliver a consistent level of quality at an acceptable price. For example, are the best people available? If not, will the people who are available have the right combination of skills and experience? Will you need to provide training? Problems like these may not be spotted until operations are already well underway and you might not know how to handle them if they occur. Some operations are simple and easily managed with standard operating procedures. Other operations are more complex or vary considerably from one customer to another resulting in greater deliverables risk.

Try to anticipate which deliverables risks are relevant to your idea and rate the likelihood that each could occur. Then consider the magnitude of the consequences for each one if it happens. The combination of likelihood and consequences determines how significant a particular risk is to your business opportunity. By identifying the most significant deliverables risks first, you maximise the chance that you will focus your attention on the critical issues. If deliverables risk exposure is high then you may want to consider your options. You can accept the risk and work to mitigate it. You can look for ways to transfer the risk by subcontracting or outsourcing some of the difficult tasks. Serious deliverables risks in which countermeasures are unreliable or unavailable may be a reason to consider abandoning the idea.

Liquidity risk

Too many businesses start out with insufficient money because the owner doesn't appreciate how much it takes to establish a new business. Initially, money is needed for things like research and development, market research, setting up distribution channels, training, equipment, premises, production, packaging, promotion and working capital. The more money it takes just to get the doors open, the greater the chance you will not have enough money to keep going until the business becomes cash positive. New businesses are especially vulnerable to liquidity problems because they not only tend to operate with inadequate cash reserves but they also tend to miss the implications of a cash flow deficit until it is too late. Unfortunately, the financial accounting process does not distinguish between accounting transactions and cash transactions. The following example illustrates why the profits recorded in your accounting system are not cash.

You have discovered a fantastic new business opportunity. If you give your customers thirty days' credit on their purchases, sales will be $10 000 in the first month of trading and will double every month thereafter! Your stock is to be paid for in cash when it is delivered and it will cost you half of the retail price. Your operating expenses will be 10 per cent of sales revenue and must also be paid in cash. The result is that you will have a net profit margin of 40 per cent and after four months of trading your profit will be $60 000.

	Month 1	Month 2	Month 3	Month 4	Total
Sales revenue	10 000	20 000	40 000	80 000	150 000
Expenses					
Stock	5000	10 000	20 000	40 000	75 000
Operating costs	1000	2000	4000	8000	15 000
Profit	4000	8000	16 000	32 000	60 000

Your accountant will be so impressed by your trading results that she will probably double her fees. Your bank manager, however, will not be so impressed. In fact, he will be downright disturbed by what has happened to the balance in your bank account. After the same four months of trading, you have a $20 000 overdraft!

	Month 1	Month 2	Month 3	Month 4	Total
Receipts	0	10 000	20 000	40 000	70 000
Payments	6000	12 000	24 000	48 000	90 000
Cash flow	(6000)	(2000)	(4000)	(8000)	(20 000)

How can a business with a $60 000 profit end up with a $20 000 overdraft? Remember, your customers do not have to pay for their purchases for 30 days but you have to pay your expenses immediately. The reason is because the $80 000 in sales revenue from Month 4 has not actually been received—it is tied up in accounts receivable. PROFITS ARE NOT CASH. Without cash flow planning, this profitable operation will run out of cash and go out of business. This is liquidity risk.

The liquidity cycle is a series of activities that continuously transforms the components of working capital. Cash is transformed into raw materials by purchasing. Raw materials are transformed into finished goods by manufacturing. Finished goods are transformed into accounts receivable by selling on credit. And accounts receivable are transformed back into cash when they are collected. The cycle repeats itself continuously so long as there are no bottlenecks to restrict its flow. When bottlenecks do occur, they cause a stop/start reaction that disrupts the smooth flow of the liquidity cycle. For example, if collections slow down, accounts receivable will increase and cash will dry up. Without cash, purchases will have to be curtailed and manufacturing will stop. Once manufacturing stops, sales will fall off when inventory runs out. One of the important objectives of cash flow budgeting is to keep the liquidity cycle running smoothly. The length of the liquidity cycle is the average amount of time it takes for one revolution of the cycle. The shorter the liquidity cycle the less cash is required and the easier it is to maintain cash flow. The longer the liquidity cycle the more cash is needed and the more difficult it is to maintain cash flow. Your ability to control the length of the liquidity cycle plays an important role in managing liquidity risk.

As long as your cash flow remains positive there is no need for concern. However, nearly all businesses experience liquidity problems at one time or another. If it looks like negative cash flow is going to drive your bank balance into the red, here are a number of strategies for overcoming the problem:

Shorten the liquidity cycle: Essentially, this means increasing the efficiency of working capital by reducing the cash committed to it by more aggressive collection of accounts receivable, stricter credit terms and tighter control of inventory.

Slow down growth: Slowing the growth in sales decreases the investment required in the components that make up the liquidity cycle. In the last example, the cash flow deficit will not get worse if sales are held steady. Slowing growth is difficult for most business operators to contemplate but holding growth in check is a rational alternative to a liquidity crisis.

Look for more capital: For smaller amounts, it may be possible to approach friends and relatives who are more prone to invest in you rather than the idea itself, or informal investors who may be inclined to invest in a project which is of personal interest. If your credit rating is good, you may be able to approach a bank or other lender for a personal loan. If you need a large amount of money and you need to approach formal investors the rules of the game shift dramatically and family ties and personal interests are laid aside.

Maintain a cash reserve: Cash is an idle asset because it makes no direct contribution to your profits. In theory, the best cash position is a zero cash balance. However, in order to ensure that enough cash is on hand to pay the bills as they come due, you should have a minimum cash reserve.

Reconsider starting up: Other ways to avoid liquidity risk are to postpone establishing your business until you have sufficient funds to get started, or abandon the project altogether.

Personal risk

Is this idea right for you? Are you right for this idea? It is one thing to recognise the business risks involved in commercialising an idea but there are also personal risks that you need to consider. Establishing a new business can create an enormous strain on your finances, your family, your social life and your emotions. Before you make the decision to go ahead think seriously about the personal risks involved. You will have to work long hours which means time for family and friends will be difficult to find. Your income may become uncertain and sometimes it could fluctuate enormously as a result of factors you cannot control. You will face the unrelenting pressure of having to make decisions and solve problems when you are not sure about what to do. You will still have a boss—in fact, you will have many bosses including customers, suppliers, government agencies and your banker. You may eventually hate your business in the same way that other people hate their job, and you may find it difficult to get out of business without incurring an unacceptable loss.

Some ideas might exert too much pressure on your family. There can be a conflict between what is best for the family and what is best for the business. The two most sensitive issues are time and money. There is never enough of either. In order to give both the business and the family the best opportunity to prosper you need to strike a mature balance between conflicting pressures.

A number of research studies have revealed that new business opportunities sometimes falter because the owner's motives are misguided. Here are some examples:

A desire to be one's own boss: Some people don't succeed because they underestimate the commitment that a business requires and the impact that this commitment will have on their lifestyle.

A desire for financial independence: Some people don't realise that along with the opportunity for financial independence comes the risk of losing everything they own.

A dislike for working with others: If an individual does not work well with others then it is also going to affect how they get on with customers, employees and suppliers.

A disdain of bureaucracy and paperwork: With increasing regulation, paperwork has become a significant part of the life of every business.

A desire for creative freedom: Everybody wants to be able to do their own thing. However, the 'thing' needs to be a product or service that appeals to a large enough market for the business to succeed.

The risk of failure is real and the evidence tells us that it is greatest during the first year of operation. The risk is usually lower for parallel opportunities, a bit higher for new market opportunities, higher again for new product or service opportunities and highest for radical opportunities. We also know that the vast majority of failures are caused by the owner's own limitations rather than by outside influences. If you fail, you will lose some money, maybe even all of your money. You may feel bad for a while because your self-esteem will be bruised. There may even be some lingering ill-will on the part of former partners, suppliers, employees or customers. There is also an element of luck, which means that success may elude you no matter how carefully you do your homework. You need to consider the personal risks involved in pursuing your idea and ask yourself if you are comfortable with taking these risks. Not everyone shares the same attitude towards risk so you need to be sure that your idea is within your comfort zone.

Part D

FINDING THE RIGHT BUSINESS MODEL

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8 Skills and experience

In this chapter we consider the skills and experience required to move your idea into the marketplace. The extent of the skills and experience required depends on the sophistication of your idea and the nature of the market it faces. Having a balance of skills and experience is just as important as having a depth of expertise in particular areas. Some people focus on the idea without actually making contacts and getting orders. Some people focus on finding the resources but don't have the expertise required to exploit them. Some people work at getting orders without having the resources to actually make delivery. Some people have great technical know-how but they begin operations without a clear vision of the business itself.

Determining what skills and experience are important can only be made on a case-by-case basis. This chapter provides a framework for making this analysis. Its purpose is to help you identify the skills and experience required to commercialise your idea and enable you to determine if you already have this expertise or if you can find a way to acquire it. The overriding premise is that the nature of your idea dictates the marketing, technical, financial, operational and managerial expertise you need to commercialise it. You should also make a serious and frank assessment of your personal skills and experience and compare them with what your idea requires to determine the gaps that need to be filled.

Few individuals have all the expertise that is needed, particularly for a radical idea in a large market. A good knowledge of just one or two elements of business is simply not enough. Before you can realistically contemplate running your own business you need well-rounded business skills together with some hands-on experience in the line of business you want to enter. The best time to get your business training is before launching into business. The best way to get experience is to work in the type of business you intend to enter. A thorough preparation for going into business is just as important as any other form of apprenticeship. If you are already in business and your skills and experience are not strong, then more expedient alternatives include employing people with the right expertise, taking on a partner with complementary expertise or engaging outside consultants and advisers.

Marketing expertise

Marketing is not just about selling. It incorporates a broader way of thinking and acting in which every decision is driven by an intense focus on how to deliver the right benefits to the right customers. Few new ideas get off the ground without marketing expertise. This is particularly true of consumer products that need to be skilfully designed, packaged, promoted, priced and distributed in order to gain the consumer's attention. If you hear yourself saying 'I know it will sell', then take this as a sign that your approach to marketing is not only naive but potentially disastrous. There is a range of marketing issues to consider when taking a new idea into the marketplace. The following list may help you to think about the marketing knowledge, skills and experience you will need to put your idea into operation:

Business location	**Product design**
Competition evaluation	**Merchandising**
Marketing research	**Customer service**
Marketing strategy	**Distribution channels**
Product positioning	**Packaging and presentation**
Retail layout	**Direct selling**

Pricing and discounts	**Advertising and promotion**
Credit terms	**Internet marketing**
Sales forecasting	**Supply chain management**
Trade shows	**Export marketing**

What level of marketing expertise will it take to get your idea out of the starting blocks? If it is only modest then perhaps you will be able to develop a marketing plan and carry it out yourself. Ideas that require a high level of marketing expertise and sophistication are probably best tackled by those who have the skills, experience and resources. If you want help then look for someone with the expertise you require.

A marketing strategy has a number of operational components, known collectively as the *marketing mix*. These components are typically described as *the four Ps*: product (including services), place, promotion and price. Managing the marketing mix is analogous to baking a cake. The marketing strategy is your recipe and the four Ps are your ingredients. Just as there are different cakes to suit different tastes, there are different marketing mix strategies to suit different marketing objectives. The key is to select a marketing mix that gives you the most direct and least expensive access to your target market.

Product

A *product line* is a group of products or services that have similar characteristics and uses. The product line that you decide to offer is called your *product mix*. The best product mix is the one which best meets the needs of your target market. The assortment within a product line is called *product depth*. For example, the more models of cameras that a camera shop has for sale the more depth it has in that product line. The number of product lines offered by a business is called *product breadth*. If you offer only one or two product lines then your product breadth is narrow. If you offer a variety of product lines then your product breadth is wide. For example, if the camera shop sells only cameras then its product breadth is narrow. If it sells many other things such as accessories and photo processing then its product breadth is wide. Decisions about product lines, product mix, product breadth and product depth constitute your product strategy. The same principles apply to a service business. Product strategy decisions need to be consistent with your target market and the benefits they want to buy.

Place

Place strategy is the second component of the marketing mix. It refers to the means by which you put your product or service before your customers. If your product or service is not available where and when your customers want it then you will lose the sale. Place, therefore, is not just about your location or the layout of your premises but also the distribution channels you select.

Promotion

Promotion strategy is the third component of your marketing mix. Many exciting new ideas fail simply because too few buyers know about them. Getting the word out requires real expertise. The objective is to create an image and stimulate sales. Your promotion strategy consists of the ways in which you communicate with customers including advertising, publicity, merchandising techniques and personal selling. The objectives of advertising and promotion are to inform, to persuade and to remind customers about your business and what it offers. In order to give your advertising and promotion a clear focus, you need to be able to answer a few questions:

Purpose: What do you want your advertising and promotion to accomplish? Be as precise as you can about why you are communicating and what you want to achieve. Is it to increase awareness, to attract competitors' customers, to reinforce customer loyalty or to generate immediate sales?

Target: To whom is your advertising and promotion directed? Trying to communicate with everyone rarely succeeds. Successful advertising and promotion is directed at a specific market.

Message: What should your advertising and promotion say? Your message should clearly and convincingly speak to your target market explaining the important benefits that you offer.

Medium: How should you deliver your message to your intended audience? No single medium is inherently good or bad. Look for one that fits your advertising and promotion goals, reaches your target market and is cost effective.

Price

Price is the fourth component of your marketing mix. Don't under-price your product or service. Profit is the reason that you are in business and profit is what enables you to stay in business. The objective is to set your price in order to maximise profits, not to maximise sales. The relationship between price and sales volume is called *price elasticity.* This term describes the effect that a change in price has on the amount of a product or service that customers will buy. When a product or service has *high* price elasticity it means that a small change in the price will have a strong impact on the amount purchased. Therefore when the price is lowered, sales volume will increase significantly. With a price hike, however, sales volume will fall off sharply. *Low* price elasticity means that changes in price have little effect on sales volume. In very competitive businesses with little product differentiation price elasticity tends to be high. In specialised businesses with highly differentiated products price elasticity tends to be low.

Technical expertise

Every business must possess the technical skills and knowledge needed to produce and deliver its product or service. In an electrical contracting business someone must know how to install the wires and equipment. In a travel agency someone must know how to research transportation and accommodation and how to make bookings. Do you have the technical expertise needed to commercialise your idea or will you need to acquire the services of someone who does? There are three dimensions of technical expertise and you need to be clear about which ones you really need. *Functional* technical expertise consists of the skills and experience needed to carry out a job. These are learned job skills such as how to test for water quality or how to write an instruction manual. *Product* technical expertise consists of a thorough understanding of the product or service itself and the skills and experience needed to produce it. *Industry* technical expertise is knowledge about the technical expectations of customers and the technological environment in which a business operates.

Some ideas are straightforward and require very little technical input. However, even low-technology ideas require some technical expertise. The need for technical input is not a significant barrier as long as you are prepared to pay for it. However, ideas that require a very high level of technical expertise are usually best left to those who know what they are doing. It is easy to underestimate the degree of technical sophistication involved in a project. This is especially so if you lack technical expertise or you haven't been through the start-up process before.

Does your idea require modest technical expertise or does it require a high level of technical expertise? If only a modest level of technical expertise is needed then you may be able to handle it yourself. If a moderate level of technical expertise is indicated, be prepared to either invest in developing these capabilities yourself or hire an expert to fill the gaps. Either strategy is acceptable, but you need to plan for it because finding the right technical expert usually takes time and costs money. Ideas that require a high level of technical expertise and sophistication are sometimes commercialised by very small firms. However, the caveat is that development to the market-ready stage requires high levels of sustained technical input. This will be beyond the capacity of some individuals and other strategies such as selling or licensing the idea to another organisation may be more appropriate.

Financial expertise

It is important to be properly capitalised, but it is just as important to know how to manage your financial resources. The primary cause of financial failure is poor financial planning—underestimating capital needs and inadequate control of cash flow. Growth, particularly rapid growth, does not generate capital—it consumes it. The following list may help you to think about the financial knowledge, skills and experience you need to put your idea into operation:

Budgeting	**Preparing financial statements**
Cash flow	**Ratio analysis**
Break-even analysis	**Debtor control**
Banking relationship	**Creditor control**
Bookkeeping	**Cost control**
Borrowing money	**Payroll**
Leasing	**Goods and services tax**
Equity capital	**Income tax**
Using an accountant	**PAYG procedure**

Will your idea require modest financial expertise or will it need a high level of financial expertise? A low level of financial expertise is generally all that is required by small-scale operations with little or no financing requirements and a simple accounting system. A modest requirement for financial expertise means you will probably want to get some advice from your accountant. Ideas that require a high level of financial expertise are either going to need substantial in-house expertise or professional assistance.

Success in any business is affected by the type of financial information system you have and how you use it. Common sense will tell you that without current, reliable financial information at your fingertips, it is going to be difficult to make sensible financial decisions. One way to gain financial expertise quickly is to carefully select and engage an accountant. Finding an accountant is easy—just look in the telephone directory. Look for a Chartered Accountant (CA) or a Certified Practising Accountant (CPA). Finding an accountant with whom you can work effectively may take a little digging. Ask your friends, business associates or your trade association about an accountant. Your solicitor or your bank manager may also be able to make a recommendation.

