
OPEN TEXTBOOK

CAPE Entrepreneurship

Unit 2 - Entrepreneurship Practice

**Business Education Department
Ministry of Education, Science & Technology
Antigua and Barbuda**

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Acknowledgements

The Business Education Department wishes to thank those below for their contribution to this Open Textbook:

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Contents

About this Open Textbook	6
How this Open Textbook is structured	6
Course Overview	7
Welcome to CAPE Entrepreneurship	7
Unit 2 - Entrepreneurship Practice	7
Course objectives.....	7
Timeframe	8
Assignments	9
Assessments.....	9
Getting around this Open Textbook	9
Margin icons	9
Unit 2 - The Entrepreneurship Practice	11
Introduction.....	11
Module 1 – Essential of Business Ownership	11
Module Introduction	11
Lesson 1 – Types of Ventures	12
Lesson 2 - Legal and Regulatory Framework	33
Lesson 3 - Ethics and Social Responsibility.....	43
Module 2 – New Venture Planning and Creation	57
Module Introduction	57
Lesson 1 - Market Research	57
Lesson 2 - Feasibility Analysis.....	64
Lesson 3 - Start-up capital and Financial Statements.....	70
Lesson 4 – Developing the Business Model.....	96
Lesson 5 - Implementing and managing the venture.....	128
Lesson 6 - Harvesting the Venture	138
Module 3 – Managing, Growing and Harvesting the Venture	143
Module Introduction	143
Lesson 1 - Venture Life Cycle.....	143
Lesson 2 - Venture Models.....	147
Lesson 3 – Importance of venture valuation and valuation methods	159
Lesson 4 – E-commerce and growing the venture	175

About this Open Textbook

The Business Education Department has produced CAPE Entrepreneurship - Unit 2 - Entrepreneurship Practice. All Open Textbooks produced by the Business Education Department are structured in the same way, as outlined below.

How this Open Textbook is structured

The course overview

The course overview gives students a general introduction to the course. The information contained in the course overview helps students determine:

- What you already needed to know.
- What you can expect from the course.
- How much time you need to invest in completing the course.

The overview also provides guidance on:

- Study skills.
- Course assignments and assessments.
- Activity icons.
- Units.

We strongly recommend that students read the overview *carefully* before starting your study.

The course content

The course is broken down into units. Each unit comprises:

- An introduction to the unit content.
- Unit outcomes.
- Core content of the unit with a variety of learning activities.
- A unit summary.
- Assignments and/or assessments, as applicable.
- Answers to Assignment and/or assessment, as applicable.

Resources

For those interested in learning more about this subject, we provide you with a list of additional resources at the end of this Open Textbook; these may be books, articles or websites.

Your comments

After completing CAPE Entrepreneurship, we would appreciate if you would take a few moments to give us your feedback on any aspect of the course. Your feedback might include comments on:

- Course content and structure.
- Course reading materials and resources.
- Course assignments.
- Course assessments.
- Course duration.
- Course support (assigned tutors, technical help, etc.)

Your constructive feedback will help us to improve and enhance this course.

Course Overview

Welcome to CAPE Entrepreneurship

Unit 2 - Entrepreneurship Practice

The Entrepreneurship programme seeks to empower students by providing the knowledge, skills, and attitudes to achieve entrepreneurial success in a variety of settings. The programme places emphasis on the individual's acumen to realise the opportunity, assess risk, and apply the skills necessary to transform innovative ideas into viable and successful ventures.

The programme provides students with the mindset that supports creativity and innovation needed to transform ideas into ventures that create value and wealth. Also, the programme seeks to fill that void in the continuum from idea generation to venture creation and appraises students of ways to access training, technical support, funding and legislative incentives offered and provided by business organisations.

Entrepreneurship addresses fundamentals of entrepreneurial behaviour and thinking and engages students in practical experiences through idea generation and opportunity identification in implementing, managing and harvesting a venture. Moreover, the programme acquaints students with the essentials of business ownership, legal and regulatory frameworks, and the importance of market research, feasibility analysis and the development of a business model to successfully compete in the global marketplace.

The course provides a solid foundation for further studies in Entrepreneurship and preparation for Caribbean Advanced Proficiency Examination (CAPE). Individuals starting and operating a venture and/or becoming an entrepreneurial employee (entrepreneur) can utilize the acquired knowledge and understanding of the entrepreneurial process to create sustainable ventures.

Course objectives



Objectives

The objectives of this course are to:

1. Develop an entrepreneurial mindset to deal with uncertainties in regional and global market environments
2. Understand the diverse character traits and behaviours which inform entrepreneurs
3. Demonstrate an understanding the entrepreneurial process from idea generation to concept development and creation of the venture

4. Develop critical thinking and problem-solving skills through creativity, innovation, and logical applications.
 5. Develop an entrepreneurial mindset to deal with uncertainties in regional and global market environments
-

Timeframe



How long?

The course is worth 14 credits, and each credit is equivalent to 10 notional hours. Students are, therefore, advised to spend not less than 150 hours of study on this course. The notional time includes:

- Reviewing activities embedded in the study material
- Peer group interaction (where necessary)
- Face-to-face tutorials (where necessary)
- Working with tutor-marked assignments
- Preparing and sitting examinations (where that is required)
- Class discussion, peer tutoring, and scaffolding of knowledge
- ICT tools and internet sources (including audio-visual material)

Study Skills



As an adult learner, your approach to learning is different to that of your school days: you will choose what you want to study, you will have professional and/or personal motivation for doing so, and you will most likely be scheduling your study activities around other professional or domestic responsibilities.

Essentially, you will be taking control of your learning environment. As a consequence, you will need to consider performance issues related to time management, goal setting, stress management, etc.

Your most significant considerations will be *time* and *space*, i.e. the time you dedicate to your learning and the environment in which you engage in that learning.

We recommend that you take time now—before starting your self-study—to familiarize yourself with these issues. There are a number of excellent resources on the web.

Assignments



Assignments

You will be provided with detailed instructions for your final project by your instructor. Ideally, the final project for this course will require you to prepare a business proposal for a proposed business venture. The course has been designed to provide you with guidance and activities that will prepare you to complete the final project assigned by your instructor.

Assessments



Assessments

Assessments will take the form of responding to activities, as well as coursework assignments, a final project, and examinations as determined from time to time by the institution. In cases where coursework, assignments, projects and examinations are used in combination, the percentage rating for each component will be communicated to you at the appropriate time. Your instructor will provide you with guidance on how he or she will grade and provide comments or feedback concerning all graded assignments.

Getting around this Open Textbook

Margin icons

While working through this Open Textbook, you will notice the frequent use of margin icons. These icons serve to “signpost” a particular piece of text, a new task or change in activity; they have been included to help you to find your way around this Open Textbook.

