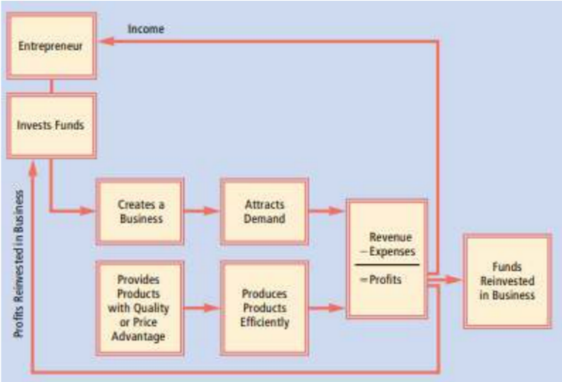
F. Entrepreneurship and Business Planning



1. Creating a New Business
   Each year, hundreds of thousands of small businesses are created. Though the largest businesses receive the most publicity, small businesses are vital to the economy. More than 99 percent of all firms have fewer than 500 employees. Small businesses are created by entrepreneurs who have a business idea and are willing to invest their own money to back the idea.

   - Online Resources for Creating a Business
     Starting a small business can be a difficult process. Business publications and the Small Business Administration (SBA) have been the usual sources for advice. Financing has primarily been available through local financial institutions and has been relatively difficult to obtain.
     The Internet has made this process much easier. A variety of sites provide advice about starting a business. Information on government grants, advice about specific industries, business plan templates, and discussions of legal issues are readily available.

   - Pros and Cons of Being an entrepreneur
     Some of the more important advantages of being an entrepreneur are:
     - As an entrepreneur, you may possibly earn large profits on your business, and therefore earn a much higher income than if you worked for another business.
     - You can be your own boss and run the business the way that you want.
     - Because you are in control, you do not need to fear being mistreated by a boss or being fired.
     - You have the satisfaction of working in a business that you created, and you will likely be more willing to work because you are dire

Being an entrepreneur also has some disadvantages that should be considered:

- You may possibly incur large losses and could even lose your entire investment in the business.
- Though you may be in control of the business, you have to ensure that the business functions properly. Being in control does not necessarily mean that you can skip work whenever you desire; the income you earn is tied to how well the business is managed on a daily basis.
- Though, as the owner of a business, you will not be fired, you could still lose your source of income if the business fails.

- Entrepreneurial Profile

  Consider whether you fit the entrepreneurial profile.
  - Risk Tolerance Entrepreneurs must be willing to accept the risk of losing their business investment.
  - Creativity Entrepreneurs recognize ways to increase customer satisfaction.
  - Initiative Entrepreneurs must be willing to take the initiative to make their ideas happen.

2. Assessing Market Conditions

   Before creating a new business for a particular market, the following conditions in that market should be considered:
   - Demand

     Every product has its own market, where there are consumers who purchase the product and businesses that sell the product. In the market for personal computers (PCs), there is demand by millions of people for PCs, and there are many businesses (such as Dell and Hewlett-Packard) that produce PCs to accommodate that demand. There is also a market for services such as those provided by hairstylists, dentists, and mechanics. Since these services cannot be shipped, the demand for services within an area is accommodated by firms within that area.

   - Competition

     Each business has a market share, which represents its sales volume as a percentage of the total sales in a specific market.

     If the competition within a particular market is limited, firms can more easily increase their market share and therefore increase their revenue. In addition, they may also be able to increase their price without losing their customers. Therefore, entrepreneurs prefer to pursue markets where competition is limited.

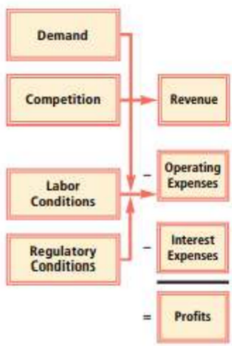
     When competition in a particular market increase, it can reduce each firm's market share, thereby reducing the quantity of units sold by each firm in the market. Second, a high degree of competition may force each firm in the market to lower its price to prevent competitors from taking away its business. Consider the intense competition recently in the market for long-distance phone services.