Some accountants do not offer the full range of accounting services and limit themselves to the preparation of tax returns and statutory reports. A few do not take the trouble to provide simplified accounting reports that can be easily understood. Let your accountant know exactly what you want. Ask them to recommend an accounting software package that will enable you to record information electronically. Ask how you can use the accounting services most effectively to save yourself time and money. When you do find the right accountant make maximum use of this major source of financial information and assistance. Be sure to see an accountant *before* you start or buy a business. Meet with your accountant personally and as frequently as you require. You can save time and money if you prepare for meetings by drawing up an agenda of the matters on which you need advice.

Operational expertise

Operational expertise underpins the way in which a business goes about performing its tasks. Some operations consist of repeating a series of relatively straightforward tasks, others are more complex but relatively repetitive, and some are highly complex with few repetitive elements. Operational expertise is more likely to be a critical factor for a new, inexperienced, or under-financed business and you need to carefully assess your requirements. What operating functions are going to be critical to launching your idea? Will it require modest operational expertise or a high level of operational expertise? If production expertise, for example, is a problem, consider other options such as licensing, outsourcing or subcontracting. Taking the operational sophistication of your idea into consideration, use the following list to help you identify the operational knowledge, skills and experience you need for your idea:

Purchasing	**Productivity**
Stock control	**Quality control**
Production	**Cost control**
Service delivery	**Scheduling and workflow**
Plant and equipment	**Transport and freight**
Staff recruitment and selection	**Computer systems**
Regulations and awards	**Negotiating**
Staff training	**Problem solving**
Supervising	**Decision making**

The building blocks of an operations strategy are plant, processes, programs and people. Plant includes location, equipment, technical sophistication and maintenance. Processes vary between batch processes, flow processes, continuous processes, jobbing, mass production and flexible systems. Programs include forecasting, co-ordination and integration. People include numbers of staff, locations, skills required, recruitment, deployment, training and performance management. Whatever operational mix you choose, your operations management strategy should be aimed at the following goals:

Lowest unit cost: Minimise your direct labour costs, material costs and overhead costs in order to deliver your product or service at the lowest possible unit cost.

Highest quality: Maximise the ways in which your product or service conforms to specifications including eliminating production errors.

Reliable delivery: Minimise the time between receiving an order and performing the service or completing delivery.

Flexibility: Maximise your ability to offer a variety of products or services without affecting cost, quality or performance.

Your main concerns are the productivity of time and assets. Time productivity is called *cycle time* and asset productivity is called *capacity utilisation*. There is a cycle time for many operations in a business including production time, stock turnover time, invoice processing time and service delivery time. The way in which a process has been designed and managed determines its cycle time. Reducing cycle time is one way to lower costs and improve customer service. Capacity consists of the operating assets in your business. High capacity utilisation means minimising the investment in physical assets and people relative to the level of activity in your operation so that plant and equipment are lean and hard-working and the people you employ are fully occupied.

Manufacturing, wholesale and construction operations are primarily concerned with producing and distributing physical goods. Therefore, production scheduling is important if customers are going to receive their orders on time. In some manufacturing operations, production scheduling amounts to 'When we get the orders, we make the products'. In other firms, it means 'We produce for the season so we have stock available when the season starts'. Either way, you have to work out how much you expect to sell and when you need to make delivery. Production scheduling consists of a number of interrelated elements including determining the work that needs to be done, scheduling the people to do the work, scheduling the equipment to be used, scheduling the materials to be used and integrating the work, people, equipment and materials to create a smooth flow of production.

A service business also relies on operational knowledge, skills and experience. Unlike tangible goods, however, a service is not easily separated from the individual who provides it. A service business can range from a simple standardised operation like car detailing to a complex operation like preparing corporate tax returns. *Standardisation* is an operations strategy that emphasises reducing costs, improving productivity and producing a single uniform service. *Flexibility* is an operations strategy aimed at providing a broad range of services. *Diversity* is an operations strategy designed to offer more and more types of services to an existing customer base.

There are a number of unique operational issues that apply to service businesses:

Services are intangible: They cannot be seen, tasted, felt, heard or smelled before they are bought.

Services are inseparable: From the customer's point of view the person delivering the service *is* the service and so the person and the service are inseparable.

Services are variable: Service quality may vary depending on the person delivering the service, the time, the location and the circumstances.

Services are perishable: Services are produced and consumed at the same time and cannot be stored in readiness for a peak in demand.

The customer is involved: Services usually involve the customer in their delivery which adds an uncontrollable element of variation and perceptions of service quality.

Price, value and quality are service customers' basic buying considerations. Therefore, you need to identify service differences that are highly valued and affordable, superior in quality, and capable of being effectively advertised and promoted. Research has shown the following operational areas influence customers' perception of service quality.

- The appearance of physical facilities, equipment and staff.
- The ability to perform the promised service dependably, accurately and consistently.
- A consistent willingness to perform promptly.
- An empathy for the customer that results in caring individualised attention.
- The knowledge and courtesy that give assurance and instil trust and confidence.
- The availability and accuracy of information relating to the service before, during and after the service delivery.

Managerial expertise

Managerial expertise is different from other expertise because the emphasis is on working *on* the business rather than working *in* the business. One of the key factors to keep in mind when assessing managerial expertise is that the skills, knowledge and experience needed to manage an ongoing business are very different from those needed to develop the initial idea. Perhaps knowing how to recognise your own limitations is the greatest skill of all. What sort of managerial expertise does your idea need to turn it into a viable business enterprise? If modest managerial expertise is all that is needed then perhaps you will be able to get along on your own with some occasional outside assistance. If a bit more managerial expertise is needed then use consultants to fill the important gaps. It is usually easier and less expensive to use outside consultants for specialised activities than it is to develop your own expertise for non-routine functions.

Depending on the complexity of your idea, the managerial expertise required may call for personal characteristics, knowledge and skills that you do not have or you may be called on to perform tasks for which you are not prepared. Ideas that require a very high level of managerial expertise are going to be difficult unless you already have substantial experience in managing an ongoing enterprise. In this case, you might want to recruit a qualified general manager or you may want to look for ways in which you can profit from selling or licensing your idea instead of going into business.

There is tremendous diversity in the types of new business opportunities and even greater diversity in the characteristics and motives of people who launch them. What really matters is whether you think your personal characteristics are suited to the business opportunity you want to pursue and if you have or can acquire the managerial knowledge and skills to undertake the managerial role needed to fully realise the potential of your idea.

Personal characteristics of successful business operators

New business opportunities are frequently in the hands of men and women who are the rebels of the business world. They have a highly developed sense of independence, or at least a strong desire to be independent. They have a strong sense of enterprise, or at least a desire to put their own ideas and capabilities to effective use. And they often have a strong dislike of conformity and routine. Research studies from all over the world have identified that the following personal characteristics seem to be associated with successful business operators:

Drive and energy	**Self-confidence**
Long-term involvement	**Persistence**
Goal setting	**Awareness of time**
Moderate risk taking	**Capacity to deal with failure**
Willingness to use feedback	**Initiative**
Ability to tolerate uncertainty	**Use of outside resources**
Innovativeness	**Assertiveness**
Opportunity recognition	**Ambition**
Competitiveness	**Independence**

Resourcefulness	**Optimism**
Task orientation	**Determination**

Managerial principles

Regardless of what type of business interests you, there is a set of principles that apply to how any business can be planned, managed and controlled. These can be divided into a few major groups:

Administration and management: These principles are involved in strategic planning, resource allocation, human resources, leadership, production and service methods, and the coordination and integration of people and resources.

Sales and marketing: These are the principles and methods for promoting and selling products and services; they include marketing strategy and tactics, sales techniques and sales control systems.

Customer service: These are the principles and processes for providing customer and personal services; they include assessing customer needs, meeting quality standards and evaluation of customer satisfaction.

Finance and accounting: Finance and accounting principles and practices, institutional relationships and the analysis and reporting of financial information are all included here.

Legal and governance: The principles involved relate to commercial law, government regulations, directors' duties and responsibilities, shareholder agreements, partnership agreements and taxation.

Human resources: This incorporates principles and procedures for staff recruitment, selection, training, compensation and benefits, industrial relations and employee information systems.

Managerial skills

Managerial skills are different from managerial principles. Managerial skills are competencies that call for greater insight than the skills required of others who work in the business. They are:

Active listening: Give full attention to what other people are saying, taking time to understand the points being made and asking questions.

Critical thinking: Use logic and reasoning to identify the strengths and weaknesses of alternative solutions to a problem.

Negotiating: Bring others together and reconcile differences.

Monitoring: Assess the performance of yourself, your staff and other organisations in order to make improvements or take corrective action.

Making judgements and decisions: Take into consideration the relative costs and benefits of potential actions in order to choose the one that is most appropriate.

Developing objectives and strategies: Establish the goals you want to reach and specify the strategies and tactics needed to achieve them.

Managerial tasks

Managerial tasks are the things that a manager does in the process of fulfilling their leadership role in the business:

Getting information: Observe, receive reports and otherwise obtain information from relevant sources.

Making decisions and solving problems: Analyse information and evaluate the results to decide on the best solution.

Communicating internally: Impart information to your staff orally, in writing or electronically in ways that are clear and easy to understand.

Communicating externally: Represent your business to people and organisations such as customers, the public, a trade association, the media or government.

Building relationships: Establish and maintain constructive and cooperative working relationships with other individuals and organisations.

Team building: Encourage and build mutual trust, respect and co-operation among your staff.

Resolving conflict: Handle complaints, settle disputes and resolve grievances and conflicts both inside and outside your business.

It is a rare person indeed who can claim to have mastered all of the knowledge, skills and tasks of business management. Nevertheless, developing a new business opportunity into a successful enterprise means you will necessarily need to master some of them. Perhaps the most distinctive attribute of a good manager is the ability to recognise when it is time to undertake some training or bring others into the business with the knowledge and skills you need.

9 Resources

When you control the right mix of resources you are in a position to exploit your idea. Resources represent the fundamental building blocks of your business plan and include financial resources, physical resources, human resources, intellectual resources and network resources. Not all resources, however, are strategically important. While *common* resources, such as office space, are necessary to carry out normal day-to-day business activities, it is *critical* resources, such as a key piece of intellectual property, that create competitive strength. The purpose of this chapter is to help you identify the resources needed to commercialise your idea and to distinguish between those that are common and those that are critical.

New businesses typically suffer from insufficient resources. The result is it takes them too long to get to market, they perform poorly when they do get to market and they often fail to capitalise on the full potential of the original idea. Cutting corners typically means that market research is foregone resulting in products and services that fail to gain market approval. Operations begin under pressure resulting in lost efficiency, differentiation and value. And the initial investment is exhausted before the opportunity gets a fair test. One cause of too little resources is too many opportunities. This happens when resources are thrown at several projects simultaneously in the hope that one of them will get some traction. The lesson is to avoid wasting resources by carefully concentrating them on the one project that has the best chance of success and learning to say 'no' to opportunities that threaten to stretch your resources too far.

Financial resources

It is easy to underestimate the financial resources required to bridge the gap between your initial idea and its successful commercialisation. Having enough money when you start out means more than just having enough cash to open the doors. You also need enough money to cover operations while you wait out the inertia of customers. Customers are creatures of habit and they are unlikely to change their behaviour immediately just because a new product or service enters the marketplace. Will commercialising your idea require modest financial resources, moderate financial resources or substantial financial resources? Financial resources consist of your savings, your borrowing capacity and your ability to raise equity. The less money you need to get your idea into the marketplace the less complicated will be the process of getting started. The better you are able to control critical financial resources the more effectively you will be able to create competitive strength.

Borrowing money

The ability to borrow money when you need it is important. For that reason, you need to maintain a good relationship with your banker and other potential lenders even when you do not need a loan. The better they know you the more inclined they will be to lend you money when you do need it. Sometimes your signature is all that is required if the lender already knows you and the loan is for a short period. However, most lenders require security or collateral especially for longer term loans. A lender may also want to impose conditions on you in order to protect themselves against poor management practices. Examples of loan conditions include no further borrowing without the lender's agreement, maintaining working capital, carrying adequate insurance and supplying the lender with regular financial reports. Lenders also like to match the term of a loan with the useful life of the asset it is financing. That is why they want to know about your business generally and the specific use intended for the money you are borrowing.

The distinction between short-term borrowing and long-term borrowing is an important factor when determining the most suitable type of loan for your circumstances. Short-term borrowing is used to finance assets that turn over quickly such as accounts receivable (sometimes called *trade debtors*) and inventory (sometimes called *trading stock*). It is usually repaid within one year. Contractors with substantial work-in-progress sometimes need short-term finance until they receive their next progress payment. Wholesalers and manufacturers with seasonal sales need short-term finance to carry the increases in accounts receivable and inventory until the end of the selling season. The main sources of short-term borrowing are trade credit, overdraft, accounts receivable financing and bridging finance.

Long-term borrowing is used to finance assets that have a longer useful life such as vehicles, equipment, plant, buildings and property. It can also be used to provide funds for the purchase of an existing business, to help establish a new one or to finance permanent additions to working capital. Long-term assets need to produce enough income to meet the interest and principal repayments in addition to earning a profit. Therefore, when it comes to long-term borrowing, lenders look for assurances that the business will be able to repay the loan out of earnings over the period of the loan. The main types of long-term borrowing are personal loans, hire purchase, term loans and mortgages.

Leasing

Leasing assets such as computers, phone systems, vehicles and other equipment is another source of finance for many new businesses. Leasing can be an alternative to purchasing these assets, especially if you don't have much cash available. It enables you to regulate your cash flow by having predictable, regular monthly lease payments rather than a single lump sum purchase. When you lease an asset you don't own it because the ownership of a leased asset remains with the lessor. At the end of the lease period you may either return the leased asset to the lessor or offer to purchase it for a previously stipulated *residual value*. If you decide to return the leased asset the lessor will sell it. If the sale price is less than the residual value then you will have to pay the difference. You are generally responsible for maintaining the asset for the lease period. Despite many claims about the advantages of leasing it is simply an alternative to borrowing.

Fleet leasing is an option when you have five or more passenger and light commercial vehicles. The services generally included with fleet leasing are vehicle sourcing, maintenance, management and disposal. One fixed monthly rental payment is made for the entire fleet. *Novated leasing* is designed to finance motor vehicles that are part of staff salary packages. You commit to making the lease payments which you deduct from your employees' pay. If they leave the job they take the vehicle and the lease with them.

Equity capital

Equity capital is the money invested in a business by its owners. It is a permanent source of capital. There are two types of equity capital: internal and external. The principal source of *internal* equity capital is your own money. It may be your savings or it may be money that you have borrowed on a personal basis to provide equity capital for your business. Another source of internal equity capital is profits that are retained and reinvested in the business. If you need more equity capital than you can provide from internal sources, then you will need to look for *external* equity capital. Perhaps you have relatives, friends or acquaintances who have some spare cash to invest in the business. However, before you jump into a financial arrangement with family and friends you might like to consider the consequences of making business partners out of people with whom you have a personal relationship. They may be a great source of financial and emotional support or they may meddle in the business by annoying you with incessant questions or unwanted advice. Would this personal relationship be able to survive intact if the venture fails and the money is lost?

A source of external equity capital for smaller businesses is private investors known as *business angels*. These are individuals who invest equity capital by buying shares or a partnership. Business angels tend to work informally by seeking investment opportunities through a network of personal contacts. For this reason they can be difficult to locate. Ask your state small business agency to tell you about some of the services that connect business owners with business angels. Despite the name, don't assume that a business angel is making a charitable donation to your business. They are buying a part of your business, they expect to be involved in the decisions that affect the business and they expect a share of the profits. In the longer term, they also expect to sell their part of the business for a substantial capital gain.

Venture capital refers to equity or equity-linked finance made available through specialised venture capital funds. Venture capitalists obtain most of their earnings through capital gains from their investments. Therefore, they look for high growth companies with a view to high returns on exit. Due to the rigorous selection criteria, venture capital is suited to only a small number of new business opportunities.

Listing a company on the stock exchange is referred to as an *Initial Public Offering*. It is a source of equity finance from new shareholders and provides a mechanism for shareholders to buy and sell shares in the company on the stock exchange. Listing can be an onerous and expensive exercise, so the amount of capital to be raised should be substantial before it will be cost effective. Following listing, the company will be required to fulfil continuing listing requirements including full public disclosure of its activities and financial reports.

Bootstrapping

Bootstrapping is a word used to describe ways of acquiring the use of resources without having to borrow money or raise equity from traditional sources to pay for them. It also includes other ways of conserving cash so you don't need finance. Bootstrapping helps to fill the gaps when conventional sources of finance are not available. Try to maximise early cash flow by choosing customers who will pay in advance or who will pay promptly. Minimise your costs by buying used equipment, employing temporary staff, negotiating with suppliers for the best price and payment terms, employing relatives or friends at a minimum wage, or running your business from home. Other methods include sharing resources with other businesses, bartering in lieu of buying goods, borrowing equipment, acquiring inventory on consignment, combining purchases with other businesses to get a bigger discount, sharing employees with other businesses, sharing equipment with other businesses or sharing office space.