A complete icon set is shown below. We suggest that you familiarize yourself with the icons and their meaning before starting your study.

 Activity	 Assessment	 Assignment	 Case study
 Discussion	 Group activity	 Help	 Note it!
 Outcomes	 Reading	 Reflection	 Study skills
 Summary	 Video	 Objectives	

Unit 2 - The Entrepreneurship Practice

Introduction

The teaching of entrepreneurship provides students with an opportunity to generate a feasible and sustainable income while making a meaningful contribution to their country. The unit continues the process by examining the entrepreneurship practice, assessing the essentials of business ownership, new venture planning, and creation and managing, growing and harvesting the venture.



Upon completion of this unit you will be able to:

1. Understand the various types of ventures
2. Conform to local, regional and international legal and regulatory framework;
3. Understand the importance of ethics and social responsibility in operating venture.

Module 1 – Essential of Business Ownership

Module Introduction

In Module one, students will examine the essentials of business ownership and develop an awareness of types of ventures, risk, and benefits of different types of ventures, the legal and regulatory framework of different venture along with ethics and social responsibilities as an entrepreneur. You will also examine the best practices of entrepreneurship development. The aim of this module is to develop your understanding of entrepreneurship ventures, and have you evaluate the different aspects of different types of business ventures.

Lesson 1 – Types of Ventures



Upon completion of this lesson you should be able to:

1. understand the various types of ventures
2. evaluate the risks and benefits associated with each form of venture.
3. discuss the importance of observing legal and regulatory practices in operating a venture
4. explain the role of ethics and corporate social responsibilities

Introduction

In the lesson, we will begin to examine the essential of business ownership. As an entrepreneur, there are several types of business venture that one can engage to create economic activity. In this unit, students will explore different types of business ventures, their features and pros, and cons of each form of business.

Sole Trader

A **sole proprietorship**, also known as the **sole trader** or simply a **proprietorship**, is a type of business entity that is owned and run by one natural person and in which there is no legal distinction between the owner and the business. The owner is in direct control of all elements and is legally accountable for the finances of such business, and this may include debts, loans, loss, etc.

The owner receives all profits (subject to taxation specific to the business) and has unlimited responsibility for all losses and debts. The proprietor owns every asset of the business, and all debts of the business are the proprietor's. It is a "sole" proprietorship in contrast with partnerships (which have at least two owners). A sole proprietor may use a trade name or business name other than his, her, or its legal name. They will have to legally trademark their business name, the process being different depending upon country of residence.¹

Advantages

A large advantage of the sole proprietorship structure is its ease of filing incorporation and tax documents as well as having uninterrupted control of the business. The sole proprietorship is one type of business structure

¹ <https://www.boundless.com/finance/textbooks/boundless-finance-textbook/introduction-to-the-field-and-goals-of-financial-management-1/types-of-business-organizations-26/pros-and-cons-of-sole-proprietorship-160-3825/> (CC-BY-SA)

that does not require formal incorporation, meaning that sole proprietors do not need to formally file articles of incorporation, hold regular meetings, or elect an advising or directing board. This simplicity is also reflected in tax treatment, as a sole proprietor files taxes as personal income. Sole proprietors also have control over the aspects of their business without the involvement of elected board members.

Disadvantages

On the flip side, the sole proprietorship has one main disadvantage: there is no separation between the entrepreneur and the business. With sole proprietorships, like some forms of partnership, owners can be personally liable for business losses, meaning their personal assets are not protected against the claims of creditors. The sole proprietorship is not a separate entity from the owner/entrepreneur, unlike a corporation. As a result, if the proprietor dies, the business ceases to exist. Because the enterprise rests exclusively on one person, it often has difficulty raising long-term capital.²

Franchise

Key Points

- *A business format franchise is a franchising arrangement where the franchisor provides the franchisee with an established business, including name and trademark, for the franchisee to run independently.
- *A product franchise is a franchising agreement where manufacturers allow retailers to distribute products and use names and trademarks.
- *A manufacturing franchise is a franchising agreement where the franchisor allows a manufacturer to produce and sell products using its name and trademark.³

Types of Franchises

While there are many ways to differentiate between different types of franchises (size, geographic location, etc.), we will be looking at how different franchisors allow franchisees to use their name. On this basis, there are three different types of franchise:

² <https://www.boundless.com/finance/textbooks/boundless-finance-textbook/introduction-to-the-field-and-goals-of-financial-management-1/types-of-business-organizations-26/pros-and-cons-of-sole-proprietorship-160-3825/> (CC-BY-SA)

³ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/types-of-franchises-257-1725/>

- Business format franchises
- Product franchises
- Manufacturing franchises

Business Format Franchises

In business format franchises (which are the most common type), a company expands by supplying independent business owners with an established business, including its name and trademark. The franchiser company generally assists the independent owners considerably in launching and running their businesses. In return, the business owners pay fees and royalties. In most cases, the franchisee also buys supplies from the franchiser. Fast food restaurants are good examples of this type of franchise. Prominent examples include McDonald's, KFC, Burger King, and Pizza Hut.

McDonalds⁴



McDonald's is perhaps the most famous franchise in the world.

Franchises

With product franchises, manufacturers control how retail stores distribute their products. Through this kind of agreement, manufacturers allow retailers to distribute their products and to use their names and trademarks. To obtain these rights, store owners must pay fees or buy a minimum amount of products. Tire stores, for example, operate under this kind of franchise agreement.

Manufacturing Franchises

Through manufacturing franchises, a franchiser grants a manufacturer the right to produce and sell goods using its name and trademark. This type of franchise is common among food and beverage companies. For example, soft drink bottlers often obtain franchise rights from soft drink companies to produce, bottle and distribute soft drinks. The major soft drink companies also sell the supplies to the regional manufacturing franchises. In the case of Coca-Cola, for example, Coca-Cola sells the syrup

⁴ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/types-of-franchises-257-1725/>
(CC BY NC SA)

concentrate to a bottling company, who mixes these ingredients with water and bottles the product and sells it on.⁵

Advantages of Franchises

- Benefits to the franchisor include regular royalty payments, expansion with reduced financial risk, and a greater geographical presence.
- Franchisee benefits include lower risk, lower startup costs, existing brand recognition, and parent company marketing support.
- Potential franchisees can select a franchise based on their location, interests, resources, and needs, which means that entering into a franchising arrangement can be a flexible process.
- Royalty payments
- Franchisee benefits include:
- Higher chance of success due to tried and tested business model
- Franchisor support, training, and expertise
- Brand recognition and national marketing⁶

Benefits for the Franchisor

Franchisors benefit from franchise agreements because they allow companies to expand much more quickly than they could otherwise. A lack of funds and workers can cause a company to grow slowly. Through franchising, a company invests very little capital or labor because the franchisee supplies both. The parent company experiences rapid growth with little financial risk.

