GLOBAL EDITION

Entrepreneurship

and effective small business management

ELEVENTH EDITION

Norman M. Scarborough • Jeffrey R. Cornwall

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Eleventh Edition
Global Edition

Entrepreneurship and Effective Small Business Management

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invest funds. It is also potential lenders' and investors' first impression of the company and its managers. Therefore, the finished product should be highly polished and professional in both form and content.

Three Tests That Every Business Plan Must Pass

4.

Describe the elements of a solid business plan.

Preparing a sound business plan clearly requires time and effort, but the benefits greatly exceed the costs. Building a plan forces a potential entrepreneur to look at his or her business idea in the harsh light of reality by refining the concepts developed in the business model and defining them in more detail. To get external financing, an entrepreneur's plan must pass three tests with potential lenders and investors: (1) the reality test, (2) the competitive test, and (3) the value test. Entrepreneurs develop the information used for these three tests in the feasibility analysis discussed earlier in this chapter. The first two tests, discussed in the following sections, have both an external and an internal component.

Reality Test

The external component of the reality test revolves around proving that a market for the product or service really does exist. It focuses on industry attractiveness, market niches, potential customers, market size, degree of competition, and similar factors. Entrepreneurs who pass this part of the reality test prove in the marketing portion of their business plan that there is strong demand for their business idea. Evidence they gather during the testing of the business model should be an integral part of the marketing plan to bolster the proof for the idea using real customers.

The internal component of the reality test focuses on the product or service itself. Can the company *really* build it for the cost estimates in the business plan? Is it truly different from what competitors are already selling? Does it offer customers something of value?

Competitive Test

The external part of the competitive test evaluates the company's position relative to its key competitors. How do the company's strengths and weaknesses match up with those of the competition? Do competitors' actions threaten the new company's success and survival?

The internal competitive test focuses on management's ability to create a company that will gain an edge over existing rivals. To pass this part of the competitive test, a plan must prove the quality, skill, and experience of the venture's management team. What other resources does the company have that can give it a competitive edge in the market?

Value Test

To convince lenders and investors to put their money into the venture, a business plan must prove to them that it offers a high probability of repayment or an attractive rate of return. Entrepreneurs usually see their businesses as good investments because they consider the intangibles of owning a business—gaining control over their own destinies, freedom to do what they enjoy, and others. Lenders and investors, however, look at a venture in colder terms: dollar-for-dollar returns. A plan must convince lenders that the business will repay the money they lend to the business, and it must convince investors that they will earn an attractive return on their money.

Even after completing a feasibility analysis and building a business model, entrepreneurs sometimes do not come to the realization that "this business just won't work" until they build a business plan. Have they wasted valuable time? Not at all! The time to find out that a business idea will not succeed is in the planning stages *before* committing significant money, time, and effort to the venture. It is much less expensive to make mistakes on paper than in reality. In other cases, a business plan reveals important problems to overcome before launching a company. Exposing these flaws and then addressing them enhances a venture's chances of success. Business plans help nascent entrepreneurs nail down important aspects of their concepts and prevent costly mistakes.

The real value in preparing a plan is not as much in the plan itself as it is in the *process* the entrepreneur goes through to create the plan—from the feasibility analysis, through the development and testing of the business model, and finally with the crafting of the written business plan. Although the finished product is extremely useful, the process of building the plan requires entrepreneurs to explore all areas of the business and subject their ideas to an objective, critical evaluation from many different angles. What entrepreneurs learn about their industry, target customers, financial requirements, competition, and other factors is essential to making their ventures successful. Building a business plan is one controllable factor that can reduce the risk and uncertainty of launching a company.

In the Entrepreneurial Spotlight

The Battle of the Plans

The Burton D. Morgan Center for Entrepreneurship at Purdue University runs four entrepreneurship competitions each year. Two of these competitions are for entrepreneurs to compete for prize money to support their life science or nanotechnology ventures. One of their competitions is an elevator pitch competition. The Burton D. Morgan Business Plan Competition is the oldest of these events. The 2012 competition marked the 25th anniversary of this competition. Even though it is limited to Purdue University students, its rich history and significant prize money has made it a major competitive event.