Physical resources

Physical resources are the tangible assets that you need in your day-to-day business operations. Most start-ups are short on resources and make up for it with hard work and ingenuity. Before you spend your limited financial resources on plush premises or expensive equipment give some thought to your approach to acquiring physical resources. For example, why buy anything new if you can buy it second-hand? Why buy anything second-hand if you can rent or lease it? Why rent or lease anything if you can borrow it?

Key categories of physical resources include:

- Location—especially when location constitutes a competitive advantage.
- Premises—including offices, production facilities and outlets through which services are provided.
- Equipment—required for manufacturing a product, delivering a service or setting up an office.
- Transport—including cars, trucks and vans, specialised vehicles, ships, aircraft and trains.
- Storage facilities—used to store finished goods and raw materials.
- Inventory—including raw materials and goods for sale.
- Marketing facilities—including distribution channels.
- Computer systems—including the integration of operating, marketing and financial information systems.

Many of these are the everyday physical resources that are required to operate most businesses. Others, however, are the critical physical resources that give you competitive strength like the best location, state-of-the-art equipment or access to a sole source of supply. The need for physical resources can be substantial for some types of business, such as many manufacturing operations, or they can be modest for other types of businesses, such as many service operations. Does your idea require a modest investment in physical resources or a significant investment in physical resources? The fewer physical resources you need the easier it will be to commercialise your idea. If you are able to acquire critical physical resources, however, the greater will be your ability to create competitive strength.

Human resources

It is one thing to start a business and take responsibility for your own future, but it is quite another thing to become an employer. There are a number of impediments that can make employing staff a difficult proposition:

- difficulty finding skilled staff
- difficulty finding reliable staff
- high cost of employing staff
- red tape and paperwork
- superannuation legislation
- government and union interference
- workers compensation
- occupational health and safety legislation.

Perhaps these are the reasons why more than half of Australian small businesses have no employees. Before you commit yourself to employing staff think carefully about the consequences. You need to be prepared to devote a great deal of time, effort and money in order to cope with the issues that come with being an employer, especially if you encounter individuals who do not share your ideals about quality, productivity or employer loyalty.

Eventually you may find that you cannot be everywhere at once and you are no longer able to do everything yourself. If you want your business to grow, then you will have to employ staff. With the right recruitment and training strategies, the people who work for you have the potential to become your greatest asset. However, unless you learn how to find, attract, and develop people who will work in a productive and cooperative manner, your business is unlikely to reap benefits from becoming an employer. Will commercialising your idea require a modest investment in human resources, a moderate investment in human resources or a significant investment in human resources? The fewer people you require, the easier it will be to get into business. The better you are able to gain access to staff with critical skills and experience, however, the more you will be able to create competitive strength.

What specific duties and functions must your staff perform? What knowledge, skills and experience are needed? You need to determine these and decide beforehand whether they must have them before being employed or if you can teach them on the job. An untrained person in a position requiring specific knowledge is a liability to your business and a source of future expense if you have to replace them. Filling a job with an over-trained person can also be a waste of talent and money as well as a likely source of personal frustration for the employee. Be sure to select your front-line staff so they match your customers. Customers enjoy doing business with people who share their interests and with whom they feel comfortable. For example, a health food store needs staff who are interested in the role of nutrition in maintaining good health, a music store needs staff who are enthusiastic about all forms of music, and a sporting goods store needs staff who enjoy participating in sports.

You can leverage your human resources by engaging the services of temporary staff through a *temp agency*. A temp agency is not an employment agency although some agencies perform both roles. When you use the services of a temp agency you are not hiring an employee, you are buying the use of someone's time. The temp agency employs people and assigns them to you when you request assistance. The agency is responsible for payroll, bookkeeping, tax deductions, workers compensation, fringe benefits and all of the functions connected with being an employer. Moreover, you are relieved of the burden of recruiting, interviewing, screening, testing and training. You can engage temporary help for a day, a week, a month or longer.

Here are some examples of the types of skills available through a temp agency:

Trades
Fruit picking
Manufacturing
Engineering
Reception
Customer service
Hospitality
Public relations

Maintenance	**Information technology**
Telecommunications	**Building**
Production	**Bookkeeping**
Sales and marketing	**Secretarial**
Distribution	**Transport**
Data entry	**Warehousing**

Another way to leverage your human resources is *outsourcing*. Outsourcing consists of contracting another person or business to do some of your work. It enables you to focus on your own core competencies while gaining access to expertise in other areas. The main reason for outsourcing is to save money. Outsourcing may be cheaper than trying to do something yourself because the supplier has economies of scale giving you access to their cheaper technology or expertise. Outsourcing is also a way to gain access to people with the right skills without having to hire them. Outsourcing can make your operation more flexible by giving you quick access to short-term resources. For example, outsourcing enables you to bid for several jobs at once without worrying about how you will handle the work if you win all of them.

Intellectual resources

Although intellectual resources are intangible, they can be just as important as financial, physical and human resources. There is a strong relationship between intellectual resources and your ability to make the best use of financial, physical and human resources. Two key intellectual resources are specialised knowledge and intellectual property.

Specialised knowledge

Although much knowledge is common and easily copied, specialised knowledge is not easily transferred because it may be unspoken, hard to teach, hard to observe, complex or secret. Specialised knowledge may also lead to the development of inventions and innovations in which intellectual property protection such as a patent or design registration is possible.

Three examples of specialised knowledge are creative knowledge, market knowledge and technical knowledge. *Creative knowledge* is critical information and know-how that provides an insight into identifying and combining resources in ways that deliver greater value to customers than they can expect to get elsewhere. Creative knowledge tends to be unique to an individual and it is not the sort of knowledge that can be learned from textbooks. *Market knowledge* is critical information and know-how that provides an insight into customers. Understanding the customers' perspective makes it possible to deliver greater value to customers than competitors can deliver. *Technical knowledge* is critical information and know-how that provides an insight into creating value by solving problems. Technical knowledge is a critical resource for a growing number of high-tech firms and an important key to creating competitive strength.

Intellectual property

Patents, trademarks, registered designs, copyrights and trade secrets are collectively known as *intellectual property*. The purpose of intellectual property rights is to protect the entitlement of inventors and developers to realise a commercial benefit from their work. There are two things to remember about intellectual property. The first is to ensure that you avoid infringing the intellectual property rights of others. The second is to protect the intellectual property rights to which you may be entitled. Intellectual property rights are administered by a Commonwealth Government agency called IP Australia. Its internet site is www.ipaustralia.gov.au which contains explanation and information, contact details and examples of Australian intellectual property.

A *patent* is a right granted for any device, substance, method or process that is new, inventive and useful. An Australian standard patent is legally enforceable and gives the owner the exclusive right to commercially exploit the invention in Australia for a period of twenty years. You must make an application to IP Australia for a patent and your application will be examined to ensure that it meets all of the legal requirements before it is granted. Intellectual property law is complicated and it is in your interest to seek specialist legal advice. Registering a patent in Australia does not give you international protection. Most countries have similar patent systems and Australia is party to a number of international agreements that can reduce the complexity of applying for patents overseas. Keep in mind that if you demonstrate, sell or discuss your invention in public before you file your patent application you will not be granted a patent. You can talk to employees, business partners, or advisers about your invention but only on a confidential basis. Get a signed confidentiality agreement before you disclose any information. *Innovation patents* were introduced in response to a demand, largely from small businesses, for a type of intellectual property that would protect lower level inventions that don't satisfy the requirements for a standard patent. The approval process is quicker and less costly than for a standard patent but the protection available under an innovation patent only lasts for eight years.

A *trademark* is a letter, number, word, phrase, sound, smell, colour, shape, logo, picture, aspect of packaging, or any combination of these things that identifies a product or service and distinguishes it from similar products and services. The owner of a registered trademark has the exclusive right to use that trademark. Initial registration is for a period of ten years but as long as you keep using the trademark you can renew the registration indefinitely. You do not have to register a trademark to use it. However, protecting an unregistered trademark is a difficult legal process.

A *design* refers to the appearance of industrial or commercial articles in terms of features such as shape, configuration, pattern or ornamentation. Design registration is used to protect the new or original visual appearance of manufactured products including clothing. It does not apply to designs that are essentially artistic works which are covered by copyright laws. Initial design registration is for a period of one year but it can be extended up to sixteen years.

Copyright provides protection for original material in literary, artistic, dramatic or musical works, films, broadcasts, multimedia products and computer programs. Once a work is created, copyright is automatically recognised in Australia and you do not have to apply in order for your copyright to be protected. Copyright confers formal legal protection for distribution, reproduction and performance rights for at least fifty years.

Trade secrets overlap with patents. A trade secret is intellectual property that you decide to keep secret. It is an alternative to formally registering a patent. The reasons why you may prefer a trade secret to a patent include situations in which you are not confident that a patent application will be approved or you may want to retain exclusive use of your intellectual property beyond the legal life of a patent. However, trade secrets are a significant risk because they do not preclude anyone else from independently inventing or developing the same thing and exploiting it commercially. There is also a risk that former employees or others will try to benefit from your trade secrets, so be sure you have signed confidentiality agreements in place with everyone who has ever had knowledge of your trade secret. Protecting your rights to a trade secret is very difficult compared with defending registered intellectual property rights.

Network resources

Operating a business doesn't mean you are forced to rely entirely on your own skills, experience and judgement. In fact, research has shown that successful business operators rely on a number of individuals and organisations for help and assistance. How connected are you up and down the value chain with suppliers and customers and across the industry? How can you get connected if you are not? There are significant benefits from building a network of organisations and people who have information, knowledge and expertise that will help you. Initially, the formal part of your network will probably consist of professional advisers, your trade association and government agencies.

Engage an accountant before you go into business and ensure that you are dealing with a Chartered Accountant (CA) or a Certified Practising Accountant (CPA). Experience has shown that many business operators only use their accountant to prepare tax returns and statutory reports. Let your accountant know exactly what you want. Don't hesitate to change your accountant if they fail to measure up to your expectations. Ask them if they offer the full range of accounting services and advice, including:

Taxation advice
Preparation of statutory reports and returns
Auditing
Planning and budgeting
Use of computer facilities
Preparation of loan applications
Bookkeeping
Investment advice
Financial statements
Purchase/sale of a business
Cash flow analysis
Superannuation planning
Cost analysis
Estate planning

It also pays to engage a solicitor before you go into business. Look for a solicitor who specialises in commercial law and who is familiar with the problems of smaller businesses. A good solicitor will be able to anticipate your legal needs if you take them into your confidence and keep them informed. Your solicitor should be able to provide you with the following range of legal services and advice:

Registration procedures
Leases
Forms of business structure
Partnership agreements
Contracts
Conveyancing
Warranties
Confidentiality agreements
Trademarks and patents
Litigation
Effects of legislation
Liabilities and insurance
Windup procedures

A trade association consists of people who are engaged in the same or a similar type of business. They are generally the best source of industry-specific information and assistance. There are hundreds of trade associations in Australia. Check the *Yellow Pages* of your capital city telephone directory under 'Organisations—Business & Professional' or ask your state small business agency. There is also a *Directory of Australian Associations* that is available in many libraries. When you find the right trade association join it and take advantage of all the benefits it provides. Most publish a regular newsletter that will help you keep up to date with things like regulatory issues, important industry concerns and training programs. There is also a chamber of commerce in most communities that is affiliated with a state chamber of commerce in your capital city. It is not only worthwhile participating in the activities of your local chamber of commerce but it is equally important to know what services are available from the state office.

There are many government departments and agencies that provide help and assistance to people in business. The main difficulty has always been finding the right person to help you. Business.gov.au is a Commonwealth Government website that makes it easy to deal with all levels of government including federal, state and territory government agencies and industry associations. You can log onto the Business.gov.au internet site at www.business.gov.au. It should be your first contact with government because it reduces red tape and provides you with direct access to a wide range of information and related services.

Small business advisory services operate in all states and territories. They offer free information, advice and referrals. You can find your state small business agency in your capital city telephone directory or by searching for its internet site. Business Enterprise Centres help small businesses by providing free advisory and counselling services. Other services include skills training, courses, seminars, workshops and managed workspaces with on-site management services. They generally have a full-time manager who will work with you and they can help you to reduce costs through shared facilities and an accessible, low-cost consultancy network. Your state small business agency can put you in contact with a Business Enterprise Centre near you.

AusIndustry was formed to improve the efficiency of Australian firms and thereby increase their competitiveness in international markets. AusIndustry provides information on assistance programs offered by the Commonwealth Government. There is an AusIndustry office in each state and territory. Check your capital city telephone directory, ask your state small business agency, or visit the AusIndustry internet site at www.ausindustry.gov.au.

Austrade (the Australian Trade Commission) was established to help Australian exporters in overseas markets. It works together with AusIndustry, state government agencies, industry associations, businesses and individuals. Austrade services reduce the time, risk and cost of exporting and its government status can open doors in other countries. Austrade's Export Access program is delivered through a network of business and industry organisations. Austrade has offices around the world. It concentrates its efforts in those markets where it can be of most value to Australian exporters and where major opportunities can be found for Australian businesses. Austrade provides assistance to manufacturers, service providers, agents, consultants, traders, and new or inexperienced exporters. You can visit the Austrade internet site at www.austrade.gov.au.

Don't underestimate the significance of informal contacts as part of your network resources. Contacts can open doors to customers, suppliers and sources of finance. They can contribute their insight and experience to help you develop your idea. They can give you access to their networks and put you in contact with people who have specialist expertise. How strong is your informal network? Do you need to develop a network of informal contacts to help you get your idea into operation?

Developing contacts through professional associations and other organisations can be time well spent, but it takes time out of your schedule and money out of your pocket so you want to be selective about which organisations you join. When you do decide to join one you will get more out of it by being an active member rather than just reading their newsletter. Prepare for networking events by having a brief, succinct description about what you do. You typically have only a minute or two to get someone's attention and for them to understand what you do. Make sure you always have a supply of business cards. You also need to listen in order to learn about other people and what they do. A network of contacts will eventually prove to be enormously valuable, not only in terms of information and assistance but also as a source of potential sales.

A good reputation is an important element in developing your network resources because it creates trust. Trust is a powerful advantage because it reduces the formality, and hence the cost and difficulty, of doing business. Your reputation comes from other peoples' perceptions of you as an individual, your product or service, your brand or your business. Research has shown that the most important drivers of reputation are quality, integrity and financial soundness. Having a positive reputation among your customers is obviously important, but you also want to foster your reputation within your industry, among suppliers and the business community generally.

As you practise your networking skills, you are eventually bound to run into your competitors. You don't have to give away any secrets but you shouldn't be afraid to strike up a conversation either. You can learn a lot from your competitors, especially the ones who have been out on their own a bit longer. If you have complementary skills and expertise then you may even discover a basis for working together.

10 Dollars and sense

A business model is your strategy for how you will commercialise your idea together with a forecast of the financial outcomes you expect. The financial forecasts are built on your analysis of the market, how you will handle the risks and how you plan to operate the business. A business model fails if the numbers don't make sense. The purpose of this chapter is to explain how to convert the description of your idea into the language of money by answering the following questions:

- Do you have a realistic forecast of sales revenue based on genuine market research?
- Do you have projected income statements that demonstrate profitability?
- Do you understand the dynamics of your cost structure and break-even point?
- Do you have projected balance sheets that demonstrate what assets you need and how they will be financed?
- Do you have a cash flow budget that demonstrates how you will maintain liquidity?

Dollars and sense is also the language of investors. Maybe you don't need investors and you are able to pursue your business opportunity without external capital. However, most worthwhile business opportunities do not reach their full potential without finance. The five questions in this chapter are the same five questions that investors ask: How much do you expect to sell and how do you justify your sales projections—your sales forecast? How profitable will you be and how long will it take you to break even—your profitability? What assets do you need and how much money do you need to pay for them—your cost and financial structures? How soon will you become cash positive and will you be able to maintain cash flow and stay out of trouble—your cash flow? Answering these questions not only satisfies the need to forecast the financial future of your idea, but it also demonstrates to a potential investor that you have done your homework and your business opportunity deserves their support.

Sales forecast

A sales forecast is a projection of expected sales for a specific period of time, usually month by month over the first three years of a start-up business. The sales forecast is built upon your estimate of potential demand and reflects your conclusions about market approval and competitive strength. The sales forecast is also tempered by the risks you anticipate. The mix of skills and resources you employ and the way in which you use them also affect your judgement about projected sales.

Forecasting sales for parallel opportunities can usually be done with reasonable certainty because market information is available. Similarly, market data is usually available to help you make projections for new market opportunities. New product opportunities and radical opportunities present greater unknowns and greater uncertainty because there is not much market information available making sales forecasting more difficult. Nevertheless, a sales forecast is an essential element of your business model. If you do a really bad job of forecasting sales it will flow through the entire financial planning process. However, it is not necessary to be perfectly accurate. If your sales forecast is within a reasonable range of the eventual outcome, your business model will reveal all the important financial issues that you need to know.