- Labor conditions
  Some markets have specific labor characteristics. The cost of labor is much higher in industries such as health care that require specialized skills. Unions may also affect the cost of labor. Some manufacturing industries, particularly those in the northern states, have labor unions, and labor costs in these industries are relatively high. Industries that have labor unions may also experience labor strikes.

- Regulatory conditions
  Although all industries are subject to some form of government regulation, some industries face especially restrictive regulations. Automobile and oil firms have been subject to increased environmental regulations. Firms in the banking, insurance, and utility industries have been subject to regulations on the types of services they can provide.

- Summary of Market Conditions
  An entrepreneur must consider all of the market conditions identified here before deciding to create a new business. The means by which these conditions affect the potential performance of the business are shown in Exhibit 6.2. Demand and competition affect the demand for a firm's products and therefore affect its revenue. Since these conditions also influence the quantity of products that a new business would produce, they also affect operating costs, such as manufacturing and administrative expenses. Any changes in the labor and regulatory environments typically affect the expenses of a new business.

Exhibit 6.2
Effects of Market Conditions on a Firm's Performance



3. Developing a Competitive Advantage
   Once entrepreneurs have identified and assessed their key competitors, they can search for ways to increase or at least maintain their market share. They must assess their specific market segment to determine whether they have a competitive advantage.

- Key Advantages
    - Produce Products Efficiently
    - Produce Higher-Quality Products

- Using the Internet to Create a Competitive Advantage
    - Advantages of a Web-Based Business
      One of the most important advantages of a website is that it may be able to replace a store. A business website can be especially effective in reducing expenses when it provides services in the form of information. Another benefit of a Web-based business is that it can reach additional customers and therefore increase the revenue that the business generates.

- Expenses of a Web-Based Business
  Along with the competitive advantages, some expenses are associated with a Web-based business. First, there is the cost of developing a website and installing a shopping cart system on the site to accept orders.
  Second, a firm is needed to screen the credit card payments and ensure that the customers are using legitimate credit cards. Third, businesses commonly pay a website firm a small monthly fee to host the site and ensure that the site is constantly accessible to potential clients. Fourth, a business may need to pay marketing expenses to increase its visibility to customers.

- Using SWOT Analysis to Develop a Competitive Advantage
  Entrepreneurs commonly use SWOT analysis to develop a competitive advantage. The acronym SWOT stands for strengths, weaknesses, opportunities, and threats. Thus, a new business can use SWOT analysis to assess its own strengths (such as a lower price or higher quality) and weaknesses, as well as the external opportunities and threats it faces.

4. Developing the Business Plan
   After entrepreneurs assess markets and consider their competitive advantages, they may decide to create a particular business. They will need to develop a business plan, which is a detailed description of the proposed business, including a description of the product or service, the resources needed for production, the marketing needed to sell the product or service, and the financing required.

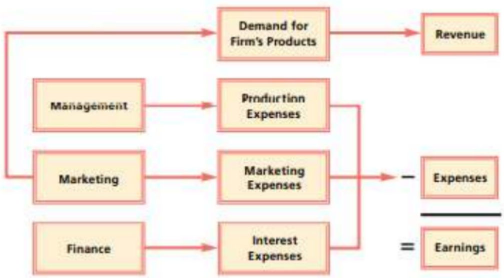
    - Assessment of the Business Environment
        - Economic Environment
          The economic environment is assessed to determine how demand for the product may change in response to future economic conditions.
        - Industry Environment
          The industry environment is assessed to determine the degree of competition.
        - Global Environment
          The global environment is assessed to determine how the demand for the product may change in response to future global conditions.