The event has two divisions. The Gold division is the open division with teams comprised undergraduate students, graduate students, or a combination of both. Staff and faculty of Purdue University may be included on the teams. The winning team of the Gold division receives a $30,000 first prize. The Black division is only for teams wholly made up of currently enrolled undergraduate students. The winning team in the Black division receives a $20,000 first-place prize. The goal of the competition is to provide an opportunity for Purdue students to learn about entrepreneurship by developing and presenting a business idea to a panel of judges. Participants in the competition have an opportunity to define their ideas in commercial terms and compete for substantial cash prizes that they can use to commercialize their business ideas.

The competition has three stages of judging. The first phase is based on an executive summary of the business plan. After organizers narrow that group of submissions, teams submit business plans. Competition organizers evaluate the plans and select five finalists in each division to compete in the final competition, which includes a presentation to a panel of judges. The judges evaluate the students' executive summaries, business plans, and presentations using the criteria of commercial viability, technical viability, financial viability, and strength of the management team.

In a recent competition, one of the finalists in the Black division was Azzip Pizzeria, a fast-casual restaurant concept aimed at the fastest-expanding sector of the industry. The team was led by Brad Niemeier, a senior studying hospitality and tourism management and a member of the Boilermaker football team. Niemeier came up with his idea from his experience making pizzas for his teammates. Niemeier's teammates loved his pizzas and ate all that he made for them.

Niemeier made the most of both his hospitality classes and his entrepreneurship classes. His entrepreneurship classes gave him the confidence and skills to open a restaurant at such a young age. His hospitality classes taught him the skills he needed to manage his business day-to-day.

Niemeier's team faced stiff competition in the finals. The other four finalists were Dentural (all-natural adhesive for dentures), Kyk Energy (flavor-neutral energy powder that can turn any drink into an energy drink), PlayitSafe (head impact monitoring system), and Gamers' Esc (a video gaming center).

Past finalists in this competition have had great success as entrepreneurs. In a survey of past finalists in the Burton D. Morgan Business Plan Competition, 67 percent of the respondents indicated that they currently view themselves as entrepreneurs, 35 percent indicated that they started companies as a result of participating in the business plan competition, and 67 percent of the companies launched following the competition, which began in 1987, remain in existence.

In the end, Azzip Pizza won $20,000 as the top finisher in the Black division. Although he played in only two games during his football career at Purdue, Niemeier is proving to be a winner in game of business.

1. What benefits do entrepreneurs who compete in business plan competitions such as the one at Purdue University gain?
2. Work with a team of your classmates to brainstorm ideas for establishing a business plan competition on your campus. How would you locate judges? What criteria would you use to judge the plans? What prizes would you offer the winners, and how would you raise the money to give those prizes? Who would you allow to compete in your competition?
3. Using the ideas you generated in question 2, create a two-page proposal for establishing a business plan competition at your school.

Sources: Stacy Clardie, "Dream Realized," *Rivals.com*, May 15, 2012, *http://purdue.rivals.com/content.asp?CID=1365657&PT=4&PR=2*, *www.purdue.edu/newsroom/students/2012/120222CosierBizPlan.html*, and *www.insideindianabusiness.com/newsitem.asp?ID=52293*.

The Elements of a Business Plan

5.

Explain the three tests every business plan must pass.

Wise entrepreneurs recognize that every business plan is unique and must be tailored to the specific needs of their business. They avoid the off-the-shelf, "cookie-cutter" approach that produces a look-alike business plan. The elements of a business plan may be standard, but the way entrepreneurs tell their stories should be unique and reflect the strengths of their business models, the experience of their team, their personalities and how they will shape the culture of the business, and their enthusiasm for the new venture. In fact, the best business plans usually are those that tell a compelling story in addition to the facts. For those making a first attempt at writing a business plan, seeking the advice of individuals with experience in this process often proves helpful. Accountants, business professors, attorneys, advisers working with local chapters of the Service Corps of Retired Executives (SCORE), and consultants with Small Business Development Centers (SBDCs) are excellent sources of advice when creating and refining a plan. (For a list of SBDCs, see the Small Business Administration's Web SBDC Web page at *www.sba.gov/content/small-business-development-centers-sbdcs* and for a list of SCORE chapters, see their Web site at *www.score.org*.) Remember, however, that you should be the one to author your business plan, not someone else.