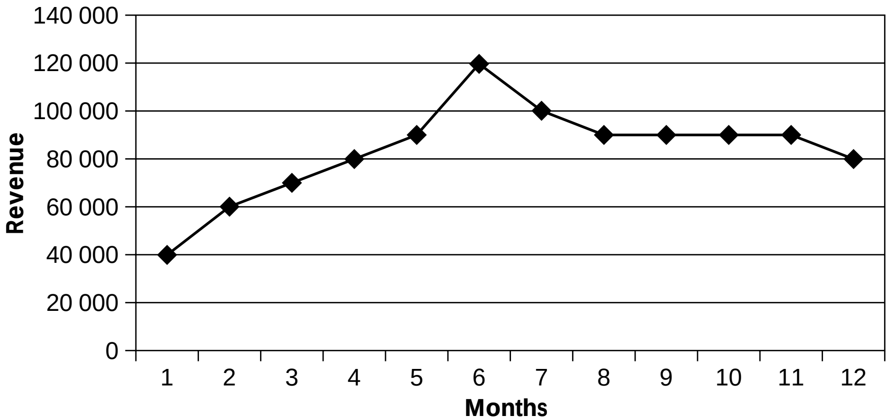
Not all potential customers will rush out to make a purchase. Consumers, businesses and institutions vary in their willingness to try a new product or service. Research has shown that only about 2 per cent of potential purchasers will try a new product immediately and another 15 per cent will be early adopters. The others are likely to wait and see. Therefore, the speed at which you penetrate the first two groups is crucial because their purchasing behaviour influences the others. Many promising new products and services fail because they are slow to penetrate these first two groups and they run out of resources before they can capture the attention of the mainstream market.

In Chapter 3 we presented an example in which we identified unexploited potential demand of $1 400 000 annually in our target market. Let's use annual sales of $1 000 000 as a reasonable revenue forecast for our business opportunity in the first year. The next step is to divide the annual forecast into monthly estimates that reflect seasonality and other trends in the market. A graph of the monthly sales estimates reflects the buildup of sales during the first six months of operations rising to the highest monthly turnover during the Christmas period. Sales level off in the second half of the financial year dipping slightly during the quiet period in June.

Table 10.1 Monthly sales estimates

Month	**Units sold**	**Revenue $**
July	4000	40 000
August	6000	60 000
September	7000	70 000
October	8000	80 000
November	9000	90 000
December	12 000	120 000
January	10 000	100 000
February	9000	90 000
March	9000	90 000
April	9000	90 000
May	9000	90 000
June	8000	80 000
Total	100 000	1 000 000

Figure 10.1 Monthly sales estimates



Forecasting sales is a challenging activity and crystal balls become more cloudy the further out you project. There are a number of techniques that you can use to help you make sales forecasts:

Judgement is based on your intuition. Forecasting sales using your judgement is inexpensive, expedient and it works well when demand is stable and you have lots of market experience. However, it is a mistake to use judgement for relatively new or rapidly changing opportunities as it can result in excessive optimism and overstated sales forecasts. If you don't have genuine market experience it isn't really judgement—it's simply guessing.

Surveys are used to gain information directly from potential customers or to ask experts what potential customers are likely to think. Customer surveys reflect buying intentions, not actual purchases, and they can be expensive to carry out. They are often used for new product sales forecasts. Expert opinions by professionals such as marketing specialists, economists, consultants or other people with specific expertise are also used to forecast sales when the idea is still in the concept stage.

Time series analysis uses historical data to discover patterns that help to predict sales and generally involves an analysis of trends, cycles, seasonal variations and other factors. This method is useful for parallel opportunities and new market opportunities but it cannot be used if there is no historical data available.

Regression analysis is a method of predicting sales based on finding a relationship between past sales and one or more variables such as population, disposable income or some other factor. This method is also useful for parallel opportunities and new market opportunities but it cannot be used if there is no historical data available.

Market tests involve putting a new product or service on the market in one or more test areas and measuring variables such as consumer demand and use patterns, and consumer response to price or promotion. Market tests are effective in forecasting sales for new market opportunities and new product opportunities. The chief disadvantage is that they are time consuming, expensive and it can be difficult to select a test area that is representative of the market generally.

Profitability

The sales forecast is the starting point for determining the profitability of your business model. Projected *income statements*, previously called *profit and loss statements*, are used to demonstrate profitability. They usually forecast the first three years of a start-up business. The income statement reports sales revenue together with the expenses incurred obtaining the revenue and shows the resulting profit or loss. The income statement can be tailored to match the requirements of your particular type of business and the amount of detail contained in the revenue and expense items depends on what you need to effectively manage your business.

Sales

The major activity of most businesses is the sale of products and/or services. The figure used is net sales after discounts, allowances and returned goods have been deducted.

Cost of sales

An important item in calculating profit or loss is the cost of the

Projected income statement
for the year ending 30 June 20XX

	$	$
Sales		1 000 000
Cost of sales		
Beginning stock	40 000	
Purchases	660 000	
Less ending stock	(100 000)	600 000
Gross profit (40%)		400 000
Operating expenses		
Salaries	35 000	
Wages	50 000	
Marketing	100 000	
Occupancy	45 000	
Administration	40 000	
Depreciation	20 000	
Interest	20 000	310 000
Net profit before tax		90 000
Provision for income tax		27 000
Net profit after tax		63 000
Dividend		28 000
Retained earnings		35 000

goods or services that the business has sold. Large firms employing sophisticated cost accounting systems use some very complicated methods for calculating the cost of sales. There are much simpler, generally accepted ways of calculating average cost of sales for different types of businesses. In a retail firm, cost of sales can be found by adding the amount of stock purchases during the period to the beginning stock and subtracting the ending stock. Wholesale firms calculate cost of sales in the same way as retail firms, except they include the cost of freight and cartage with their purchases. Service firms typically include a wage component in addition to materials in their cost of sales. Only those wages and materials directly involved in providing the service are counted. Because manufacturing firms convert raw materials into finished goods, their method of accounting for cost of sales differs significantly from the others. In manufacturing, cost of sales includes raw materials, goods in the process of being manufactured, finished goods, direct wages and factory overhead costs.

Gross profit

The difference between sales and the cost of sales is the gross profit. Gross profit is also expressed as a percentage of sales. The gross profit percentage is important because it represents the average profit margin on each dollar of sales before operating expenses.

Operating expenses

The other costs of running a business, besides the cost of sales, are operating expenses. The amount of detail that you need to include in your operating expenses is dictated by the requirements of your business. The income statement in our example contains the following operating expenses:

Salaries not only include compensation for your permanent staff but also the on-costs such as leave loadings, long service leave accruals, superannuation contributions and payroll tax. Don't forget to include your own salary because excluding the owner's compensation from operating expenses distorts the actual profitability of the business.

Wages represent compensation for your casual and hourly staff including the associated on-costs.

Marketing includes things such as advertising, promotion, commissions, travel and samples.

Occupancy includes things like rent, insurance, heating and cooling, electricity, repairs and maintenance.

Administration includes things such as telephone, stationery, postage, accounting and legal fees.

Depreciation is discussed when we describe the balance sheet. Although no money changes hands, depreciation is a real expense because it represents the cost of using fixed assets.

Interest represents interest payments to lenders but not principal repayments.

Net profit before tax

When operating expenses have been subtracted from gross profit, the difference is net profit before tax. If the business receives revenue from non-operating sources such as rents, dividends on shares or interest on money invested, it is added to net profit before tax at this point. This is the figure on which income tax is calculated.

Provision for income tax

This represents the amount of income tax payable on your net profit before tax. The amount of taxation and how it is paid is affected by whether your business is organised as a proprietorship, a partnership or a company. In our example, the provision for income tax is shown as a liability on the balance sheet until it is actually paid.

Net profit after tax

After the income tax liability has been provided for, the next entry is net profit after tax. It is from this amount that *dividends* or distributions of profits may be paid to the owners. Any profits that are not paid out to the owners will be reinvested in the business and added to *retained earnings* in the balance sheet.

Cost structure

Understanding the dynamics of your cost structure is a powerful tool for managing profitability. *Fixed costs* are those costs that tend to remain about the same regardless of changes in sales. They include items such as rent, salaries, insurance, council rates and depreciation which are not affected by variations in sales activity. *Variable costs* are those costs that vary in direct proportion to changes in sales. They include items such as the cost of sales, wages and marketing expenses. One advantage of understanding the concept of fixed and variable costs is that it permits you to condense the income statement into a simple format that is more convenient for analysis. The following example is the income statement rearranged into fixed and variable costs:

Analysis of fixed and variable costs

	Variable costs $	Fixed costs $
Sales		1 000 000
Cost of sales	600 000	
Operating expenses		
Salaries		35 000
Wages	50 000	
Marketing	100 000	
Occupancy		45 000
Administration		40 000
Depreciation		20 000
Interest		20 000
Total costs	750 000	160 000
		910 000
Net profit before tax		90 000

Cost of sales represents the cost of the goods and services that were sold to customers. It has been entered into the variable cost column because it varies in direct proportion to sales activity. Salaries are paid to the permanent staff regardless of the level of sales, therefore they are a fixed cost. Wages, on the other hand, are paid to the casual and hourly staff, so they are a variable cost. Marketing includes some fixed costs, but since it is predominantly tied to the level of sales activity, it has been entered into the variable cost column. Occupancy, administration, depreciation and interest expenses will be the same irrespective of the level of sales activity so they have each been entered into the fixed cost column. Total fixed costs are $160 000. When sales volume is $1 000 000, variable costs are $750 000. The separation of fixed and variable costs enables you to isolate the relationship of variable costs to sales. In this example, we have $750 000 in variable costs when sales are $1 000 000. The rate of variable cost, therefore, is 75 per cent of sales. Knowing the total fixed cost and the rate of variable cost enables you to determine the profit or loss for any level of sales.

Contribution margin

A business without any sales will have a loss exactly equal to its fixed costs. Every dollar of sales contributes to a decrease in that loss. The rate of contribution is the difference between a dollar of sales and the variable cost per dollar of sales. It is called the *contribution margin*. Sales in our example are \$1 000 000 and the variable cost is \$750 000 or 75 per cent of sales. Therefore, the contribution margin is \$250 000 or 25 per cent of sales. That means for every dollar of sales, 25 cents is going to pay for the fixed costs. Once the fixed costs are paid it becomes the rate at which sales contribute to profit. Profit or loss can be determined for any level of sales if you know the contribution margin. Increasing sales decreases the loss until the break-even point is reached. Beyond the break-even point, each dollar of sales contributes a rate of profit equal to the contribution margin.

Calculating the break-even point

The break-even point is important. When sales in your business reach the break-even point, you know that you can pay the bills and the chances for a profitable business are significantly enhanced. To find the break-even point, divide the fixed costs by the contribution margin. Using this formula, the break-even point in our example is \$640 000.

$$\text{Break-even point} = \frac{\text{Fixed costs}}{\text{Contribution margin}} = \frac{\$160\,000}{25\%} = \$640\,000$$

Margin of safety

The *margin of safety* is the difference between the break-even point and the current level of sales. It indicates the extent to which sales may decline before you begin to operate at a loss. It is expressed as a percentage of current sales. Currently we have a margin of safety of 36 per cent.

$$\text{Margin of safety} = \frac{\text{Current sales} - \text{Break-even point}}{\text{Current sales}}$$

$$= \frac{\$1\,000\,000 - \$640\,000}{\$1\,000\,000} = 36\%$$

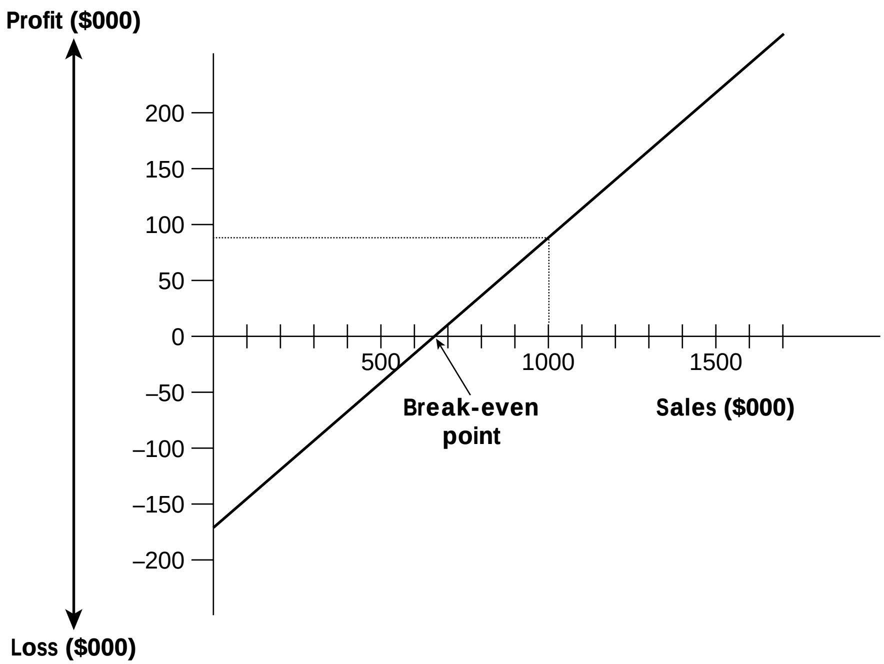
A high margin of safety indicates a sound sales and cost position. In this example we could absorb a 36 per cent decline in the current level of sales before incurring a loss.

Preparing a profit–volume chart

A profit–volume chart is a picture of the short-run relationship between sales volume and the contribution margin. Not only does it provide you with a visual presentation of the break-even point but it also allows you to inspect the effects of changes in pricing, sales volume, variable costs and fixed costs. Its flexibility makes it a useful tool for analysing and managing profitability. The profit–volume chart is constructed by incorporating the information on fixed and variable costs.

Sales appear on the horizontal axis and profit/loss appears on the vertical axis. First, plot the fixed costs of $160 000 on the profit/loss axis as a loss. This represents a loss equal to the fixed costs when

Figure 10.2 Profit–volume chart



there are no sales. Next, plot the net profit before tax of $90 000 on the vertical axis against sales of $1 000 000 on the horizontal axis. Now draw the profit line between the two points. The break-even point occurs at $640 000 where the profit line crosses the horizontal axis. The profit or loss on either side of the break-even point can now be read directly from the chart. At zero sales there are no variable costs so the fixed costs of $160 000 show up as a loss. As sales move to the right toward the break-even point the losses become smaller. When sales pass the break-even point further increases in sales produce increased profits.

Financial structure

Projected balance sheets are used to demonstrate what assets are needed to operate your business and how they will be financed. They are usually drawn up for the first three years of a start-up business. The balance sheet is an itemised listing of the assets owned by the business, the debts owed by the business and the owner's investment in the business.

Assets are what the business owns. They are recorded in descending order of their convertibility into cash. Those which can be converted into cash within a reasonable period of time are called *current assets*. Those which are used in the operation of the business over a longer period of time are called *fixed assets*.

Liabilities are debts owed by the business. They are recorded in the balance sheet according to the order in which they come due. They are claims against the total assets although they are not usually claims against any specific assets except in the case of mortgages. Liabilities are divided into current liabilities and long-term liabilities.

Owner's equity consists of the capital contributed by the owner (or owners) plus any earnings that have been retained in the business. Together, they represent the sum due to the owner if the assets were sold for the amounts appearing in the balance sheet and the liabilities were paid off. Owner's equity is essentially a balancing figure in the sense that the owners get whatever is left over after the liability claims have been satisfied.

Projected balance sheet
30 June 20XX

	$	$
Current assets		
Cash	1 250	
Accounts receivable	98 750	
Inventory	100 000	200 000
Fixed assets		
Plant and equipment	100 000	
Accumulated depreciation	(20 000)	
Buildings	150 000	
Land	70 000	300 000
Total assets		500 000
Current liabilities		
Overdraft	Nil	
Accounts payable	63 000	
Provision for taxes	27 000	90 000
Long-term liabilities		
Term loan	100 000	100 000
Total liabilities		190 000
Owner's equity		
Contributed capital	275 000	
Retained earnings	35 000	310 000
Total liabilities and owner's equity		500 000

Current assets

These are cash and any other assets that can be converted into cash within one year from the balance sheet date. Lenders and others pay particular attention to current assets because they represent the amount of cash that might be raised quickly to meet current obligations. The balance sheet in our example contains the following current assets:

Cash consists of funds available to use immediately and without restrictions. These funds are usually in the form of your cheque account balance at the bank, cash register money and petty cash.

Accounts receivable (sometimes called *trade debtors*) are amounts owed to the business by its customers as a result of selling on credit. They are one step removed from cash. The time it takes for accounts receivable to be converted to cash depends upon your credit policy and your customers' payment habits.

Inventory (or *stock*) consists of raw materials, goods in the process of manufacture and finished goods that are being held for sale. Inventory is two steps removed from cash. First, a sale must take place to shift the current asset from inventory to an account receivable. Second, the account receivable must be collected to turn it into cash.

Fixed assets

Fixed assets are items owned by the business that have a relatively long life. In our example they consist of plant and equipment, buildings and land. Most fixed assets are subject to depreciation which means the original cost is apportioned over the useful life of the asset. In our example, plant and equipment were acquired one year ago for $100 000. When these assets were purchased, their original cost was recorded on the balance sheet. Plant and equipment have a useful life of five years, so each year one-fifth of the original cost goes into another account called *accumulated depreciation.* After the first year, there is $20 000 in accumulated depreciation. The difference between the original cost and the accumulated depreciation is the remaining book value for plant and equipment. There are different ways to calculate how much of an asset's cost can be deducted for depreciation.

