Chapter 6
Entrepreneurship and Business Planning

Learning Objectives

1. Identify the advantages and disadvantages of being an entrepreneur and creating a business
2. Identify the market conditions that should be assessed before entering a market
3. Explain how a new business can develop a competitive advantage
4. Explain how to develop a business plan
5. Identify the risks to which a business is exposed, and explain how they can be managed

Entrepreneurship

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit Potential</td>
<td>Loss Potential</td>
</tr>
<tr>
<td>- Your Own Boss</td>
<td>- Accountability</td>
</tr>
<tr>
<td>- Direct Rewards</td>
<td>- Failure Possibility</td>
</tr>
</tbody>
</table>

Industry Effects on a Firm’s Performance

Industry Demand is affected by:

1. Economic Conditions
2. Demographics
3. Consumer Preferences

Industry Competition is affected by:

1. Firm’s Market Share
2. Level of Competition
3. Development of a Competitive Advantage

Industry Competition

Graph showing the distribution of competitive situations among small businesses. In general, most small businesses are concerned about more than one competitor. When asked how the number of competitors has changed in the last three years, the small businesses responded as follows:

- Increased competition: 40%
- No change in competition: 40%
- Decreased competition: 20%
- New competitors: 5%
Industry Competition
Market Segments

<table>
<thead>
<tr>
<th>Price per Product</th>
<th>Perceived Quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>BMW 325</td>
<td>Toyota Celica</td>
</tr>
<tr>
<td>Corvette</td>
<td>Ford Escort</td>
</tr>
</tbody>
</table>

Industry Effects on a Firm’s Performance

**Labor Environment** is affected by:
1. Cost of Labor
2. Skills Needed
3. Unions

**Regulatory Environment** is affected by:
1. Government Regulation
2. Industry Regulation

Characteristics Affecting Degree of Exposure to Industry Conditions

1. Firm’s market share.
2. Firm’s focus on its main industry.
   - Higher the focus, the higher the exposure to risk.
   - Diversification: reduces firm’s exposure to one industry.
     - Westinghouse: electronics, real estate.
     - However, too much diversification loses focus.
     - Chrysler failed in corporate aircraft, military defense, and car rental.

Developing a Competitive Advantage

1. Low-cost production
2. Better quality
3. Product differentiation

Creating a Business Idea

- Identify a competitive advantage.
- Differentiate the product or service from competitors.
- Determine necessary resources.
- Assess feasibility of the idea.

Business Plan

→ **Who is it for?**
  - For the Entrepreneur.
  - For Investors and Creditors.

→ **What does it provide?**
  - Detailed description of the proposed business, including types of customers, competition, and facilities needed for production.
Possible Business Plan Sections

<table>
<thead>
<tr>
<th>Cover Letter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 1 Executive Summary</td>
</tr>
<tr>
<td>Section 2 Company Background</td>
</tr>
<tr>
<td>Section 3 Management Team</td>
</tr>
<tr>
<td>Section 4 Environment</td>
</tr>
<tr>
<td>Section 5 Management Plan</td>
</tr>
<tr>
<td>Section 6 Marketing Plan</td>
</tr>
<tr>
<td>Section 7 Financial Plan</td>
</tr>
<tr>
<td>Section 8 Appendix</td>
</tr>
</tbody>
</table>

Can be between 25 and 50 pages and take up to six months to complete.

Business Plan: Environment Section

The business environment must be assessed:

- Economic Environment – impacts demand for products
- Industry Environment – level of competition may impact product pricing strategy
- Global Environment – exchange rates may impact the cost of doing business

Business Plan: Management Section

- Organizational structure
  Identifies roles and responsibilities of each employee in the firm.
- Production
  Decisions about production process, location, and facilities.
- Human resources
  Set up work environment that will motivate the employees to help the business succeed.

Business Plan: Marketing Section

- Target Market: Profile of the target customer.
- Product Characteristics: Detailed description of product.
- Pricing: Proposed price of the product(s).
- Distribution: How products will get to the customer.
- Promotion: How products will be communicated to the target market.

Business Plan: Financial Section

- Feasibility
  Estimate costs and benefits of the business, including sales forecasts and all expenses.

- Financing the Business
  Summary of the initial outlay needed to start the business.

Considerations in Assessing a Business Plan

- Potential revenue.
- Demand for product or service.
- Expense of production.
- Overall potential for profitability.
Risk Management

Identify Risk  
Protect Against Risk  
Achieve More Stable Business Performance  
Cost of Obtaining Funds  
Increase Firm's Value

Risk Management

Business Risk: possibility that a firm’s performance will be lower than expected because of its exposure to specific conditions.

Protecting against risk:
- Eliminate the risk
- Shift the risk
- Assume the risk

Firm Specific Risk Exposure

Characteristics that influence business risk include:
- Limited funding
- Reliance on one product
- Reliance on one customer
- Reliance on one supplier
- Reliance on a key employee
- Property losses
- Liability losses
- Employee compensation claims

Hedging Against Key Employee Death and Illness

Death of Key Employee
- Whole-life insurance
- Term insurance
- Decreasing term insurance
- Universal life insurance

Illness of Key Employee
- Health insurance
- Diversity of employees

Exposure to Lawsuits

- Firms have been bombarded in recent years by a variety of lawsuits
  - Consumer sues because of product defects.
  - Poorly performing employee who is fired.
  - Employee taking illegal drugs and performing poorly is fired.
  - Employee promoted as the most qualified - less qualified employees sue.
  - Employee is fired for walking into office with a loaded gun.

Exposure to Lawsuits

- Impact on business strategies
  - Compensating injured persons can force companies into bankruptcy.
  - Eliminating products from product line to avoid risk of lawsuits.
  - Withholding products from market to avoid risk of lawsuits.
  - Attempting to avoid unfavorable judgments by using procedures that are well documented and that demonstrate a firm’s efforts to treat customers and employees properly