A company can also ensure it has competent and highly motivated owners and managers at each outlet through franchising. Since the owners are largely responsible for the success of their outlets, they will put in a strong and constant effort to make sure their businesses run smoothly and prosper.

⁵ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/types-of-franchises-257-1725/>
(CC BY NC SA)

⁶ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/advantages-of-franchises-258-7918/> (CC BY NC SA)

In addition, companies can provide franchising rights to only qualified people.

Other benefits include:

- Franchising allows a business to have an international presence.
- Franchisors can experience economies of scale.
- Franchisors can benefit from growth without worrying about running costs.
- Franchisors receive royalty payments that are set as a percentage of profits.

Benefits for the Franchisee

The franchisee also has numerous advantages that come from entering a franchising agreement, including:

- There is a low risk due to the tried and tested formula. Buying a franchise business provides a higher chance for success. They get the benefit of owning a proven business formula that has been tested and shown to work well in other locations. In addition, they receive the support from the main company toward establishing the business, and the training to operate it successfully.

- There are lower start-up costs since the business idea was already developed.

- They are buying a name and brand that is recognized by the public. So they have a big advantage over starting a business from scratch, as they already have an established customer base.

- A franchise gives more security from the beginning. New independent businesses are known to have as high as a 90% failure rate, often causing the business owner heavy losses and at times bankruptcy.

- When you start a business from scratch, you spend huge amounts of time trying to operate the business without being successful because you may not have the necessary skills for that particular area. When you purchase a franchise, all the necessary groundwork has been done already. In addition, the franchisee gets training and head office support from the franchisor; this may be essential if the franchisee is new to running a business and has no experience or business knowledge.

- The franchisee gets the support of national marketing which a small business would not normally be able to afford. In some cases of larger brands, they may have customers waiting for their doors to open (for example in a new McDonalds).

- Since all the product selection and the marketing have been already developed, you simply have to take care of the daily operations of the

business. Your goal will be to grow from an established foundation and expand from there.

- The new franchise owner gains many benefits from the association with the main franchise company. The franchisor offers a great deal of business experience that would take years for the average business person to acquire.

Pizza Hut Franchise⁷



Franchisees gain many benefits from being a franchisee rather than starting their own business from scratch.

There are a lot of part-time franchising opportunities, which are perfect if someone has a small amount to invest and wants to support themselves and maintain their investment. They may be able to sell the franchise to someone else once they no longer wish to run it.⁸

Disadvantages of Franchises

- Disadvantages to franchisors include a lack of control over franchisees, reputational risks, and slow growth through franchising compared to mergers and acquisitions.
- Disadvantages to franchisees include high costs and royalty payments, strict product rules, and other start-up challenges.
- Entering into an agreement with an interested franchisor is important. Uninterested franchisors will not provide adequate support and are only interested in collecting fees and payments from franchisees.

Franchisee disadvantages may include:

- - High entry costs, which include fees and start-up capital, and ongoing royalty fees

⁷ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/advantages-of-franchises-258-7918/> (CC BY NC SA)

⁸ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/advantages-of-franchises-258-7918/> (CC BY NC SA)

- - Lack of support from uninterested franchisors
- - Lack of flexibility in how to trade, as well as where to locate⁹

Disadvantages to the Franchisor:

Of course, no business arrangement is without potential risks and disadvantages. While there are many advantages for the franchisor in entering a franchising agreement, some of the potential risks are:

- Difficult to control activities of franchisees: In any franchise agreement (particularly when there is a geographical separation between the franchisor and the franchisee), it can be difficult to control the activities of the franchisee and ensure that their activities are up to standard.

- Huge risk in reputation by allowing other businesses to use their names. If a franchisee does not live up to the quality standards of the franchisor (cleanliness, customer service, pricing, quality of the product, etc.), this can have a negative reputational effect not just on the franchisee, but on the broader reputation of the franchisor as well. Thus, there is a risk in allowing others not directly connected to the business to use the business name and trademark.

Disadvantages to the Franchisee

- High entry and ongoing cost: It can be more expensive to start a franchise than an independent business. You can open your own burger bar for a fraction of the cost of buying the rights to a McDonald's franchise. Thus, franchising is often an option open only to already wealthy businessmen.

- Franchisees have to pay a significant percentage of their revenues to the franchisor: On top of the upfront money needed to start a franchise, the franchisee must pay fees and royalties to the franchisor. The franchise fee may range anywhere from \$5,000 to over \$1 million and hence can be a major expenditure for the franchisee. Royalties are paid periodically during the life of the franchise agreement. They are either a percentage of an outlet's gross income—usually under 10 percent of an outlet's gross income—or a fixed fee.

- Other franchise costs: In addition to royalties and payments, the franchisee may be required to buy certain items from the franchisor like computer systems and software.

⁹ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/disadvantages-of-franchises-259-1362/> (CC BY NC SA)

- Uninterested franchisors: Some franchisors may have little interest in their franchisee's success and may be more interested in just collecting the fees associated with the franchise. Thus, support and marketing may not be adequately provided.

- Strict product rules: Franchisees experience less flexibility to use their own initiative due to restraints from the franchisor. Franchisees can only sell the products of the franchise, and they may be tied into a national brand with a strict set of instructions about how they should trade.

- Startup challenges: The franchisee may have to find or build the right location, hire and train staff and install equipment. This may be difficult for someone with limited business skills just starting out.



Closed shop¹⁰

Franchisees face risks and disadvantages that may jeopardize their ability to stay open.

Franchise costs vary to some extent because of costs associated with different

kinds of businesses and with different locations.¹¹

Limited Liability Company (LLC)

A Limited Liability Company (LLC) is a hybrid business entity having certain characteristics of both a corporation and a partnership or sole proprietorship (depending on how many owners there are). An LLC, although a business entity, is a type of unincorporated association and is not a corporation. The primary characteristic an LLC shares with a corporation is a limited liability and the primary characteristic it shares with a partnership is the availability of pass-through income taxation. It is often more flexible than a corporation, and it is well-suited for companies with a single owner.

¹⁰ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/disadvantages-of-franchises-259-1362/> (CC BY NC SA)

¹¹ <https://www.boundless.com/business/textbooks/boundless-business-textbook/types-of-business-ownership-6/franchising-52/disadvantages-of-franchises-259-1362/> (CC BY NC SA)

Advantages

- Choice of tax regime. An LLC can elect to be taxed as a sole proprietor, partnership, or corporation (as long as they would otherwise qualify for such tax treatment), providing for a great deal of flexibility.
- A limited liability company with multiple members that elects to be taxed as a partnership may specially allocate the members' distributive share of income, gain, loss, deduction, or credit via the company operating agreement.
- Limited liability, meaning that the owners of the LLC, called "members," are protected from some or all liability for acts and debts of the LLC depending on state shield laws.
- Much less administrative paperwork and record keeping than a corporation.
- Using default tax classification, profits are taxed personally at the member level, not at the LLC level. LLCs can be set up with just one natural person involved.
- Less risk of being "stolen" by fire-sale acquisitions (more protection against "hungry" investors).
- For real estate companies, each separate property can be owned by its own, individual LLC, thereby shielding not only the owners but their other properties from cross-liability.