Current liabilities

Current liabilities are the debts that fall due within one year of the balance sheet date. Our balance sheet example contains the following current liability accounts:

An overdraft is a line of credit with your bank that allows you to write cheques for amounts in excess of your account balance. Repayment is usually expected in a short time.

Accounts payable (sometimes called *trade creditors*) are the amounts you owe to vendors and suppliers from whom you have bought items on account and for which payment is expected in less than one year.

Provision for taxes is the amount of income tax that is yet to be paid.

Long-term liabilities

Debts that do not come due within one year are called *long-term liabilities*. In our example, long-term liabilities consist of a term loan. Any part of a long-term liability that falls due within one year from the balance sheet date would be listed as part of the current liabilities.

Cash flow

If the cash flowing into your business exceeds the cash flowing out then you can continue to operate. But if the cash flowing out of your business exceeds the cash flowing in then you will eventually run out of cash and your business will grind to a halt. Even if the cash deficit is only for a short time, it can put you out of business. That is why you need to project your cash flow on a monthly basis for the first three years to ensure that you can maintain liquidity. A controlled cash flow, the result of this process, will more than repay the time and effort you put into planning. The five steps of cash flow budgeting can be demonstrated using an example.

Step 1: Forecasting sales

Forecasting sales is the first and most important step in cash flow budgeting. Begin by making a forecast of sales in terms of the number of units sold, the number of transactions completed or the number of customers served. Then translate these figures into dollar figures according to your pricing schedule. The sales forecast is based on the sales forecast at the beginning of this chapter and it has been divided into expected cash sales and credit sales.

Step 2: Identifying cash receipts

Cash receipts can be divided into two categories: operating and non-operating. The non-operating cash receipts are usually associated with one-off balance sheet transactions such as obtaining new equity, borrowing money or selling off an asset. There are two non-operating cash receipts in the month before start-up. They are $275 000 in owner's equity and a term loan for $100 000. If you sell on a cash basis only, then your operating cash receipts will be the same as your sales forecast. If you sell on credit, however, your operating cash receipts will depend on the proportion of sales that are credit sales and how long it takes to collect accounts receivable.

Step 3: Identifying cash disbursements

Cash disbursements can also be categorised as operating and non-operating. Operating disbursements consist of two groups: variable operating disbursements and fixed operating disbursements. Variable operating disbursements depend upon forecasted sales. An example is stock purchases. Wages and marketing are also variable operating disbursements that depend upon the monthly sales forecast. Fixed operating disbursements are not directly related to sales. The fixed operating disbursements in our example are lumped together for each month. Depreciation is not in the cash flow budget because it is not a cash disbursement. There are five non-operating disbursements in our example: the initial purchases of stock, plant and equipment, buildings and land in the month before start-up, and a dividend payment at the end of the year.

Step 4: Determining net cash flow

This step consists of summarising the cash receipts and the cash disbursements to determine their net effect. You can see in the example there are negative net cash flows in the first half of the year (except for November) becoming positive in the second half of the year (except for June). This tells us we need to make provision for a cash drain during the first six months of operations and we will have a positive cash flow to repay loans or expand operations thereafter. At this point, we can identify the major consequences of our expected cash flow.

Cash flow budget

	June (Month before start-up)	July	Aug	Sept	Oct	Nov	Dec
Sales forecast							
Unit sales		4 000	6 000	7 000	8 000	9 000	12 000
Dollar sales		40 000	60 000	70 000	80 000	90 000	120 000
Cash sales		10 000	15 000	17 500	20 000	22 500	30 000
Credit sales		30 000	45 000	52 500	60 000	67 500	90 000
Receipts							
Cash sales		10 000	15 000	17 500	20 000	22 500	30 000
Collections			15 000	37 500	48 750	56 250	63 750
Term loan	100 000						
Owner's equity	275 000						
Total	375 000	10 000	30 000	55 000	68 750	78 750	93 750
Disbursements							
Purchases	40 000	26 400	39 600	46 200	52 800	59 400	79 200
Wages		2 000	3 000	3 500	4 000	4 500	6 000
Marketing		4 000	6 000	7 000	8 000	9 000	12 000
Interest				5 000			5 000
Fixed operating		5 000	5 000	5 000	5 000	5 000	5 000
Plant and equipment	100 000						
Buildings	150 000						
Land	70 000						
Dividend							
Total	360 000	37 400	53 600	66 700	69 800	77 900	107 200
Net cash flow	15 000	(27 400)	(23 600)	(11 700)	(1 050)	850	(13 450)
Cash position	15 000	(12 400)	(36 000)	(47 700)	(48 750)	(47 900)	(61 350)

Cash flow budget

	Jan	Feb	Mar	April	May	June	Total
Sales forecast							
Unit sales	10 000	9 000	9 000	9 000	9 000	8 000	100 000
Dollar sales	100 000	90 000	90 000	90 000	90 000	80 000	1 000 000
Cash sales	25 000	22 500	22 500	22 500	22 500	20 000	250 000
Credit sales	75 000	67 500	67 500	67 500	67 500	60 000	750 000
Receipts							
Cash sales	25 000	22 500	22 500	22 500	22 500	20 000	250 000
Collections	78 750	82 500	71 250	67 500	67 500	67 500	656 250
Term loan							100 000
Owner's equity							275 000
Total	103 750	105 000	93 750	90 000	90 000	87 500	1 281 250
Disbursements							
Purchases	66 000	59 400	59 400	59 400	59 400	52 800	700 000
Wages	5 000	4 500	4 500	4 500	4 500	4 000	50 000
Marketing	10 000	9 000	9 000	9 000	9 000	9 000	100 000
Interest			5 000			5 000	20 000
Fixed operating	5 000	5 000	5 000	5 000	5 000	6 000	61 000
Plant and equipment							100 000
Buildings							150 000
Land							70 000
Dividend						28 000	28 000
Total	86 000	77 900	82 900	77 900	77 900	104 800	1 280 000
Net cash flow	17 750	27 100	10 850	12 100	12 100	(17 300)	1 250
Cash position	(43 600)	(16 500)	(5 650)	6 450	18 550	1 250	

If the net cash outflows are too heavy we can examine ways to reschedule or eliminate some of the disbursements. On the other hand, if we foresee large net cash inflows we can start to think about salting away some cash or perhaps looking for new investment opportunities.

Step 5: Determining the future cash position

In this last step, we simply relate the monthly net cash flow to our bank balance. In the example we have $375 000 to finance the business in the month before start-up. By adjusting the bank balance by the net cash flow in each month we can forecast how it will look at the end of the month. In the example, there is not enough cash to sustain operations. The cash flow budget reveals that we reach a maximum cash deficit of $61 350 in December but we also generate enough positive cash flow to repay an overdraft by April. This is exactly the information our bank would like to see when they get an application for an overdraft. It tells them how much money we require, when it will be needed and when it will be repaid. Without a cash flow budget we may not foresee the cash deficit which will occur. The cash drain projected by the cash flow budget emphasises the critical need for cash flow budgeting. Failure to anticipate a cash deficit like this could put you out of business. Profits are simply not the same thing as cash in the bank.

Part E

COMMERCIAL FEASIBILITY

Questionnaire: Evaluating your idea

POTENTIAL DEMAND

1. Market size

Total annual sales for my idea in my target market are likely to be:

a. very large—will appeal to practically every individual
b. large—will appeal to at least one person in every household or business
c. medium—will appeal to a moderate group of consumers or businesses
d. small—will appeal to a narrow group of consumers or businesses
e. very small—will appeal to a highly specialised or very limited group of consumers or businesses.

2. Market growth

Market growth over the next few years appears to be:

a. rapidly increasing
b. gradually increasing
c. constant
d. gradually declining
e. rapidly declining.

3. Market stability

Fluctuations in demand for my idea are likely to be:

a. highly stable—not susceptible to fluctuations
b. stable—modest variations can be accurately foreseen
c. predictable—variations can be reasonably foreseen
d. unstable—susceptible to moderately unpredictable fluctuations
e. highly unstable—subject to severely unpredictable fluctuations.

4. Sustainability

The commercial life span of my idea is likely to be:

a. more than eight years
b. six to eight years
c. four or five years

d. two or three years
e. less than two years.

5. Extensions

The potential for additional related products or services is:

a. very high—many extensions are likely
b. high—a few extensions are likely
c. moderate—a few extensions are possible
d. limited—minor variations only are possible
e. very limited—this is a one-off product or service only.

MARKET APPROVAL

6. Need

For potential buyers, the level of the need my idea will satisfy is:

a. very high—an essential need that is considered very important
b. high—a non-essential need but it is considered very important
c. moderate—a need that is considered reasonably important
d. low—a need that is not considered very important
e. very low—a superficial need that is considered unimportant.

7. Recognition

For potential buyers, the features and benefits of my idea are:

a. very obvious— completely self-evident
b. obvious—easy to understand
c. noticeable—some explanation required
d. obscure—not apparent and require substantial explanation
e. very obscure—not apparent and very difficult and/or costly to explain.

8. Compatibility

Compatibility of my idea with existing attitudes and methods of use is:

a. very high—completely consistent with established customer behaviour
b. high—reasonably consistent with established customer behaviour

c. moderate—possible slight conflict with established customer behaviour
d. low—considerable conflict with established customer behaviour
e. very low—extreme conflict with established customer behaviour.

9. Complexity

The degree of difficulty in learning to use or consume my idea is:

a. very low—no learning is needed
b. low—minimal learning is needed
c. moderate—normal instruction is enough for most users
d. high—detailed instruction is required
e. very high—expensive and/or time-consuming instruction is required.

10. Distribution

The optimal distribution channel(s) for getting my idea to customers is (are) likely to be:

a. very simple and inexpensive
b. moderately simple and inexpensive
c. about average in effort and cost
d. moderately complicated and costly
e. highly complicated and costly.

COMPETITIVE STRENGTH

11. Differentiation

Compared with the alternatives, the features and benefits of my idea are:

a. very superior—have strong customer appeal
b. superior—have customer appeal
c. not noticeably better or worse—are similar to the alternatives
d. inferior—have little customer appeal
e. very inferior—have no customer appeal.

12. Value

Compared with the alternatives, the value of my idea to potential buyers is:

a. much higher—very superior to the alternatives

b. higher—superior to the alternatives
c. about the same—not noticeably better or worse
d. lower—inferior to the alternatives
e. much lower—very inferior to the alternatives.

13. Customer leverage

The vulnerability of my idea to the negotiating leverage of customers is:

a. very low—no alternatives or no incentive to negotiate
b. low—limited alternatives or limited incentive to negotiate
c. moderate—some alternatives or some incentive to negotiate
d. high—many alternatives or strong incentive to negotiate
e. very high—variety of alternatives or very strong incentive to negotiate.

14. Supplier leverage

The vulnerability of my idea to the negotiating leverage of key suppliers is:

a. very low—supply is widely available and pricing is very negotiable
b. low—supply is available and pricing is usually negotiable
c. moderate—supply is limited and pricing is occasionally negotiable
d. high—supply is very limited and pricing is rarely negotiable
e. very high—sole source of supply and pricing is never negotiable.

15. Competitors

The vulnerability of my idea to competitors is:

a. very low—no apparent competitors and very high barriers to market entry
b. low—one or two competitors and reasonably high barriers to market entry
c. moderate—a few competitors and average barriers to market entry
d. high—several competitors and low barriers to market entry
e. very high—many competitors and no barriers to market entry.

BOUNDARY RISKS

16. Regulatory risk

In terms of the relevant laws, standards and other regulations, my idea will:

a. meet them without any changes
b. require only minor changes
c. require moderate changes
d. require substantial changes
e. probably not meet them at all.

17. Technology risk

The technology on which my idea is based is:

a. very stable for the foreseeable future
b. reasonably stable for the foreseeable future
c. subject to some disruptive developments
d. subject to significant disruptive developments
e. going to be replaced by new technology very soon.

18. Environmental risk

My idea will:

a. have a positive effect on the environment
b. have no effect on the environment
c. have no effect on the environment if properly used
d. have some negative effect on the environment
e. violate environmental regulations or have dangerous environmental consequences.

19. Socio-economic risk

The impact of social and economic forces on my idea will be:

a. very positive
b. reasonably positive
c. neutral
d. somewhat negative
e. very negative.

20. Dependence risk

The extent to which the sale or use of my idea depends on another product, process, service, system, person or organisation is:

a. very low—a complete control over sales

b. low—a strong control over sales
c. moderate—a reasonable control over sales
d. high—a little control over sales
e. very high—a no control over sales.

ESTABLISHMENT RISKS

21. Planning risk

A business plan for commercialising my idea:

a. has been investigated and put in writing
b. is underway and will be finished soon
c. is not yet underway but I intend to do one soon
d. will have to be done by someone other than myself
e. is not necessary because it is all in my head.

22. Marketing risk

An investigation to help me fully understand the nature and characteristics of my target market:

a. has been completed
b. is underway and will be finished soon
c. will be simple and inexpensive to carry out
d. will be difficult and costly to carry out
e. is not necessary because it is all in my head.

23. Deliverables risk

In terms of the product or service itself and the people, equipment, processes and controls required to produce it, my idea:

a. can be consistently delivered at a very high standard
b. can be delivered at a high standard most of the time
c. can be delivered at an acceptable standard, but further development is needed to reach a high standard
d. can be delivered at an acceptable standard only after further development
e. cannot be delivered without a significant research and development effort.

24. Liquidity risk

The money to commercialise my idea will come from:

a. my personal resources

b. my borrowing capacity and contributions from family and friends
c. a private equity investor such as a business angel
d. a venture capital investor
e. a share float on the stock exchange.

25. Personal risk

The personal risk involved in commercialising my idea is likely to be:

a. totally within my comfort zone
b. reasonably within my comfort zone
c. at the limit of my comfort zone
d. outside my comfort zone
e. well outside my comfort zone.

SKILLS AND EXPERIENCE

26. Marketing expertise

In order to commercialise my idea, I need:

a. no additional marketing expertise
b. modest additional marketing expertise
c. moderate additional marketing expertise
d. significant additional marketing expertise
e. a high level of additional marketing expertise.

27. Technical expertise

In order to commercialise my idea I need:

a. no additional technical expertise
b. modest additional technical expertise
c. moderate additional technical expertise
d. significant additional technical expertise
e. a high level of additional technical expertise.

28. Financial expertise

In order to commercialise my idea I need:

a. no additional financial expertise
b. modest additional financial expertise
c. moderate additional financial expertise
d. significant additional financial expertise
e. a high level of additional financial expertise.

29. Operational expertise

In order to commercialise my idea I need:

a. no additional operational expertise
b. modest additional operational expertise
c. moderate additional operational expertise
d. significant additional operational expertise
e. a high level of additional operational expertise.

30. Managerial expertise

In order to commercialise my idea I need:

a. no additional managerial expertise
b. modest additional managerial expertise
c. moderate additional managerial expertise
d. significant additional managerial expertise
e. a high level of additional managerial expertise.

RESOURCES

31. Financial resources

In order to commercialise my idea, I need:

a. no additional financial resources
b. modest additional financial resources
c. moderate additional financial resources
d. significant additional financial resources
e. very significant additional financial resources.

32. Physical resources

In order to commercialise my idea, I need:

a. no additional physical resources
b. modest additional physical resources
c. moderate additional physical resources
d. significant additional physical resources
e. very significant additional physical resources.

33. Human resources

In order to commercialise my idea, I need:

a. no additional human resources
b. modest additional human resources
c. moderate additional human resources

d. significant additional human resources
e. very significant additional human resources.

34. Intellectual resources

In order to commercialise my idea, I need:

a. no additional specialised knowledge and/or intellectual property
b. modest additional specialised knowledge and/or intellectual property
c. moderate additional specialised knowledge and/or intellectual property
d. significant additional specialised knowledge and/or intellectual property
e. very significant additional specialised knowledge and/or intellectual property.

35. Network resources

Commercialising my idea will call for:

a. very little help and assistance from outside individuals and organisations
b. modest help and assistance from outside individuals and organisations
c. moderate help and assistance from outside individuals and organisations
d. significant help and assistance from outside individuals and organisations
e. very significant help and assistance from outside individuals and organisations.

DOLLARS AND SENSE

36. Sales forecast

The sales forecast for my idea will be based on:

a. market tests
b. customer surveys
c. historical data
d. my personal judgement
e. I don’t need to do a sales forecast.

37. Profitability

By commercialising my idea, I expect to:

a. earn an exceptionally good profit over and above my salary
b. earn a fair profit over and above my salary
c. break even after meeting my salary
d. incur losses for the first few years
e. I don't know how profitable my idea is likely to be.

38. Cost structure

The cost structure for commercialising my idea is likely to have a:

a. sound contribution margin and low fixed costs
b. sound contribution margin and high fixed costs
c. modest contribution margin
d. low contribution margin
e. I don't know what the cost structure is likely to be.

39. Financial structure

The financial structure for commercialising my idea will be:

a. mainly current assets with equity financing
b. mainly fixed assets with equity financing
c. mainly fixed assets with debt financing
d. mainly current assets with debt financing
e. I don't know what the financial structure is likely to be.