Initially, the prospect of writing a business plan may appear to be overwhelming. Many entrepreneurs would rather launch their companies and "see what happens" than invest the necessary time and energy defining and researching their target markets, defining their strategies, and mapping out their finances. After all, building a plan is hard work—it requires time, effort, and thought. However, in reality, the entrepreneur should do *both*. By getting started and seeing what happens, the entrepreneur is able to test and improve the basic business model. The plan is essential as the entrepreneur gets ready to build the business and scale its growth. The business plan is hard work that pays many dividends, and not all of these are immediately apparent. Entrepreneurs who invest their time and energy building plans are better prepared to face the hostile environment in which their companies will compete than those who do not.

Entrepreneurs can use business planning software available from several companies to create their plans. Some of the most popular programs include Business Plan Pro (Palo Alto Software*), PlanMaker (Power Solutions for Business), and Plan Write (Business Resources Software). Business Plan Pro, for example, covers every aspect of a business plan from the executive summary to the cash flow forecasts. These packages help entrepreneurs organize the material they have researched and gathered, and they provide helpful tips on plan writing with templates for creating financial statements. Business planning software may help to produce professional-looking business plans with a potential drawback: The plans they produce may look as if they came from the same mold. That can be a turnoff for professional investors who review hundreds of business plans each year.

In the past, conventional wisdom was that business plans should be 20 to 40 pages in length, depending on the complexity of the business. More recently, experts have begun to recommend that plans should be shorter, typically suggesting that they be limited to about 10 pages. There is mixed opinion on how complex the financial forecasts should be. If the forecasts are based on evidence that is substantiated by testing the business model, more detail will strengthen the entrepreneur's case. If the numbers appear to be unsubstantiated or even fabricated, more detail can actually hurt the presentation. In many ways, having to write shorter business plans can make writing them even more of a challenge. A shorter business plan does not mean that an

Source: Scott Adams/Universal Uclick.

* Business planning software from Palo Alto Software is available at a nominal cost with this textbook.

entrepreneur should omit any of the elements of the plan. Instead, the entrepreneur must work hard to communicate all of the key aspects of the plan as succinctly as possible. Although entrepreneurs find it difficult to communicate all of the important elements of their stories within the shorter-page-length recommendations, they run the risk of never getting used or read if their plans get too long! This section explains the most common elements of a business plan. However, entrepreneurs must recognize that, like every business venture, every business plan is unique. An entrepreneur should use the following elements as the starting point for building a plan and should modify them as needed to better tell the story of his or her new venture.

Title Page and Table of Contents

A business plan should contain a title page with the company's name, logo, and address as well as the names and contact information of the company founders. Many entrepreneurs also include the copy number of the plan and the date on which it was issued on the title page. Business plan readers appreciate a table of contents that includes page numbers so that they can locate the particular sections of the plan in which they are most interested.

The Executive Summary

To summarize the presentation to each potential financial institution or investors, the entrepreneur should write an executive summary. It should be concise—a maximum of one page—and should summarize all of the relevant points of the proposed deal. After reading the executive summary, anyone should be able to understand the entire business concept, what differentiates the company from the competition, and the amount of financing it requires. The executive summary is a synopsis of the entire plan, capturing its essence in a capsulized form. It should explain the basic business model and the problem the business will solve for customers, briefly describing the owners and key employees, target market(s), financial highlights (e.g., sales and earnings projections, the loan or investment requested, how the funds will be used, and how and when any loans will be repaid or investments cashed out), and the company's competitive advantage. Much like Abraham Lincoln's Gettysburg Address, which at 256 words lasted just two minutes and is hailed as one of the greatest speeches in history, a good executive summary provides a meaningful framework for potential lenders and investors of the essence of a company.