Disadvantages

Although there is no statutory requirement for an operating agreement in most jurisdictions, members of a multiple member LLC who operate without one may run into problems. The members of an LLC must establish governance and protective provisions under an operating agreement or similar governing document.

- It may be more difficult to raise financial capital for an LLC as investors may be more comfortable investing funds in the better-understood corporate form with a view toward an eventual **IPO**. One possible solution may be to form a new corporation and merge into it, dissolving the LLC and converting into a corporation.
- Many jurisdictions levy a franchise tax or capital values tax on LLCs. In essence, this franchise or business privilege tax is the fee the LLC pays the state for the benefit of limited liability. The franchise tax can be an amount based on revenue, an amount based on profits, or an

amount based on the number of owners or the amount of capital employed in the state, or some combination of those factors, or simply a flat fee.

- Typically, LLCs will choose to be taxed as a partnership to avoid double taxation, which occurs in corporations. This allows companies to distribute their income among members who then report it on their personal tax returns.
- Renewal fees may also be higher.
- The management structure of an LLC may not be clearly stated. Unlike corporations, they are not required to have a board of directors or officers. (This could also be seen as an advantage to some).
- The principals of LLCs use many different titles—e.g., member, manager, managing member, managing director, chief executive officer, president, and partner. As such, it can be difficult to determine who actually has the authority to enter into a contract on the LLC's behalf.

Variation of LLCs

1. A Professional Limited Liability Company (PLLC, P.L.L.C., or P.L.) is a limited liability company organised for the purpose of providing professional services. Usually, professions where the state requires a license to provide services, such as a doctor, chiropractor, lawyer, accountant, architect, landscape architect, or engineer, require the formation of a PLLC. Typically, a PLLC's members must all be professionals practicing the same profession. In addition, the limitation of personal liability of members does not extend to professional malpractice claims.
2. A Series LLC is a special form of a Limited liability company that allows a single LLC to segregate its assets into separate series. For example, a series LLC that purchases separate pieces of real estate may put each in a separate series so if the lender forecloses on one piece of property; the others are not affected.
3. An L3C is a for-profit, social enterprise venture that has a stated goal of performing a socially beneficial purpose, not maximizing income. It is a hybrid structure that combines the legal and tax flexibility of a traditional LLC, the social benefits of a nonprofit organisation, and the branding and market positioning advantages of a social enterprise.

4. An Anonymous Limited Liability Company is an LLC where ownership information is not made publicly available by the state where the LLC is registered. This is done by using a third-party to act as the organiser and registered agent of the LLC. The level of anonymity varies with different states.¹²



Activity

Activity

1. What are the minimum and maximum amount of persons required to form an LLC? (2 marks)
2. Discuss two ways in which an LLC can raise capital and indicate one way in which it may be difficult to do so. (9 marks)
3. An LLC may choose to be taxed as a Sole Proprietor, Partnership, or Corporation. As a student, if you were a member of an LLC, suggest, giving two reasons why which tax regime would be preferred. (4 marks)
4. Should Government be intricately involved in the running of a Statutory Corporation? Whether YES or No, give two reasons to support your position. (4 marks)
5. List two types of Statutory Corporations that should remain natural monopolies. Give a reason why any ONE of the Statutory Corporation identified should remain a monopoly. (3 marks)
6. What argument would you put forward for the privatization of a Statutory Corporation? (8 marks)

Private Companies

A private company has shareholders with limited liability, and its shares may not be offered to the general public, unlike those of a public limited company (plc).¹³ Private companies may be called corporations, limited companies, limited liability companies, unlimited companies, or other names, depending on where and how they are organised and structured. Each of these categories may have additional requirements and restrictions that may impact reporting requirements, income tax liabilities, governmental obligations, employee relations, marketing opportunities, and other business obligations and decisions.¹⁴

Limited by shares means that the liability of the shareholders to creditors of the company is limited to the capital originally invested, i.e. the nominal value of the shares and any premium paid in return for the issue of the shares by the company. A shareholder's personal assets are thus

¹² https://en.wikipedia.org/wiki/Limited_liability_company. CC BY-SA

¹³ https://en.wikipedia.org/wiki/Private_company_limited_by_shares CC BY-SA

¹⁴ https://en.wikipedia.org/wiki/Privately_held_company CC BY-SA

protected in the event of the company's insolvency, but any money invested in the company may be lost. A limited company may be "private" or "public." A private limited company's disclosure requirements are lighter. However, its shares may not be offered to the general public and therefore cannot be traded on a public stock exchange. This is the major difference between a private limited company and a public limited company. Most companies, particularly small companies, are private. Private companies limited by shares are usually required to have the suffix "Limited" (often written "Ltd" or "Ltd.") or "Incorporated" ("Inc.") as part of their name.¹⁵

Advantages

- When a limited company is formed, it must issue one or more subscriber shares to its initial members. It may increase capitalisation by the issue of further shares. The issued share capital of the company is the total number of existing shares in the company multiplied by the nominal value of each share.¹⁶
- **When private companies decide to raise outside equity capital, they can seek funding from several potential sources: *angel investors, venture capital firms, institutional investors, and corporate investors.***¹⁷
- Private investors can offer expert knowledge and direct oversight of the company in a way that can benefit performance.¹⁸
- A private company limited by shares, or an unlimited company with a share capital, may re-register as a public limited company (PLC). A private company must pass a special resolution that it be so re-registered and deliver a copy of the resolution together with an application form to the Registrar.¹⁹
- Privately held companies are not generally required to publish their financial statements. By not being required to disclose details about their operations and financial outlook, private companies are not forced to disclose information that may potentially be valuable to competitors and can avoid the immediate erosion of customer and stakeholder confidence in the event of financial duress. Further, with limited reporting

¹⁵ https://en.wikipedia.org/wiki/Private_company_limited_by_shares CC BY-SA

¹⁶ https://en.wikipedia.org/wiki/Private_company_limited_by_shares

¹⁷ <https://bus304-principlesoffinance.wikispaces.com/Chapter+13> CC BY-SA

¹⁸ <https://www.boundless.com/finance/textbooks/boundless-finance-textbook/obtaining-capital-methods-of-long-term-financing-14/comparing-public-and-private-financing-112/advantages-of-private-financing-473-5679/> CC BY-SA.