40. Cash flow

Operating cash flow from commercialising my idea is likely to become positive:

a. from the first day of operation
b. within the first year
c. within the second year
d. within the third year
e. I don't know when cash flow will become positive.

Evaluation answers

POTENTIAL DEMAND

1. Market size	a	b	c	d	e
2. Market growth	a	b	c	d	e
3. Market stability	a	b	c	d	e
4. Sustainability	a	b	c	d	e
5. Extensions	a	b	c	d	e

MARKET APPROVAL

6. Need	a	b	c	d	e
7. Recognition	a	b	c	d	e
8. Compatibility	a	b	c	d	e
9. Complexity	a	b	c	d	e
10. Distribution	a	b	c	d	e

COMPETITIVE STRENGTH

11. Differentiation	a	b	c	d	e
12. Value	a	b	c	d	e
13. Customer leverage	a	b	c	d	e
14. Supplier leverage	a	b	c	d	e
15. Competitors	a	b	c	d	e

BOUNDARY RISKS

16. Regulatory risk	a	b	c	d	e
17. Technology risk	a	b	c	d	e
18. Environmental risk	a	b	c	d	e
19. Socio-economic risk	a	b	c	d	e
20. Dependence risk	a	b	c	d	e

ESTABLISHMENT RISKS

21. Planning risk	a	b	c	d	e
22. Marketing risk	a	b	c	d	e
23. Deliverables risk	a	b	c	d	e
24. Liquidity risk	a	b	c	d	e
25. Personal risk	a	b	c	d	e

SKILLS AND EXPERIENCE

26. Marketing expertise	a	b	c	d	e
27. Technical expertise	a	b	c	d	e

28. Financial expertise	a	b	c	d	e
29. Operational expertise	a	b	c	d	e
30. Managerial expertise	a	b	c	d	e
RESOURCES					
31. Financial resources	a	b	c	d	e
32. Physical resources	a	b	c	d	e
33. Human resources	a	b	c	d	e
34. Intellectual resources	a	b	c	d	e
35. Network resources	a	b	c	d	e
DOLLARS AND SENSE					
36. Sales forecast	a	b	c	d	e
37. Profitability	a	b	c	d	e
38. Cost structure	a	b	c	d	e
39. Financial structure	a	b	c	d	e
40. Cash flow	a	b	c	d	e

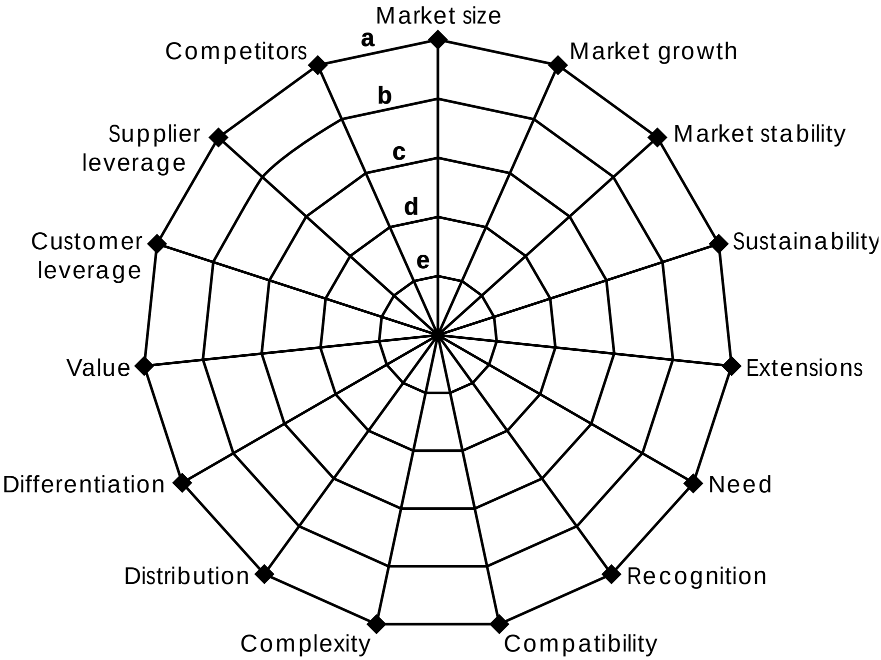
Commercial feasibility

Launching a new business opportunity is generally more difficult than most people anticipate. This is partly due to the complicated nature of the start-up process and the unexpected obstacles that inevitably occur along the way. In this section, we use your responses from the preceding questionnaire to answer the three BIG questions about identifying market viability, anticipating the risks and finding the right business model. Your responses will be used to form a series of diagnostic profiles and a commercial feasibility rating. The diagnostic profiles enable you to visualise your strengths and weaknesses for each of the three BIG questions. The commercial feasibility rating is an overall assessment of commercial potential. The objective is to make it possible for you to come to a conclusion about the commercial potential of your idea and whether or not you think it is a business opportunity worth pursuing.

Market viability

The purpose of this section is to answer the first BIG question: Can you identify evidence of a viable market? The issue is not just about the opportunity itself but also the market you want it to enter. The

Figure 11.1 Market viability profile



bottom line is that some markets are just not worth bothering with no matter how good the opportunity may be. On the other hand, some markets are sufficiently attractive that developing a marginal opportunity may be worth further consideration. Plot your responses to questions 1 to 15 on the *Market viability profile* and connect the dots. The market viability profile enables you to visualise how each response contributes to the overall assessment of market viability. The key is to focus carefully on each response in order to understand how it interacts with the others and how they collectively determine the overall market viability profile. You are looking for a well-rounded profile in which the line uniformly extends toward the outside edge of the diagram. Look carefully at any responses that fall towards the centre of the profile. Responses 'd' and 'e' are usually matters of concern that need to be investigated further. Is there anything that can be done to strengthen the market viability profile? Revisit every facet of market viability and look for possible improvements. Think of improving your idea as 'panelbeating' it into a more rounded shape. If you conclude that market viability is poor then abandoning your idea will probably be the wisest course of action. If you conclude that your idea is directed at a clear niche in which you will have a significant advantage then further development may be warranted.

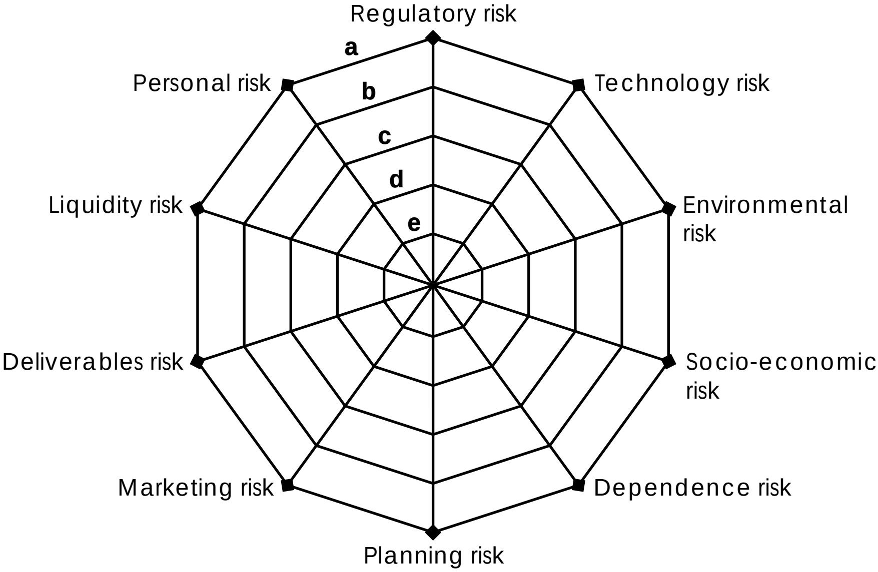
Unattractive markets are not usually fertile ground in which to plant new businesses. On the other hand a viable market is not sufficient reason to automatically invest in a new idea either. Before you can be confident that you have discovered a genuine business opportunity you need to investigate the risks involved and find a business model that makes sense.

Risk of failure

The purpose of this section is to answer the second BIG question: Can you anticipate the risks involved? No evaluation system can fully anticipate all the risks you might face if you decide to go ahead. Yet this is precisely what you need to do. And you have to ask yourself what level of risk you are willing to incur. Plot your responses to questions 16 to 25 on the *Risk profile* and connect the dots. The risk profile enables you to visualise how each response contributes to the overall risk assessment. Spend some time thinking about the strengths and weaknesses in your risk profile. The key is to focus carefully on the individual responses in order to understand how each one interacts with the others and how they affect the overall risk of commercialising your idea.

You are looking for a well-rounded risk profile that extends toward the outside edge of the diagram. Good responses do not remove all of the risks involved but it does suggest that the risks are manageable. Scrutinise every 'c', 'd' or 'e' response because these are usually matters for concern that need to be investigated further. What can you do to panelbeat your risk profile into a more rounded shape? Is there anything that can be done to minimise some of the risks? Never ignore risks in the hope they will go away. Risk reduction is important and you need to focus clearly on those risks that you can manage. Each of us varies in our willingness to take risks so give some thought

Figure 11.2 Risk profile



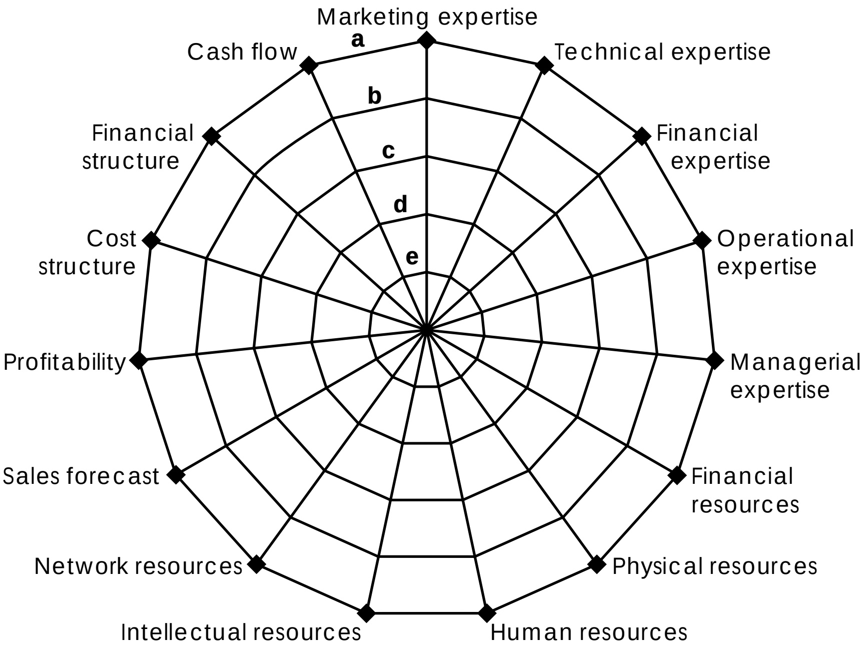
to the level of risk you are willing to accept. You get a clearer picture of your business opportunity when you consider *both* market viability and risk together.

Business model

The purpose of this section is to answer the third BIG question: Do you have a business model that makes sense? The final questions cover the skills, experience, resources and financial components that make up your business model and underpin your business plan.

Plot your responses to questions 26 to 40 on the *Business model profile* and connect the dots. The business model profile enables you to visualise how each response contributes to the overall assessment of your business model. Spend some time thinking about the strengths and weaknesses of your business model. The key is to focus carefully on the individual responses in order to understand how each one interacts with the others and how they affect the overall profile.

Figure 11.3 Business model profile



You are looking for a business model profile in which the line uniformly extends toward the outside edge of the diagram. Look carefully at any 'd' and 'e' responses because these highlight potentially important matters that may question whether putting your idea into operationis realistic. What can you do to panelbeat your business model into a better shape? Are there parts of the profile you can improve to strengthen the business model?

Commercial feasibility rating

The purpose of the commercial feasibility rating is to provide you with an overall measure of the commercial potential of your idea. This estimate should not be taken too literally, however, because it is essentially a 'best guess' based on your own evaluation. The result will fall into one of three bands which are interpreted in terms of traffic lights: green, yellow and red. To calculate the commercial feasibility rating, count the number of 'a', 'b', 'c', 'd' and 'e' responses and convert them to numerical scores according to the following scale: a = 5, b = 4, c = 3, d = 2 and e = 1. The last step is to add up your scores and divide the total by 2.

Commercial Feasibility Rating

Answer	Number of responses		Scale		Score
a	_____	x	5	=	_____
b	_____	x	4	=	_____
c	_____	x	3	=	_____
d	_____	x	2	=	_____
e	_____	x	1	=	_____
Total					_____
Total ÷ 2					_____
Commercial feasibility rating					☐

Green light

The highest possible score is 100. If your business opportunity scored a commercial feasibility rating of 80 or more, then its commercial potential is good and further investment of time, energy and money is likely to be rewarded. A commercial feasibility rating of 80 to 89 generally represents a viable market, a moderate level of risk and a realistic business model, but there could still be one or two important concerns that need to be resolved. A commercial feasibility rating of 90 and above generally represents excellent market viability, an acceptable level of risk and a solid business model.

This does not mean that a business opportunity with a commercial feasibility rating of 80 or more is automatically ready to go. On the contrary, all business opportunities have some risk and managing that risk is part of the key to long-term success. Ignoring even relatively minor risk factors can be serious, so pay careful attention to any responses that fall toward the centre of the profiles even if the commercial feasibility rating is high.

Yellow light

If your business opportunity scored a commercial feasibility rating between 60 and 79, then its commercial potential is marginal. Nevertheless, it may warrant some degree of cautious consideration. Commercial feasibility ratings in this range mean you should not invest heavily in further development at this stage. Rather, development should be limited to those activities that are not costly and you should focus on resolving some of the concerns that brought the rating down.

A commercial feasibility rating in the upper half of this range (70 to 79) generally represents satisfactory market viability but there are typically some concerns about risk and/or problems with the business model that need to be resolved. A commercial feasibility rating in this range is likely to have enough potential to warrant further limited and cautious development. A commercial feasibility rating in the lower half of this range (60 to 69) generally represents marginal market viability, significant risks, and/or considerable difficulty with the business model. It is unlikely that it will have enough potential to warrant further development.

Red light

If your business opportunity scored a commercial feasibility rating under 60, then its commercial potential is low and further consideration is not recommended. A commercial feasibility rating below 60 generally represents poor market viability, unacceptable risks, and/or an impractical business model. In this situation, abandonment may be the best course of action. Sometimes it is the opportunity itself that is flawed and sometimes the flaw is in the marketplace. Either way, it is better to reach this conclusion now rather than after you have invested your time, money and effort for no return. You have also gained valuable experience in evaluating new business opportunities that will sharpen your judgement about the next one that crosses your path.

Making your decision

The purpose of this evaluation was to help you to exercise your judgement about whether you want to move to the next stage in developing your idea into a business. There are three more questions you may want to consider, however, because they are likely to have a big influence on your decision.

First, what is your willingness to accept the risk involved and how far will you go before saying ‘No’? Some people can tolerate very high levels of risk and others cannot. Most successful business operators tend to be moderate risk-takers who are willing to bear some risks but work hard to avoid or overcome them. There are imperfections with every business opportunity, so expect a few of your responses to fall toward the centre of the profiles. Many of these concerns can be resolved. What seems to get so many people into trouble is not dealing with them early in the evaluation process.

Second, what do you think you can realistically expect to earn from this business opportunity? If you can see the potential for high returns then you may be more inclined to invest your time and money in a higher risk venture. If you expect the returns to be moderate or low, then you will probably be more cautious.

Third, how much money will you need to invest to get started? The more money you have to find, the less risk you will be prepared to take. However, this may be offset by the financial returns you expect to earn. In other words, opportunities that offer big margins and appeal to large markets generally warrant a greater investment than opportunities with limited markets and more modest prospects for profits.

If you are genuinely satisfied that your idea has passed this reality test then it is likely you have found a new business opportunity that is worth exploring seriously. The next step is to embark on the process of developing a strategy for turning your new business opportunity into a successful business enterprise.

12 Developing a start-up strategy

Too many business operators confuse hard work with success. The key to starting a successful business is a clear strategy that is designed to minimise effort and maximise results. Developing a business strategy is a process of exploring opportunities, identifying and evaluating options and arriving at a plan to achieve tangible results. Your business strategy determines the way in which your business will fit into the competitive environment. Every component of your business strategy should be driven by what your customers want. Gather enough information about your customers so that you clearly understand what will influence their decision to buy your product or service, then zero in on your market niche by positioning your business to attract them like a magnet. The greater your competitive strength, the more powerful will be the force of your magnet. You not only need a strategy to get into business, but you also need to evolve your strategy to successfully stay in business. That is why a rolling business plan that is refreshed and updated at regular intervals helps you to stay focused and on track.

Understanding your customers

Understanding your customers begins by identifying their basic buying motives. While products and services are constantly changing, basic buying motives such as health, beauty, safety, comfort, convenience, economy and enjoyment change very slowly. A business strategy that is squarely aimed at satisfying your customers' basic buying motives will pay off in greater sales, lower costs and higher profits. Understanding your customers also means gaining an insight into their buying role. The buyer/user decides what is needed, what will be bought and where it will be purchased. In some situations these roles may be played by different people. It helps to identify who has the need, who influences the purchase decision and who actually decides what and where to buy. Begin by looking for answers to the following questions:

Who will	use my product or service?
	decide to make the purchase?
	actually make the purchase?
	buy from me?
	buy from a competitor?
Where will	my product or service be used?
	customers find information?
	customers decide to buy?
	customers actually buy?
	the customers be located?
What	benefits does the customer want?
	is the basis of comparison with other services or products?
	is the rate of use?
	price are customers willing to pay?
	are the potential sales for this product or service?