The executive summary is a written version of what is known as "the elevator pitch." Imagine yourself on an elevator with a potential lender or investor. Only the two of you are on the elevator, and you have that person's undivided attention for the duration of the ride, but the building is not very tall! To convince the investor that your business idea is a great investment, you must condense your message down to its essential elements—key points that you can communicate in a matter of no more than two minutes. In the Babcock Elevator Competition at Wake Forest University, students actually ride an elevator 27 floors with a judge, where they have the opportunity to make their elevator pitches in just two minutes. "The competition was designed to simulate reality," says Stan Mandel, creator of the event and director of the Angell Center for Entrepreneurship. Winners receive the chance to make 20-minute presentations of their business plans to a panel of venture capitalists, who judge the competition using criteria that range from the attractiveness of the business idea and the value proposition it offers to the quality of the plan's marketing and financial elements.[18]

Like a good movie trailer, an executive summary is designed to capture readers' attention and draw them into the plan. If it misses, the chances of the remainder of the plan being read are minimal. The difference between an executive summary and a movie trailer, however, is that the executive summary should give away the ending! A coherent, well-developed summary of the full plan establishes a favorable first impression of the business and the entrepreneur behind it and can go a long way toward obtaining financing. A good executive summary should allow the reader to understand the business concept and how it will make money as well as answering the ultimate question from investors or lenders: "What's in it for me?" Although the executive summary is the first part of the business plan, it should be the last section written to ensure that it truly captures all of the important points as they appear in the full plan.

Mission and Vision Statement

As you learned in Chapter 4, a mission statement expresses an entrepreneur's vision for what his or her company is and what it is to become. It is the broadest expression of a company's purpose and defines the direction in which it will move. It anchors a company in reality and serves as the thesis statement for the entire business plan by answering the question "What business are we in?" Every good plan captures an entrepreneur's passion and vision for the business, and the mission statement is the ideal place to express them. Entrepreneurs should avoid using too much business jargon and business clichés. It should clearly state what the business sells, its target market, and the basic nature of the business (i.e., manufacturing, consulting, service, outsourcing, and so forth).

Company History

The owner of an existing small business should prepare a brief history of the operation, highlighting the significant financial and operational events in the company's life. This section should describe when and why the company was formed, how it has evolved over time, and what the owner envisions for the future. It should highlight the successful accomplishment of past objectives and should convey the company's image in the marketplace.

In the Entrepreneurial Spotlight

A Business Plan: Don't Launch Without It

A recent study by the Small Business Administration reports that entrepreneurs who create business plans in the early stages of the start-up process are more likely to actually launch companies and complete typical start-up activities such as acquiring patents, attracting capital, and assembling start-up teams more quickly than entrepreneurs who do not. "Early formal planners are doers," write the study's authors. "Challenging prospective entrepreneurs to accomplish a formal business plan early in the venture creation process enables them to engage in additional start-up behaviors that further the process of venture creation."

In 1991, days before his 30th birthday, Bob Bernstein quit his job at the *Tennessee Journal* even though did not really know what he wanted to do next. However, he had been thinking about opening a coffeehouse. Nashville did not really have a true coffeehouse. The closest thing to a coffeehouse was located in a strip mall bookstore.

Bob was not prepared for the shock of the transition from employee to entrepreneur. There were mornings when it was almost unbearable to get out of bed and face the day. He had been living on his savings but soon found the $10,000 he had set aside to fund whatever he decided was his next step in life was all that was remaining.

Bob hoped that with the $10,000 and his great idea, he would be off and running to start up his coffeehouse. Realistically, he knew he would need more funding, so he decided to approach some local banks. They were not interested in financing his start-up. Not only was he proposing a food service business, which bankers are not generally eager to lend to, but Bob had no experience. He mentioned his idea to a friend and former colleague from his journalism days, Chuck Kane. Chuck thought he knew someone, Brad Green, who might be interested in investing in Bob's idea.

Bob wrote an "offbeat" business plan to present to Brad Green, which mixed traditional writing with cartoons. Green liked the plan and introduced Bob to another person who would eventually become one of his investors. Bob found his next investors from his Sunday football hangout. In a casual conversation with two men from Bob's hometown of Chicago, he shared his vision for a coffeehouse. Both men were interested in the idea. Bob also began to find people who were willing to invest through his volunteer work in various community projects, friends he made at a sports bar where he went to watch Chicago Bears football games, and his personal network of friends in Nashville. As he talked about his idea with these people, he found that many were quite interested in the coffee business. Although they loved the idea, they were not interested in running the business. They all agreed that Nashville was in need of a "funky little coffeehouse."

Each of Bob's various investors contributed up to $9,000. Although individual investments were relatively small, Bob was humbled by the trust his investors placed in him and his new venture. Through various investors and his own $10,000, Bob raised the $80,000 he needed to open the first store.