¹⁹ https://en.wikipedia.org/wiki/Private_company_limited_by_shares CC BY-SA.

requirements and shareholder expectations, private firms are afforded a greater operational flexibility by being able to focus on long-term growth rather than quarterly earnings.²⁰

- Private company executives may steer their ships without shareholder approval, allowing them to take significant action without delays.²¹

Disadvantages

- Shares in a private company are usually transferred by private agreement between the seller and the buyer, as they may not be offered to the general public.²²
- The articles of association of private companies often place restrictions on the transfer of shares²³.
- Going public provides companies with greater liquidity and better access to capital. By going public, companies give their private equity investors the ability to diversify.²⁴



Activity

Activity

1. What is the primary advantage of forming a private company over a public company? (3 marks)
2. Private Companies may raise equity capital from angel investors, venture capital firms and corporate investors. Giving three reasons why explain which type of investment may be safer for the company. (12 marks)

Non-Governmental Organisations

Non-governmental Organisations - A **non-governmental organisation (NGO)** is a not-for-profit organisation that is independent of states and international governmental organisations. They are usually funded by donations, but some avoid formal funding altogether and are run primarily by volunteers. NGOs are highly diverse groups of organisations engaged in a wide range of activities, and take different forms in different parts of the world. Some may have charitable status, while others may be registered

²⁰ https://en.wikipedia.org/wiki/Private_held_company CC BY-SA.

²¹ https://en.wikipedia.org/wiki/Private_held_company CC BY-SA.

²² https://en.wikipedia.org/wiki/Private_company_limited_by_shares CC BY-SA.

²³ https://en.wikipedia.org/wiki/Private_company_limited_by_shares CC BY-SA.

²⁴ <https://bus304-principlesoffinance.wikispaces.com/Chapter+13>

for tax exemption based on recognition of social purposes. Others may be fronts for political, religious, or other interests.²⁵

Characteristics of Non-governmental Organisations

NGOs exhibit some specific characteristics including:

a. The majority of NGOs are small and horizontally structured with short lines of communication and are therefore capable of responding flexibly and rapidly to clients' needs and to changing circumstances. NGOs often maintain a field presence in remote locations, where there are few government facilities. However, because NGOs' projects are small in size they rarely address the structural problems. Small size, independence, and differences in philosophy also limit learning from each other's experience and the creation of effective forums, at national and international level.

b. They have pioneered a wide range of participatory methods for diagnosis and introduced approaches for testing new technology and incorporate local knowledge systems. However, NGOs have limited capacities for agricultural technology development and dissemination.

c. Most NGOs are more accountable to external funding agencies than to the clientele they claim to serve.²⁶

Types of Non-Governmental Organisations

- Community-Based Organisations (CBOs)
- Social Enterprises
- Charities and Endowment/Foundations
- Cooperative Societies

²⁵ https://en.wikipedia.org/wiki/Non-governmental_organization#cite_note-3 CC BY-SA.

²⁶

http://www.oerafrica.org/FTPFolder/Website%20Materials/Agriculture/haramaya/Perpective_Agricultural_Extension/AICM%20Module%20Final%20Jan%2031,%202012/12_2_characteristics_of_ngos.html CC BY-SA.

Advantages of Non-Governmental Organisations

1. NGOs have the ability to experiment freely with innovative approaches and, if necessary, to take risks.
2. They are flexible in adapting to local situations and responding to local needs and therefore able to develop integrated projects, as well as sectoral projects.
3. They enjoy good rapport with people and can render micro-assistance to very poor people as they can identify those who are most in need and tailor assistance to their needs.
4. They have the ability to communicate at all levels, from the neighborhood to the top levels of government.
5. They can recruit both experts and highly motivated staff with fewer restrictions than the government.

Disadvantages of Non-Governmental Organisations

1. Paternalistic attitudes restrict the degree of participation in program/project design.
2. Restricted/constrained ways of approach to a problem or area.
3. Reduced/less replicability of an idea, due to non-representativeness of the project or selected area, relatively small project coverage, dependence on outside financial resources, etc.
4. "Territorial possessiveness" of an area or project reduces cooperation between agencies, seen as threatening or competitive.
5. Top-down models of development minimize the role of local knowledge and ownership to submit or conform to international norms and expectations.²⁷
6. Dependency on external assistance decreases the pressure for local and national governments to provide for their citizens.

Community-Based Organisations (CBOs)

- *Community-based organisations* (CBOs) arise out of people's own initiatives. They can be responsible for raising the consciousness of the urban poor, helping them to understand

²⁷ <http://symbioticlearning.wikispaces.com/Non+Governmental+organization> CC BY-SA.

their rights in accessing needed services and providing such services.²⁸

Social Enterprises

A **social enterprise** is an organisation that applies commercial strategies to maximize improvements in human and environmental well-being—this may include maximizing social impact alongside profits for external shareholders. Social enterprises can be structured as a for-profit or non-profit and may take the form (depending on which country the entity exists and the legal forms available) of a co-operative, mutual organisation, a disregarded entity, social business, a benefit corporation, a community interest company or a charity organisation. They can also take more conventional structures. What differentiates social enterprises is that their social mission is as core to their success as any potential profit.²⁹

Charities

A **charitable organisation** is a type of non-profit organisation (NPO). It differs from other types of NPOs in that it centers on philanthropic goals as well as social well-being (e.g. charitable, educational, religious, or other activities serving the public interest or common good).

The legal definition of a charitable organisation (and of charity) varies according to the country and in some instances the region of the country in which the charitable organisation operates. The regulation, tax treatment, and the way in which charity law affects charitable organisations also varies. Charitable organisations often depend partly on donations from for-profit organisations. Such donations to charitable organisations represent a major form of corporate philanthropy.³⁰

Endowment

A **financial endowment** is a donation of money or property to a nonprofit organisation for the ongoing support of that organisation. Usually, the endowment is structured so that the principal amount is kept intact while the investment income is available for use, or part of the principal is released each year, which allows for their donation to have an impact over

²⁸ https://en.wikipedia.org/wiki/Non-governmental_organization#cite_note-3 CC BY-SA.

²⁹ https://en.wikipedia.org/wiki/Social_enterprise CC BY-SA.

³⁰ https://en.wikipedia.org/wiki/Charitable_organization CC BY-SA.

a longer period than if it were spent all at once. An endowment may come with stipulations regarding its usage.

The total value of an institution's investments is often referred to as the institution's endowment and is typically organised as a public charity, private foundation, or trust. Among the institutions that commonly manage endowments are academic institutions. For example, colleges, universities, and private schools), cultural institutions (museums, libraries, and theaters), service organisations (hospitals, retirement homes, the Red Cross), and religious organisations (churches, synagogues, mosques).