The Australian Bureau of Statistics is a useful source of demographic information. For example, you can use census data and household expenditure information to compile a profile of consumer markets. You can establish the age distribution of the local population, the ethnic composition, average income, family size, whether they own or rent their home, if they have a car and the number of school-age children. You can also establish how much the average household spends on a variety of goods and services. Studying this type of information helps you to construct a picture of your target market. For example, consumers over the age of fifty-five represent a huge and growing market that is largely neglected. Consider some of the demographics. They have half of all domestic spending power and more discretionary income than any other consumer group. They are the greatest consumers of services. Nearly three-quarters like to travel and they spend more on travel than younger tourists. They also have an average of two grandchildren and are therefore significant purchasers of children's products as well. You can also contact your trade association to see what statistical information they have gathered and analysed. For example, if you are starting a tourist venture for seniors then the Tourism Industry Association may have just what you need.

The limitation of statistical information is that it is based on historical data and it is purely descriptive. More useful information comes directly from potential customers themselves. Some of the market research tools for obtaining information from potential customers are home interviews, focus groups and surveys. Home interviews enable you to observe things such as the circumstances of the family or the use or presence of certain products. The personal nature of a home interview makes it possible to handle sensitive subjects better than with other methods. A focus group is a small group of selected customers invited to meet with you in order to talk about your product or service. Focus groups enable you to get first-hand insight into what matters most to your target market. Surveys are relatively inexpensive and many people will respond to a questionnaire. However, some people become judges and opinion givers rather than responding as consumers. Most surveys need to be limited to only a few questions that are simple, short and direct. There are specialists who can help you refine your methods and get the most from your market research. Having information about your customers puts you in a position to forecast probable events based on demographic trends and customer behaviour. It is the best means you have of finding out where you stand and where your business strategy ought to be taking you.

Finding your niche

A niche market is usually a subset of a larger market. For example, apparel aimed at plus-sized teenage girls is a subset of the misses' clothing market. New businesses usually start out by serving niche markets and the prospects for niche market opportunities are escalating with advances in technology, globalisation and communications. Not only is it feasible to source specialised products and services globally but it is also practical to sell them globally as well. Niche businesses have more flexibility and better cost structures to serve smaller markets than most large companies and they are positioned to develop intimate customer knowledge in markets that are too narrow for large companies to service. Niche businesses have also shown themselves to be more responsive in terms of delivery time, small order size and customised products and services.

An essential building block in developing a business strategy is deciding on a specific target market to aim at. *Market segmentation* is the process of identifying customer groups with similar characteristics. The objective is to select a group that matches your strengths and is large enough to support your business. This does not mean that you ignore the other groups. It simply means that a high proportion of your sales will come from the group that you target. Either individually or in combination, there are many criteria that can be used to segment consumer markets:

Age	**Gender**
Marital status	**Family size**
Occupation	**Income**
Geographic location	**Shopping style**
Religious affiliation	**Ethnic identity**
Lifestyle	**Leisure activities**
Brand loyalty	**Special interests**
Pricing and discounts	**Advertising and promotion**
Home ownership	**Education**

Industrial or business-to-business markets are usually segmented differently. They are based on the relative importance of the following types of benefits:

Availability of stock
Response to inquiries
Competent advice
Reliable service
After-sales service
Convenient ordering
Rapid delivery
Competitive prices

You need to clearly identify the market segment you want to attract, thoroughly understand their basic buying motives, and know exactly how your product or service will provide the benefits they want. The next step in developing your start-up strategy is to *position* your business according to the niche you have chosen. When customers decide to make a purchase they mentally rate all of the businesses that are most likely to offer what they want. They develop an image of each business that sums up their feelings about it and they will go first to the business they rate best. The way to get to the top position on the list is by creating competitive strength.

Creating competitive strength

The way in which you create competitive strength depends upon the market niche you target and the way you position your business. This is the part of your strategy in which you choose the *value drivers* aimed directly at satisfying customers' basic buying motives. Value drivers are the things that your business will do particularly well and that cannot be easily duplicated by competitors. Here are some examples:

Broader and deeper product lines
Lower costs and prices
Unique products or services
Better quality or availability
Superior skills and experience
More pleasant atmosphere
Recognised image or reputation
Superior customer service
More effective marketing methods
More convenient location
Better parking

It pays to concentrate on those value drivers that are consistent with your image, that reinforce your market position, and are efficient at motivating customers to make a purchase. It is also important that your value drivers can be easily advertised and promoted because customers need to be clear about how these value drivers satisfy their basic buying motives. Competitive strength is the magnet that draws customers to your door. Once your image and position are reinforced with strong value drivers, your competitors will have great difficulty in challenging customers' perceptions about your business.

Having established your competitive strength, you can choose how you will enter the market.

Head-on attack: This is the traditional frontal attack on an established competitor. It is sometimes used by very large firms with massive resources but it is not a tactic that usually succeeds for smaller businesses. A head-on attack typically calls for an expensive advertising and promotion campaign. It works best for established brand names and franchises that can leverage existing customer awareness and a 'coming to a store near you' approach.

Flanking manoeuvre: This consists of attacking your competitors where they are vulnerable. A flanking manoeuvre needs to take place firmly and swiftly before your competitors have an opportunity to react. It could be based on something like a lower price, better service or a neglected market niche.

Narrow focus: This consists of entering a market niche that is too small to attract larger competitors. This is the domain of many smaller businesses with specialised skills and low volume sales. The idea is to dominate a narrow niche market so that potential competitors are not tempted to enter it. It can also be a springboard strategy for entering other related niche markets.

Strategic alliance: This means creating a relationship with other businesses. It could be a joint venture, a licensing arrangement or another form of cooperation that fulfils the needs of a target market. This type of alliance sometimes occurs among related niche businesses in which none is interested in direct competition but wants to take advantage of the synergies that can result from cooperation.

Adapting to change

The nature of your business will change over time and part of your rolling business plan will be to adapt your business strategy as a result. The life cycle of a business consists of a number of phases, each with a different set of goals and requiring a different mindset. It is not only important to learn how to create an effective business strategy, but it is equally important to recognise when to change it. You always need two strategies: one that capitalises on the forces that are naturally at work and a second 'Plan B' strategy that acts as a safety net if the first strategy does not succeed.

Start-up phase

The start-up phase is characterised by tremendous uncertainty. You may lack confidence and your decisions may be compulsive, erratic and inconsistent. Your main goal is to generate enough cash flow to stay in business. You need to be a good initiator, innovator, problem solver and organiser in order to transform your initial idea into a genuine business. *Entry strategies* are designed to get into business. The avenues for entry include starting from scratch, buying an existing business or perhaps buying a franchise. Effective entry strategies rely on robust competitive strength. Plan B is an *exit strategy* designed to get out of business during the start-up phase if your competitive strength prematurely expires. Exit strategies consist largely of minimising the losses associated with discontinuing operations. The focus is on how to handle the existing obligations and how to avoid any further liabilities that may arise from winding up.

Take-off phase

The take-off phase is characterised by a sharp increase in sales. The dominant goal is to capitalise on your competitive strength. You will probably find it necessary to invest in more resources to support the increased sales and there is a danger that any lingering cash flow problems left over from the start-up phase will be aggravated. After an agonising period of uncertainty, the business finally turns the corner and starts to show a profit. However, overwork and stress may start to take their toll unless you learn to be selective about how you use your time and outsource those activities that you cannot or prefer not to do yourself. *Growth strategies* are designed to significantly and permanently increase the level of sales. The rapid increase in sales means you will need to invest in more resources in order to support greater sales volume. Growth strategies include sophisticated refinements to your competitive strength in order to meet any competition that is attracted by your success. Plan B is a *concentration strategy* designed for recovery if a growth strategy falters because rivals damage your competitive strength. The objective is to refocus your resources and your efforts on a slightly different target market in order to improve short-run cash flow and long-run profits.

Harvest phase

Eventually the growth in sales stabilises and the business enters the harvest phase. This can be a very prolonged part of the business life cycle when the dominant goal is to make profits. Internal matters like controlling costs and efficiency will occupy more of your time. Your competitive strength is entrenched and the business settles into a more predictable routine. *Profit strategies* are designed to make the best use of competitive strength and existing resources to produce large profits and positive cash flows. The focus shifts from acquiring new customers and more resources to making the most of existing customers and efficiently utilising existing resources. The ultimate profit strategy is the eventual sale of the business as a going concern for a price that reflects its competitive strength and long-term profitability. Plan B is a c*ontraction strategy* that is called for when the resources committed to the business become too large for the sales and profits they generate. Contraction strategies are designed to reduce your investment while maintaining profitability.

Renewal phase

The renewal phase begins with the recognition that competitive strength has become eroded. It often coincides with the owners' desire to withdraw from the business. They find themselves resisting changes to the way they have operated in the past. Faced with deadening inertia, the business may be in danger of withering away unless there is a new burst of enthusiasm or a successor is found. *Turnaround strategies* are designed to reverse the declining fortunes of a business on the premise that it is worth saving. Turnaround strategies are usually based on revenue-increasing measures or cost-reducing measures depending on which measures will have the greatest and most expedient effect on cash flow. Plan B is a *liquidation strategy* brought about by a decision to abandon the business. A liquidation strategy is designed to generate as much cash flow as possible while methodically withdrawing from the business. Liquidation strategies work best when the situation can still be controlled. They consist of either liquidating the business and winding it up or attempting to sell the business as a potential turnaround opportunity for a new owner.

Writing a business plan

There are two reasons for writing a business plan. The first and most important purpose of a business plan is to serve as a guide for establishing and operating your business. It is a blueprint for making the transition from your initial idea into a successful business and it is the result of investigation, deliberation and a vision about the results you expect to achieve. A business plan identifies the characteristics of the target market and the strategies that will be employed to address that market. It includes your methods for creating competitive strength and exploiting it, the day-to-day procedures you will use to operate the business and the financial results you expect to achieve. The second reason for writing a business plan is to provide information for people who are in a position to help you. This is especially true if you are seeking finance because a business plan is easily adapted to become a financing proposal for lenders and investors. Putting your business plan on paper represents an opportunity to think through all the aspects of organising and operating your business. It provides you with a way to examine the consequences of different strategies and to determine what skills, experience and resources are needed.

A business plan consists of strategic elements, operational elements and financial elements. Strategic elements are concerned with creating competitive strength. Operational elements are concerned with the day-to-day processes that give effect to the overall strategy.

Strategic planning makes a big impact on how well you generate revenue and operational planning affects how well that revenue is converted into profits. The financial elements of a business plan are simply the outcome of strategic and operational plans expressed in dollars. Sometimes one element of planning will dominate your thinking, but the best business plan is the result of an integrated approach that encompasses all three elements. It is not unusual for a realistic business plan to take several months to finalise. When you have a business plan in which you have confidence then you are ready to go into business. One way to approach writing a business plan is to organise it around specific questions.

What is the business?

A business plan should begin with a brief summary, sometimes called an *executive summary*, which describes the business and puts it into context. What type of business do you intend to enter? What will you call it? How will it be organised (proprietorship, partnership, company) and what will be its main activities (retailing, service, manufacturing, wholesaling, or some combination)? What is the product or service and what will be the target market? What is your competitive strength? If the plan includes a funding proposal, how much money is needed and how will it be used?

What is your product or service?

Exactly what are you are going to sell? Is your product or service already on the market or is it still in the development stage? If it is in the development stage, what is the roll-out strategy to bring it to market? What factors make this product or service unique or superior? Will there be opportunities to develop related products or services? What will it cost to make/buy/provide the product or service? Can you price the product or service competitively and earn a healthy profit margin?

What is your market?

This is the most difficult part of a business plan but it is the key section in every business plan. If you are launching a new product or service, include the results of your market research. If you have existing customers, explain who they are and their purchasing patterns. There are four steps to determining the nature and size of your market:

Identify your customer profile: Who are your customers? Divide them into target market segments and explain your rationale. What is their basic buying motive?

Determine the size of your market: How many potential customers are there? Can this customer base be expanded? How much will they spend annually on your product or service?

Assess your competition: Who are your nearest competitors? What have you learned about their operations? What will be your competitive strength? What share of the market do you think you can capture?

Estimate your sales: Based on the previous steps, estimate the sales that you expect. Be careful—make sure your estimate lines up with the facts. This information is critical to your financial forecast.

What is your marketing strategy?

In this section you describe how you will capture the target market. Explain how your marketing strategy follows on from the assessment of the market. Explain the characteristics of your target market, highlight your intended image and market position, show how you are going to satisfy customers' basic buying motives, present your pricing policy and describe your tactics for promotion and distribution. Explain why you have chosen to enter the market now and how your choice of timing results from research and planning.

How will you operate?

In this section you describe the operating plan and how it will give effect to your overall strategy. What is the roll-out plan for getting organised and into operation? What equipment, stock and other resources will you need to acquire? What components, raw materials or supplies do you need and do you have existing relationships with vendors or will you need to establish them? What are the day-to-day processes and procedures that you will set up? Who will do the work? Are staff readily available and how will you attract them? Will they be qualified when they are hired or will you need to provide training? What functions will you outsource? How can you make use of technology in your operations?

Who is behind the business?

Having the right people to mange the business is a key part of making it a success. Lenders and investors are particularly aware of this so this section is especially important if you are seeking finance. If you are in business by yourself, explain your skills and experience and include your resumé as an appendix to the plan. If you have managerial deficiencies, explain how you will find the expertise you lack. If you have formed a partnership, explain why the partners were chosen, what they bring to the business and how their abilities complement each other. If you have formed a company, describe the role and background of each corporate officer, the composition and qualifications of the board of directors and identify the company's advisers including your accountant and legal advisor.

What are your financial forecasts?

These are the expected financial outcomes of your strategic and operating plans. Your financial forecasts are concerned with profitability, cost structure and break-even point, financial structure and cash flow. You need to be confident about the financial viability of the business and that your decision to invest in a start-up is justified. If you are seeking finance, this section will also include how much money you need and how you will use it. It might be a request for a working capital loan to meet short-term fluctuations in cash flow, a long-term loan to finance growth, or equity capital to meet permanent financing needs by selling part of your business to an investor.

Guides and templates

There are many books and websites devoted to writing business plans. Some offer templates and software to help you with the process of writing your plan. The Commonwealth Government website at www.business.gov.au offers simple and convenient access to business plan guides and templates including:

- ‘Business planning template’: This provides tips to help you with your business planning and a downloadable business planning template.
- ‘How to draw up a business plan’: A free online tutorial tells how to draw up your plan so you identify its likely readers and meet their needs.
- ‘Easy Plan business planning template’: A low-cost business plan template with interactive spreadsheets helps you prepare cash flow forecasts and annual budgets.
- ‘Business planning’: This gives an information sheet on the principles of planning.
- ‘Model business plan template’: This is a template to use when preparing your business plan.
- ‘Business planning guide’: This guide covers why you need a business plan and what should be included.

Irrespective of how you decide to organise your business plan, there are a few important things to keep in mind. Make it simple. A business plan should be easy to grasp and it should communicate its content in a practical manner. Make it specific. Be sure your objectives are tangible and each time frame is attainable. Make it realistic. When you set out your sales targets, milestones and financial projections, make sure they are aligned with the facts and are not overly optimistic. Don’t omit the weaknesses and risks from your plan. Investors and lenders will find them anyway. Demonstrating that you recognise the weaknesses and risks and explaining what you intend to do if you run into trouble gives a lender or investor confidence in your ability.

Appendix Self-employment evaluation

The purpose of this evaluation is to enable you to gain an insight into self-employment as a potential career choice. It is one thing to discover a new business opportunity, but making the leap into business on your own is a different question altogether. Achieving success in business is much easier for some people than it is for others. The objective of this exercise is to help you reflect on your personality and reach your own conclusions about self-employment as a career alternative.

There are many ways to be successful in business and understanding your personality is important because personality type greatly influences the way in which you are likely to approach self-employment. Many of us have also been conditioned by the education system and over-cautious parents to underestimate our potential. If you are not clear about your strengths or what direction to pursue, then using this tool will help you take a fresh look at your natural capabilities and how they might be used to pursue a new business opportunity.

Questionnaires like this are always subject to some degree of uncertainty. If you feel strongly that this one has incorrectly assessed some aspect of your personality then you are probably right. Nevertheless, what these questions can do is help you recognise things about yourself that you may not have previously understood. Use the answer sheet on page 207 to record your answers. Each question has two responses. Tick the box for the response that *best* describes you. When you are finished with the answer sheet, turn the page for feedback on the results.