After 20 years in business, Bernstein now has four coffee shops in various parts of the city. Although he has had many proposals to franchise his concept, he always insists that it is "too weird to franchise." The offbeat nature of the original business plan—cartoons and all—is apparent in the atmosphere and the culture of all of his stores. The work he put into his original business plan not only helped raise the money he needed to launch the business but also became the document that helped guide the development of the business and its culture.

1. Some entrepreneurs claim that creating a business plan is not necessary for launching a successful business venture. Do you agree? Explain.
2. What benefits do entrepreneurs who create business plans before launching their companies reap?
3. Suppose that a friend who has never taken a course in entrepreneurship tells you about a business that he or she is planning to launch. When you ask about a business plan, the response is, "Business plan? I don't have time to write a business plan! I know this business will succeed." Write a one-page response to your friend's comment.

Source: Cornwall, J. "Bongo Bob," United States Association for Small Business and Entrepreneurship, Proceedings, 2006, *www.bongojava.com*.

Description of Firm's Product or Service

An entrepreneur should describe the company's overall product line, giving an overview of how customers use its goods or services. Drawings, diagrams, and illustrations may be required if the product is highly technical. It is best to write product and service descriptions so that laypeople can understand them. A statement of a product's position in the product life cycle might also be helpful. An entrepreneur should include a summary of any patents, trademarks, or copyrights that protect the product or service from infringement by competitors.

One danger entrepreneurs must avoid in this part of the plan is the tendency to dwell on the features of their products or services. This problem is the result of the "fall-in-love-with-your-product" syndrome, which often afflicts inventors. Customers, lenders, and investors care less about how much work, genius, and creativity went into a product or service than about what it will do for them. The emphasis of this section should be on defining the benefits customers get by purchasing the company's products or services rather than on just a "nuts-and-bolts" description of the features of those products or services. A *feature* is a descriptive fact about a product or service (e.g., "an ergonomically designed, more comfortable handle"). A *benefit* is what the customer gains from the product or service feature (e.g., "fewer problems with carpal tunnel syndrome and increased productivity"). Benefits are at the core of the value proposition of the business model. Advertising legend Leo Burnett once said, "Don't tell the people how good you make the goods; tell them how good your goods make them."[19] This part of the plan must describe how a business will transform tangible product or service features into important but often intangible customer benefits—for example, lower energy bills, faster access to the Internet, less time paying monthly bills, greater flexibility in building floating structures, shorter time required to learn a foreign language, or others. Remember: *Customers buy benefits, not product or service features*. Table 8.2 offers an easy exercise designed to help entrepreneurs translate their products' or services' features into meaningful customer benefits.

ENTREPRENEURIAL PROFILE: Ami Kassar: Multifunding Ami Kassar came up with the idea for his Philadelphia-based business, Multifunding, from his experience in the small business credit industry. He had seen the difficulty small businesses have finding financing, yet he knew that there was financing available for many of these businesses if they could just get connected to the right source. Although the value of the service was apparent from the beginning, it took Kassar several pivots of his business model before he offered small business customers what they wanted in

TABLE 8.2 Transforming Features into Meaningful Benefits

For many entrepreneurs, there's a big gap between what a business is selling and what its customers are buying. The following exercise is designed to eliminate that gap.

First, develop a list of the features your company's product or service offers. List as many as you can think of, which may be 25 or more. Consider features that relate to price, performance, convenience, location, customer service, delivery, reputation, reliability, quality, features, and other aspects.

The next step is to group features that have similar themes together by circling them in the same color ink. Then translate those groups of features into specific benefits to your customers by addressing the question "What's in it for me?" from the customer's perspective. (Note: It usually is a good idea to ask actual customers why they buy from you. They usually give reasons that you never thought of.) As many as six or eight product or service (or even company) features may translate into a single customer benefit, such as saving money or time or making life safer. Don't ignore intangible benefits, such as increased status; they can be more important than tangible benefits.

Finally, combine all of the benefits you identify into a single benefit statement. Use this statement as a key point in your business plan and to guide your company's marketing strategy.

Product or Service *Features*	**Product or Service *Benefits***

Benefit Statement:

Source: Based on Kim T. Gordon, "Position for Profits," *Business Start-Ups*, February 1998, pp. 18–20.