- Management Plan
  - Organizational Structure
  - Production
  - Human Resources

- Marketing Plan
  - Target Market
  - Product Characteristics
  - Pricing
  - Promotion

- Financial Plan
  - Financing
  - Funding by the SBA
  - Feasibility

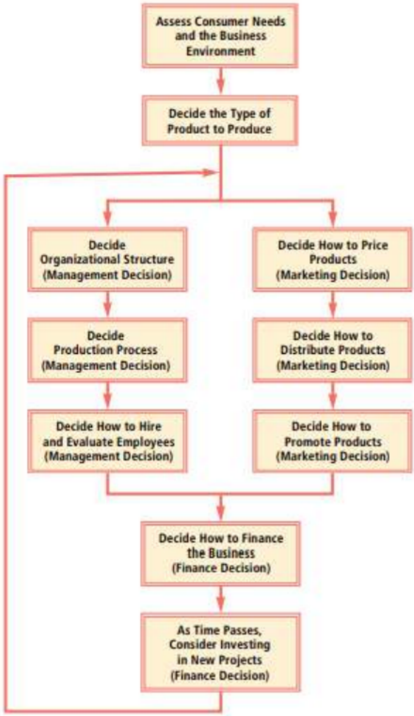
Exhibit 6.3
How a Firm's Earnings Are Measured



- Online Resources for Developing a Business Plan
  - Business Plan Outlines Packages normally offer one or more outlines of business plans that can be altered to fit most businesses.
  - Text Generation Much of the information that goes into a business plan is standardized.
  - Forecasting Any business plan software packages should include the ability to create consistent projections.
  - Graphics Business plan software offers the ability to create charts of several different types (bar charts, pie charts, line charts) and should also allow users to draw other common charts, such as organizational charts.
  - Supplementary Documents A number of business plan packages offer supplementary documents, such as disclosure agreements, which are often used in conjunction with business plans, although not necessarily as part of the document.

- Summary of a Business Plan

Exhibit 6.5
Common Sequence of Business Decisions Made in Developing a Business Plan



5. Risk Management by Entrepreneurs
   As entrepreneurs plan their new business, they recognize that they are exposed to business risk, or the uncertainty of the future performance of a business.

   - Reliance on One Customer
     Firms that rely on a single customer for most of their business have a high degree of business risk because their performance will decline substantially if the customer switches to a competitor.

   - Reliance on One Supplier
     Firms that rely on a single supplier for most of their supplies may be severely affected if that supplier does not fulfill its obligations. If that supplier suddenly goes out of business, the firm may experience a major shortage of supplies. Firms that use several suppliers are less exposed to the possibility of a single supplier going out of business, because they will still receive their supply orders from the other suppliers.

- Reliance on a Key Employee
  When a firm relies on a key employee for its business decisions, the death or resignation of that employee could have a severe impact on the firm's performance.

  - Hedging against Losses Resulting from a Key Employee's Death
    Firms can hedge against losses resulting from a key employee's death by purchasing life insurance for their key employees. The policy identifies the firm as the beneficiary in the event that a key employee dies. Thus, when a key employee dies, this type of insurance provides the firm with compensation, which the firm can use to offset the possible losses or reduced performance. The firm is cushioned from the loss of a key employee and may be able to survive while it attempts to hire a person to fulfill the key employee's responsibilities.

  - Hedging against the Illness or Loss of a Key Employee
    The illness or resignation of a key employee may also adversely affect the performance of a firm. To try to prevent employees from becoming ill, many firms offer a program that enables their employees to obtain health insurance from health insurance companies. The insurance is generally cheaper when purchased through the firm. Even if a firm provides a health insurance plan for its employees, it may still be affected by the temporary absence of an employee. Firms can reduce the potential adverse effect of an employee's illness by ensuring that more than one employee can perform each task. To attempt to prevent key employee from resigning, firms can offer good compensation and benefits.

- Exposure to E-risk
  New businesses can hire firms to establish a computer system that is protected from this exposure. Alternatively, a business may attempt to purchase insurance to cover against loss of business income, damage to reputation, loss of intellectual property, interruption of service liability, and liabilities incurred as a result of electronically published information.