Questionnaire

1. Do you:
   - a usually offer unsolicited opinions?
   - b only offer your opinion if asked?
2. Would you prefer the atmosphere in your business to be:
   - a one big happy family?
   - b strictly business?
3. Are you inclined to:
   - a get involved in too many projects at once?
   - b make sure that you do not get over-extended?
4. Do you find yourself using your imagination:
   - a occasionally?
   - b often?
5. Are you usually:
   - a comfortable with making plans?
   - b impatient with making plans?
6. Are you likely to:
   - a keep the promises that you make to yourself?
   - b not keep the promises that you make to yourself?
7. Is being able to live in a particular community:
   - a very important to you?
   - b not important to you?
8. Are competing and winning:
   - a not very important to you?
   - b important elements in your life?
9. Is building your business around a specific skill or technical area:
   - a not important to you?
   - b very important to you?
10. Would you be more likely to:
    - a risk your lifestyle to start a promising venture?
    - b pass up a promising venture to protect your lifestyle?

11. Do you tend to find yourself doing most of:
    a the talking?
    b the listening?

12. Would you be best described as:
    a a sentimental person?
    b a calculating person?

13. Do you tend to:
    a leave things unresolved for a while?
    b look for a quick resolution of issues?

14. Do you think that you would run your business in:
    a a conventional manner?
    b an unconventional manner?

15. When you go into business, will you have:
    a a detailed plan for getting started?
    b a rough plan for getting started?

16. Do you tend to:
    a find it easy to finish the things that you begin?
    b have some difficulty finishing some things?

17. Is work that is free from organisational restrictions:
    a moderately important to you?
    b very important to you?

18. Has the main challenge in your life been to:
    a develop a balanced lifestyle?
    b confront and solve problems?

19. Is becoming a business manager:
    a your main career goal?
    b only a means to becoming self-employed?

20. Have events in your life been mostly determined by:
    a yourself?
    b forces outside your control?

21. Do you tend to:
 a mix easily in a group?
 b not mix easily in a group?

22. In making business decisions, would you take:
 a people into account most?
 b facts into account most?

23. Would you tend to run your business with:
 a a flexible approach?
 b a decisive approach?

24. Would you be more likely to run your business:
 a in a tried or proven manner?
 b in an untried or experimental manner?

25. Are you a person who:
 a plans in advance?
 b waits until the last minute?

26. Do you think that you are:
 a very motivated?
 b moderately motivated?

27. Is a business that provides you with complete financial security:
 a extremely important to you?
 b moderately important to you?

28. Will a successful business be worthwhile to you:
 a only if it enables you to lead your life in your own way?
 b even if you have to make some changes to your lifestyle?

29. Is pursuing your particular trade or specialty:
 a not as important to you as general management?
 b more important to you than general management?

30. Are you likely to:
 a do whatever it takes to finish a job?
 b apply only a reasonable amount of effort to finish a job?

31. In a group, do you tend to be:
   a an organiser?
   b a participator?

32. Would you prefer your staff to have personalities that are:
   a warm and gentle?
   b formal and business-like?

33. Would you prefer to run your business in:
   a a flexible and spontaneous manner?
   b a planned and controlled manner?

34. Would you consider yourself to be:
   a more practical than creative?
   b more creative than practical?

35. If you wanted to buy a used car, would you talk it over with:
   a a motor mechanic?
   b a few of your friends?

36. Have you:
   a made some progress toward achieving your personal goals?
   b not yet made much progress toward achieving your personal goals?

37. Is a business that will give you long-term job stability:
   a very important to you?
   b only moderately important to you?

38. Is choosing and maintaining a certain lifestyle:
   a more important to you than success in business?
   b less important to you than success in business?

39. Is having a management role in which you can supervise other people:
   a very important to you?
   b not important to you?

40. When running your business, would you place emphasis on:
   a looking for new business opportunities?
   b developing existing business opportunities?

41. Are you a person with:
 a a considerable amount of social charm?
 b a modest amount of social charm?

42. Would you be best described as:
 a emotional?
 b logical?

43. Would you prefer to run your business with an approach that is:
 a spontaneous and keeps your options open?
 b predictable and controlled?

44. When you perform a task, do you like to:
 a do it in the usual way?
 b try to find another way?

45. When you begin a project, do you:
 a plan it out first?
 b work it out as you go along?

46. When you are working on a project, do you:
 a usually complete it on time?
 b often run out of time?

47. Is work that permits you to have complete freedom:
 a moderately important to you?
 b very important to you?

48. Is working on tough problems:
 a not usually enjoyable for you?
 b almost always enjoyable for you?

49. Is working in your trade or specialty for your entire career:
 a not important to you?
 b very important to you?

50. Do you have:
 a a considerable amount of self-confidence?
 b a moderate amount of self-confidence?

51. Would you describe yourself as:
   a outgoing?
   b reserved?

52. When you make decisions, do you tend to rely on:
   a your feelings?
   b facts and logic?

53. Does your thinking tend to be:
   a unstructured and free?
   b structured and focused?

54. Is the most important quality that you will bring to your business:
   a practical experience?
   b a vision of the future?

55. If you had to organise an office party, would you find this task:
   a enjoyable?
   b a burden?

56. Do you consider yourself to be:
   a a person who gets things done?
   b a bit of a procrastinator?

57. In your working life, have you been mostly concerned about:
   a security and stability?
   b your own sense of freedom?

58. Is giving equal weight to your family life and your business life:
   a very important to you?
   b moderately important to you?

59. Is being a business manager:
   a more important to you than your trade or specialty?
   b less important to you than your trade or specialty?

60. Is having friends and business associates:
   a very important to you?
   b only moderately important to you?

61. Are you:
  a always willing to try something new?
  b reluctant to try something new until you understand it first?

62. Are you more inclined to be:
  a a warm and understanding person?
  b a firm but fair person?

63. Are you usually:
  a open to the views of others?
  b not easily influenced by others?

64. When you were in school, did you do better in:
  a practical subjects?
  b theoretical subjects?

65. Do you believe success in business depends mostly on:
  a planning?
  b getting a lucky break?

66. Are you a person with:
  a a bit more than average initiative?
  b a bit less than average initiative?

67. Is a business that provides you with lifetime employment:
  a very important to you?
  b not important to you?

68. Is competing and winning:
  a not an important part of your life?
  b the most exciting part of your life?

69. Do you want to be a manager:
  a as soon as you possibly can?
  b only if it is in your area of expertise?

70. Do you think that you would be good at:
  a developing new products or services?
  b refining existing products or services?

71. Are you more likely to:
   a act spontaneously?
   b think about something before acting?

72. As a boss, would you tend to:
   a get upset by disagreements?
   b not get upset by disagreements?

73. Do you like to work in:
   a an environment that is constantly changing?
   b a more predictable environment?

74. When you plan for the future, do you rely mostly on:
   a known facts?
   b your intuition?

75. Do you usually:
   a plan your day in advance?
   b wait to see what happens first?

76. If it was late at night and you were tired, would you finish the job you were working on:
   a that night?
   b the next day?

77. Is living in a particular area and not having to move:
   a very important to you?
   b not important to you?

78. Is a business that permits you to pursue your chosen lifestyle:
   a very important to you?
   b only moderately important to you?

79. Is being in charge of a business organisation:
   a very important to you?
   b not important to you?

80. Do you usually:
   a feel comfortable taking moderate risks?
   b avoid situations in which you have to take risks?

81. Do you have a tendency to react:
   a quickly according to your 'gut' reaction?
   b only after you know all of the details?

82. When making business decisions, is it more important to:
   a consider the feelings of everyone concerned?
   b make logical and objective decisions that are not influenced by other people's feelings?

83. Do you:
   a feel comfortable when you are involved in many projects at once?
   b prefer to finish one project before starting another?

84. Would you describe yourself as:
   a practical?
   b imaginative?

85. When you have to do several things, do you:
   a make a list first, and then do them one at a time?
   b attack them all simultaneously or in no particular order?

86. Do you:
   a like to get things done ahead of time?
   b usually put things off until they have to be done?

87. Is the thing you care about most in your working life:
   a security?
   b freedom?

88. Does constantly being confronted by problems or competitive situations:
   a depress you?
   b excite you?

89. If you had less time for your specialty and you were forced to spend more time in general management, would you be:
   a just as happy?
   b unhappy enough to possibly sell your business?

90. Would you prefer a business venture with:
   a higher risk and greater possible rewards?
   b lower risk and smaller guaranteed rewards?

91. Are you the sort of person who:
 a is easy to get to know?
 b reveals themself slowly to others?

92. Do you think that you would be:
 a a sympathetic boss who got involved with the staff?
 b a firm boss who did not get involved with the staff?

93. Would you describe yourself as:
 a flexible?
 b firm?

94. Do you like doing things in:
 a tried and proven ways?
 b new and different ways?

95. Have you:
 a established your personal goals for the next five years?
 b focused mainly on the initial steps of establishing your personal goals?

96. Do you:
 a like to set your own deadlines?
 b dislike deadlines, even if you set them yourself?

97. Is the need to plan and organise your own work:
 a moderately important to you?
 b very important to you?

98. To get your business off the ground, would you:
 a not be prepared to spend much time away from your family?
 b be prepared to spend time away from your family?

99. Is the process of supervising and managing people:
 a very important to you?
 b not important to you?

100. Would you prefer to:
 a be your own boss with no guarantee of success?
 b have a guaranteed career as a manager in a big company?

ANSWER SHEET

	1	2	3	4	5	6	7	8	9	10
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	11	12	13	14	15	16	17	18	19	20
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	21	22	23	24	25	26	27	28	29	30
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	31	32	33	34	35	36	37	38	39	40
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	41	42	43	44	45	46	47	48	49	50
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	51	52	53	54	55	56	57	58	59	60
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	61	62	63	64	65	66	67	68	69	70
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	71	72	73	74	75	76	77	78	79	80
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	81	82	83	84	85	86	87	88	89	90
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
	91	92	93	94	95	96	97	98	99	100
a	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
b	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

Interpreting questionnaire responses

Extroversion

Count the number of 'a' boxes that you ticked in the column that begins with question 1 on the answer sheet. A score of 7–10 indicates that you have an *extroverted* personality. A score of 0–3 indicates that you have an *introverted* personality. A score of 4–6 indicates no clear tendency between extroversion and introversion.

Success in organising and operating a business is highly correlated with an individual's tendency toward extroversion. Extroverted individuals are sociable, active, occasionally impulsive, and enjoy working with people. They draw their energy from others and their charm and charisma help them to gain support from customers, staff and suppliers. Introverted individuals are territorial, reflective, hesitant and prefer to work in solitude. They find it difficult to develop the kind of interpersonal relationships that attract customers, motivate staff and encourage suppliers to look after them.

Approach

Count the number of 'b' boxes that you ticked in the column beginning with question 2 on the answer sheet. A score of 7–10 indicates that you have a *rationalist* approach. A score of 0–3 indicates that you have a *humanist* approach. A score of 4–6 indicates no clear tendency toward one approach or the other.

In order to achieve success in a business of your own, you need to be able to make rational decisions. Rational decision-makers generally make logical decisions based on the facts alone and ignore the feelings of other people. Humanists usually consider people first when they make decisions. They are very sensitive about other people's feelings, and they tend to approach business decisions with a great deal of compassion. The analytical, logical and somewhat impersonal rationalist has been shown to be associated with survival and success in business. Unfortunately, the sensitive and compassionate humanist does not tend to perform as well.

Flexibility

Count the number of 'a' boxes that you ticked in the column beginning with question 3 on the answer sheet. A score of 7–10 indicates that you are *flexible.* A score of 0–3 indicates that you are *inflexible.* A score of 4–6 indicates no clear tendency one way or the other.

Flexible individuals accept change as natural. They may have many projects underway at the same time. Sometimes they even appear to be indecisive because they like to keep their options open. Inflexible individuals like a planned, predetermined way of life. They have a tendency to resist change and they like to finish one project before beginning the next. Having made a decision, inflexible individuals are not likely to change their mind.

Successful business operators are flexible. Flexible operators have the ability to deal with risk spontaneously and a special tolerance for ambiguous and uncertain situations. Although flexibility may appear to demonstrate indecision, it does not—it is actually the result of the ability to make a series of revised decisions that reflect new information as it appears.

Creativity

Count the number of 'b' boxes that you ticked in the column beginning with question 4 on the answer sheet. A score of 7–10 indicates that you have a *high capacity for creativity.* A score of 0–3 indicates that you have a *low capacity for creativity.* A score of 4–6 indicates that you have average creativity.

Success in business is directly related to an individual's capacity for creativity. Creative individuals are idea generators while non-creative individuals tend to use the ideas of others. If you are creative, then your inventiveness and intuition will enable you to visualise how you will react in new situations. Your creative intuition also plays an important role in reducing risk by substituting for a lack of information. If you are not creative, then you will suffer from a competitive disadvantage that will probably reflect itself in the performance of your business.

Planning

Count the number of 'a' boxes that you ticked in the column beginning with question 5 on the answer sheet. A score of 7–10 indicates that you are an *effective planner.* A score of 0–3 indicates that you are an *ineffective planner.* A score of 4–6 indicates that you are an average planner.

A number of research studies have shown that successful business operators set realistic goals and plan how they are going to achieve them. If you are an effective planner, then you will be at ease with formulating and implementing an overall plan for your business. If you are an ineffective planner, then you may not only have a problem with the establishment of your business but also with its ongoing operation.

Initiative

Count the number of 'a' boxes that you ticked in the column beginning with question 6 on the answer sheet. A score of 7–10 indicates that you have a *high degree of initiative.* A score of 0–3 indicates that you have a *low degree of initiative.* A score of 4–6 indicates that you have average initiative.

Many individuals who intend to become self-employed never end up doing it. They include the procrastinators, those who lack self-confidence, and others who see too many hurdles to overcome. For these individuals, the missing ingredient is initiative. There is considerable agreement among researchers that successful business operators actively seek and take the initiative. They willingly put themselves in situations where they are personally responsible for success or failure. Successful business operators are doers; they are goal oriented and action oriented. They are very conscious about how they use their time and they are appalled by wasted time.

Independence

Successful business operators have been shown to have a strong sense of independence. This sense of independence, however, stems from two needs. The first is the need to achieve autonomy in one's life, while the second is the need to achieve security and stability. Count the number of 'b' boxes that you ticked in the column beginning with question 7 on the answer sheet. A score of 7–10 indicates that your sense of independence is based upon your need for *autonomy.* A score of 0–3 indicates that your sense of independence is based upon your need for *stability and security*. A score of 4–6 indicates that your sense of independence is balanced between these two needs.

Autonomy is important to individuals who do not wish to be bound by the constraints of large organisations. They have an overriding need to do things in their own way, at their own pace and according to their own standards. Therefore, they tend to be pulled towards work situations in which they can satisfy their need for autonomy. Security and stability are important to individuals who want their future to be certain. Not every business operator wants or needs unlimited growth. If they can achieve the security and stability they seek, then these individuals are content. People are different and want different things out of life, so it is important to recognise these differences and to take them into account when contemplating the type of business that is best for you.

Purpose

What is your reason for wanting to become self-employed? Are you drawn by the challenge of starting and managing your own business? Or will self-employment enable you to achieve a certain lifestyle? Count the 'b' boxes that you ticked in the column beginning with question 8 on the answer sheet. A score of 7–10 indicates that your purpose for going into business is based upon your need for *challenge.* A score of 0–3 indicates that your purpose for going into business is based upon your need for an integrated *lifestyle.* A score of 4–6 indicates a balance of purpose between challenge and lifestyle.

Some individuals look upon self-employment purely in terms of the challenge of organising and operating their own business. They define success in terms of overcoming obstacles, solving problems and winning against the competition. The type of business they choose and the way they operate it provides ongoing challenges. Other individuals look upon self-employment as a way to integrate and balance their family, career and personal development. This is not a need for independence but rather a need for a balanced way of life in which career decisions do not have to dominate. It places a premium on things like where to live, the amount of time spent working and the whole family versus business relationship.

Role

What emphasis will you place on your role in the business? Do you see yourself as a general manager or are you more inclined to pursue a particular technical or functional specialty? Count the number of 'a' boxes that you ticked in the column beginning with question 9 on the answer sheet. A score of 7–10 indicates an emphasis on *general management.* A score of 0–3 indicates an emphasis on a *technical or functional specialty.* A score of 4–6 indicates an equal emphasis on both.

Some individuals want a business in which their overall managerial efforts are what matters. They want to exercise their capacity to identify and solve problems, to influence and control other people and to be stimulated by crises. Other individuals have strong talents in a particular functional or technical specialty. They build their sense of identity around the content of their work and they see themselves as a specialist. These individuals find the work itself intrinsically meaningful and satisfying. They tend to shun management responsibilities and usually prefer a smaller operation.

Determination

Determination is much more powerful than initiative. It is evidenced by a well-thought-out, assertive action plan driven by a deep desire to succeed in your own business. Count the number of 'a' boxes that you ticked in the column beginning with question 10 on the answer sheet. A score of 7–10 indicates *strong determination.* A score of 0–3 indicates *weak determination.* A score of 4–6 indicates average determination.

Determination is generally the factor which decides whether you will actually start a business or just talk about it. Being goal oriented is not enough. What you also need is the determination to make it happen. Successful business operators tend to believe strongly in themselves and their ability to achieve the goals that they set. They believe that events in their life are mainly self-determined and that they have a major influence on their personal destiny. They are intensely committed to overcoming hurdles, solving problems and completing the job.

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