Types of endowment funds

- An unrestricted endowment can be used in any way the recipient chooses to carry out its mission.
- Term endowment funds stipulate that all or part of the principal may be expended only after the expiration of a stated period of time or occurrence of a specified event, depending on donor wishes.
- Quasi-endowment funds must retain the purpose and intent as specified by the donor or source of the original funds and earnings may be expended only for the specified purpose.
- Restricted endowments -Endowment revenue can be restricted by donors to serve many purposes. Endowed professorships or scholarships restricted to a particular subject are common; in some places, a donor could fund a trust exclusively for the support of a pet. Ignoring the restriction is called "invading" the endowment. However, the change of circumstance or financial duress like bankruptcy can preclude carrying out the donor's intent. A court can alter the use of restricted endowment under a doctrine called cy-près meaning to find an alternative "as near as possible" to the donor's intent. The restricted/unrestricted distinction focuses on the use of the funds;
- Quasi-endowments - A quasi-endowment, or fund functioning as an endowment, are funds merely earmarked by an organization's governing board, rather than restricted by a donor or other outside agency, to be invested to provide income for a long but unspecified period, and the governing board has the right to decide at any time to expend the principal of such funds. Separately from the endowment versus quasi-endowment distinction, there's another 2-way categorization of restricted and unrestricted, which focuses on the use of the funds. As an example, a quasi-endowment might be restricted by the donor to supporting the tennis team; the use is restricted

to one purpose, but the governing board could "invade principal" to support the tennis team.³¹

Foundations

A **foundation** (also a **charitable foundation**) is a legal category of nonprofit organisations that will typically either donate funds and support to other organisations or provides the source of funding for its own charitable purposes. Foundations incorporate private foundations and public foundations.

This type of non-profit organisation differs from a private foundation which is typically endowed by an individual or family.³²

Cooperative Societies

A cooperative is a legal entity owned and democratically controlled by its members. Members often have a close association with the enterprise as producers or consumers of its products or services, or as its employees.

A **cooperative** (also known as **co-operative**, **co-op** or **coop**) is an autonomous association of people united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled business. Cooperatives include non-profit community organisations and businesses that are owned and managed by the people who use their services (a consumer cooperative); by the people who work there (a worker cooperative); by the people who live there (a housing cooperative); hybrids such as worker cooperatives that are also consumer cooperatives or credit unions; multi-stakeholder cooperatives such as those that bring together civil society and local actors to deliver community needs; and second and third tier cooperatives whose members are other cooperatives.

Coop Principles and Values

Cooperative Principles are the seven guidelines by which coops put their values into practice, often called the seven Rochdale Principles:

1. Voluntary and open membership
2. Democratic member control

³¹ https://en.wikipedia.org/wiki/Financial_endowment CC BY-SA.

³² [https://en.wikipedia.org/wiki/Foundation_\(nonprofit\)](https://en.wikipedia.org/wiki/Foundation_(nonprofit)) CC BY-SA.

3. Economic participation by members
4. Autonomy and independence
5. Education, training, and information
6. Cooperation among cooperatives
7. Concern for community

Cooperatives Values, in the tradition of its founders, are based on "self-help, self-responsibility, democracy, equality, equity, and solidarity." Cooperative members believe in the ethical values of honesty, openness, social responsibility and caring for others.³³

State Owned Enterprises (Statutory Organisations)

A state-owned enterprise (SOE) is a legal entity that undertakes commercial activities on behalf of the state, its owner. SOEs are also called state-owned company, state-owned entity, state enterprise, publicly owned corporation, government business enterprise, Crown Corporation, a government-owned corporation, commercial government agency, public sector undertaking, or parastatal. Reasons for state ownership of commercial enterprises are that the enterprise in question is a natural monopoly or because the government is promoting economic development and industrialization.³⁴ SOEs can be fully owned or partially owned by the government. As a definitional issue, it is difficult to determine categorically what level of state ownership would qualify an entity to be considered as state-owned since governments can also own regular stock, without implying any special interference. Government-owned corporations are common with natural monopolies and infrastructure, such as railways and telecommunications, strategic goods and services (mail, weapons), natural resources and energy, politically sensitive business, broadcasting, demerit goods (e.g. alcoholic beverages), and merit goods (healthcare).³⁵

The legal status of SOEs varies from being a part of the government to being stock companies with the state as a regular stockholder. The defining characteristics of SOEs are that they have a distinct legal form and are established to operate in commercial affairs and commercial activities. While they may also have public policy objectives (e.g., a state railway company may aim to make transportation more accessible), SOEs should be differentiated from other forms of government agencies or state entities established to pursue purely nonfinancial objectives³⁶.

³³ <https://en.wikipedia.org/wiki/Cooperative> CC BY-SA.

³⁴ https://en.wikipedia.org/wiki/State_ownership CC BY-SA.

³⁵ https://en.wikipedia.org/wiki/State-owned_enterprise CC BY-SA.

³⁶ https://en.wikipedia.org/wiki/State-owned_enterprise CC BY-SA.

Advantages

Generally financed by the central or state government³⁷

They have to frame their own policies and procedures within the scope of the state legislature.³⁸

They can recruit and appoint their employee with their service condition since they are a corporate body.³⁹

May borrow funds from the public and government organisations through statutory sources.⁴⁰

If they are profitable, the profit is often used to finance other state services, such as social programs and government research, which can help lower the tax burden.⁴¹

Disadvantages

- They may be obliged to operate loss-making activities where it is judged that social benefits are greater than social costs — for example, rural postal and transport services.⁴²
- State-owned Enterprise is perceived as excessive government interference in, and control of, economic affairs of individual citizens.⁴³
- When ownership of a resource is vested in the state, or any branch of the state such as a local authority, individual use "rights" are based on the state's management policies, though these rights are not property rights as they are not transmissible. For example, if a family is allocated an apartment that is state owned, it will have been granted a tenancy of the apartment, which may be lifelong or inheritable, but the management and control rights are held by various government departments⁴⁴

³⁷ https://en.wikipedia.org/wiki/Statutory_corporation CC BY-SA.

³⁸ https://en.wikipedia.org/wiki/Statutory_corporation CC BY-SA.

⁴⁰ https://en.wikipedia.org/wiki/Statutory_corporation CC BY-SA.

⁴¹ <https://en.wikipedia.org/wiki/Nationalization> CC BY-SA.

⁴² <https://en.wikipedia.org/wiki/Nationalization> CC BY-SA.

⁴³ <https://en.wikipedia.org/wiki/Nationalization> CC BY-SA.

⁴⁴ https://en.wikipedia.org/wiki/State_ownership CC BY-SA.



Assignments

Essay Question

Compare and contrast an LLC and a Private Company. Based on your comparison, which company is more attractive to create in relation to investment, management and sustainability and growth. (15 marks)



Summary

Lesson Summary

As an aspiring entrepreneur, it is critical to understand the different types of ventures and the risk and benefits of these ventures. In this lesson, students examine ventures such as sole traders, partnership franchise, limited liability companies, private companies, NGO and state-owned enterprise.

In the next lesson, you will be introduced to the legal and regulatory framework of business ventures.

Lesson 2 - Legal and Regulatory Framework

Introduction

In the lesson, we will begin to examine the elements of the legal and regulatory framework. Modern day business practices emphasize the significance of protecting ventures legally to strengthen the resilience and sustainability of the venture.

Therefore, it is crucial to evaluate the roles of entrepreneurship in national and regional development to understand our role as an entrepreneur in the economy. Our goal is to start and operate a successful business.



At the end of this lesson, students should be able to:

1. Describe the types of legal framework associated with starting a venture
2. Discuss the importance of implementing legal and regulatory practices in a business
3. Identify the legal challenges for entrepreneurial ventures
4. Discuss statutory requirement for Caribbean businesses
5. Assess intellectual property protection for ventures

Registration of a Venture

The initial stage of starting a business venture is the registration of the business name with the appointed state authorities. In most countries, it is the Intellectual Property Rights Office. This process checks to verify that another business does not exist with the same business name.

Registration of a venture provides identity and ownership of the business thus showing the legality of the business. It establishes the business in the economy and for marketing purposes, contributing to the economic development of the country.

1. The Intellectual Property Rights Office is the institution responsible for registering a business. This process takes a week. In Antigua, the office is located at St. John's Street. In order to complete this process,
 - one should take identification in the form of a passport/ national ID/naturalization certification,
 - a work permit (if applicable), and

- \$112 for the application fee
- 2. On receipt of the business registration certificate, the entrepreneur would then take the certificate to the Inland Revenue Department to be issued a tax identification number for the business.
- 3. The registration certificate should be taken to the Social Security office for registration for Social Security payments and then to Medical Benefits and Board of Education to complete registration for the business for tax payment. (Ref JR 2012)



Activity

Activity

Explain THREE advantages and THREE disadvantages of registering a venture.

Intellectual Property Protection

An entrepreneur can use...

- ❖ Copyright
- ❖ Trademarks
- ❖ Patent
- ❖ Trade Secret a secret innovation or device used by a company...



Videos

<https://www.youtube.com/watch?v=mOjEpEtkp8Y>

Watch the following links that addressing the importance of protecting business ideas.

Protect Your Intellectual Property: Copyright, Trademarks, Patents and Designs

<https://www.youtube.com/watch?v=ddOLR6yoEHs>

What is the Difference Between Copyright vs. Trademark vs. Patent

<https://www.youtube.com/watch?v=gXV21NqsoLI>

<https://www.youtube.com/watch?v=J-PYuZOPrzI>

"Trademarks."

WIPO

<https://www.youtube.com/watch?v=Bb9EBtlGx7w>

the importance and role of patents

<https://www.youtube.com/watch?v=eEB5MYcj-Ns>

copyright



Activity

Intellectual Property Rights (IPR)

Click on the following link to access the web page of Antigua and Barbuda Intellectual Property and Commerce Office to learn more about the functions of this organisation and how it assists entrepreneurs in registering and protecting business ventures...

<https://www.abipco.gov.ag/>

Intellectual Property Rights (IPR)

For companies to gain financial benefits from investing in research and coming up with new inventions, there must be legal protection for those inventions. The system of law related to Research & Development and innovation is referred to as intellectual property rights. Different countries vary in the extent to which they protect intellectual property and enforce intellectual property regulations. The presence of strong, enforceable, consistent property rights serves to make the world flat. However, as long as significant differences in property rights exist around the globe, the world will be far from flat with respect to innovation.⁴⁵

Intellectual Property Rights is the legal protection of an invention developed by an individual.

The creator can own the rights to their invention or creative works.

Intellectual Property Rights:

- Establishes standards
- Minimizes competing for development
- Access to new markets
- Access to new technology.⁴⁶

Intellectual property (IP) refers to creations of the mind—inventions, literary and artistic works, and symbols, names, and images used in commerce. The term property connotes ownership that's exclusive, but the owners have the right to license or sell their IP. Under intellectual property law, owners are granted certain exclusive rights—intellectual

⁴⁵ Adapted from Challenges and Opportunities in International Business, (2012). Retrieved from <http://2012books.lardbucket.org/books/challenges-and-opportunities-in-international-business/s07-culture-and-business.html> (CC BY NC SA)

⁴⁶ Protection Measures for Creativity and Innovation by Janelle O'Mard is licensed under a Creative Commons AttributionShareAlike 4.0 International License (CC BY SA)

property rights (IPR) —to the discoveries, inventions, words, phrases, symbols, and designs they create.⁴⁷

World Intellectual Property Organisation (WIPO)

The World Intellectual Property Organisation (WIPO) is a specialized agency of the United Nations that works to harmonize the intellectual property laws of countries around the world. Although the roots of the WIPO go back to 1883, WIPO became an agency of the United Nations in 1974, with a mandate to administer intellectual property matters recognized by the member states of the UN. In 1996, WIPO expanded its role and further demonstrated the importance of intellectual property rights in the management of globalized trade by entering into a cooperation agreement with the World Trade Organisation (WTO). Today, WIPO seeks to

- Harmonize national intellectual property legislation and procedures,
- Provide services for international applications for industrial property rights,
- Exchange intellectual property information,
 - Provide legal and technical assistance to developing and other countries,
- Facilitate the resolution of private intellectual property disputes, and
 - Marshal information technology as a tool for storing, accessing and using valuable intellectual property information.⁴⁸

Patents

Rights are given to investors to exploit the invention for the life of the patent. The investor must meet certain stipulations in registering the patent to have a monopoly over the invention. This reduces the risk of competitors using, manufacturing or modifying the invention for personal and financial gain.

The creator establishes ownership of the innovation. Not all inventions are patented, and not all innovations are patentable. Creators must research and assess economic costs and feasibility in choosing a patent. Stipulations for a patent- · Must have never existed prior · Have innovative steps · Capable of industrial application. For security, creators should not publicize innovations or reveal the patent before the filing

⁴⁷ Adapted from Challenges and Opportunities in International Business, (2012). Retrieved from <http://2012books.lardbucket.org/books/challenges-and-opportunities-in-international-business/s07-culture-and-business.html> (CC BY NC SA)

⁴⁸ Adapted from Challenges and Opportunities in International Business, (2012). Retrieved from <http://2012books.lardbucket.org/books/challenges-and-opportunities-in-international-business/s07-culture-and-business.html> (CC BY NC SA)

date. The patent is not affected until it is commercialized on the market.⁴⁹

The most common way to protect an industrial discovery or invention is to patent it. A patent is an inventor's exclusive right granted by the government for an invention, whether a product or a process, that is industrially applicable (i.e., useful) or new (i.e., novel) or exhibits a sufficient "inventive step" (i.e., be not obvious) get a patent, the company must reveal the details of the invention. The rationale for revealing the invention details is so that others can build on the invention and thus promote further innovation. By revealing the invention, companies obtain legal protection and the right to exclusive sales of the invention (or the right to license or sell its use to others). The patent gives the patent owner a monopoly on the invention for a specific number of years. A patent prohibits other people from selling the identical product built in the same way as the accepted patent. Patents give the owner the right to defend the invention in court, but they do not automatically mean that the owner will win the court case.⁵⁰

Trademarks - A registered trademark gives the entrepreneur exclusive rights to use symbolic characters, sound, scents, logo, and pictures to license and sell its products. Trademarks distinguish your products from other competitors on the market.

Registration prevents others from using a similar mark that may confuse customers. However, it does not prevent the competitor from making a similar product. Registration serves a public notice of ownership, making persons knowledgeable of the brand.⁵¹

Branding - A symbol or combination of designs, names or characters associated with an organisation that identifies it from its competitors.

Copyrights - The legal protection is given to individuals who express ideas and information in mediums such as art, music, song, literary work, pictures, drawings, and architecture. Copyright focuses on the expression

⁴⁹ Protection Measures for Creativity and Innovation by Janelle O'Mard is licensed under a Creative Commons AttributionShareAlike 4.0 International License (CC BY SA)

⁵⁰ Adapted from Challenges and Opportunities in International Business., (2012). Retrieved from <http://2012books.lardbucket.org/books/challenges-and-opportunities-in-international-business/s07-culture-and-business.html> (CC BY NC SA)

⁵¹ Protection Measures for Creativity and Innovation by Janelle O'Mard is licensed under a Creative Commons AttributionShareAlike 4.0 International License (CC BY SA)

of an idea and not the idea. Copyright gives the creator the right to decide the reproductive use of original work.⁵²

Registered Design Protection

A design can be created and registered for protection by the original owner. It can apply to three-dimensional elements, shapes, colours, and textures. Design protection protects original designs from being used without the creator's permission.

Trade Secrets

In the entrepreneurial process, the entrepreneur may create a product or seek to enhance its innovative capabilities. The law allows the entrepreneur to formulate a confidential legal agreement that restricts employees or authorized persons to information by associating with the firm, from disclosing trade secrets. A trade secret consists of information that is considered and must be kept as a secret has commercial value, and the result of disclosure will affect the value of the enterprise.⁵³ Broadly speaking, any confidential business information which provides an enterprise with a competitive edge can qualify as a trade secret. A trade secret may relate to technical matters, such as the composition or design of a product, a method of manufacture or the know-how necessary to perform a particular operation. Common items that are protected as trade secrets include manufacturing processes, market research results, consumer profiles, lists of suppliers and clients, price lists, financial information, business plans, business strategies, advertising strategies, marketing plans, sales plans and methods, distribution methods, designs, drawings, architectural plans, blueprints and maps, etc.⁵⁴

The simplest way for a company to protect its intellectual property is never to reveal it—to create what is called a trade secret. This is how Coca-Cola protects the formula for its hugely popular soda. If the secret were discovered or revealed through nefarious intent, then trade secret law would allow punishment of the perpetrator, including criminal prosecution. However, if a company somehow developed the same formula on its own, Coca-Cola could do nothing to stop them. Therefore, companies opt for other IP protection—namely, patents and copyrights.

⁵² Protection Measures for Creativity and Innovation by Janelle O'Mard is licensed under a Creative Commons AttributionShareAlike 4.0 International License (CC BY SA)

⁵³ Protection Measures for Creativity and Innovation by Janelle O'Mard is licensed under a Creative Commons AttributionShareAlike 4.0 International License (CC BY SA)

⁵⁴ Adapted from Challenges and Opportunities in International Business, (2012). Retrieved from <http://2012books.lardbucket.org/books/challenges-and-opportunities-ininternational-business/s07-culture-and-business.html> (CC BY NC SA)

Copyright and Related Rights

Copyright is the body of laws which grants authors, artists and other creators' protection for their literary and artistic creations, which are generally referred to as "works." A closely associated field of rights related to copyright is "related rights," which provides rights similar or identical to those of copyright, although sometimes more limited and of shorter duration.

Licensing IP Rights

The word license, according to the World Intellectual Property Organisation (WIPO), means permission granted by the owner of the intellectual property to another to use it according to agreed terms and conditions, for a defined purpose, in a defined territory, and for an agreed period of time. In licensing IP rights, the IP owner gives permission to use the IP but retains ownership of the IP¹⁶⁶.

Personnel & Labour Laws

The business owner should be knowledgeable about the labour laws of the country where the business is established.

Peruse the following document by clicking on the link below. Identify and become more knowledgeable about the main areas that an entrepreneur should factor in managing of the human resource section of the business.

- Employment
- Legal contracts
- Leave privileges
- Remuneration and hours of work
- Severance
- Unfair dismissal
- Trade unions/labour relations
- Hiring and firing policies
- Employee representation/collective bargain

Reading



Reading

Additional Reading

<http://www.laws.gov.ag/acts/chapters/cap-27.pdf>

Tax Obligations

Taxes applicable to business ventures in the Caribbean:

- Income tax
- Import and export licenses
- Social security, medical benefits, and national insurance
- Value added tax (VAT) / ABST (Antigua and Barbuda Sales Tax)
- Unincorporated Business Tax (paid by small businesses in Antigua and Barbuda)

There are varying taxes associated with managing the venture. A business may incur payroll taxes, sales tax, and property tax.

Tax deductions in Antigua and Barbuda are:

- Social Security
- Medical Benefits
- Education Levy

Open Innovation

Open innovation factors the venture's approach to innovation. The entrepreneur attains innovation ideas or strategies from external sources. In this instance, the business does not depend on the company own innovative resources for new technology and product development.



Assignments

What is "open innovation"?

Watch the following link. Afterward, in your own words, show your understanding of defining open innovation and its usefulness to an entrepreneur.



Videos

Klaster LifeScience Kraków

<https://www.youtube.com/watch?v=A8Bp-WEndww>

Governments regulate business in order to promote fairness of and protection of workers and customers conducting trading transactions.

International Standards and Regulations

- ❖ ISO (International Standards for Organization)
- ❖ Duty of Care
- ❖ (HACCP) Hazard Analyses and Critical Control Points
- ❖ OSHA (Operation, Safety and Health Association)

Entrepreneurs are legally obligated to provide clean work environments free from discrimination and physical haphazard. Products and

strategies implemented by organizations must be ethical and have limited impact on the environment.

Occupational Safety & Health (OSHA)

The Occupational Safety and Health Administration is an agency with responsibility for setting and enforcing work safety measures in the workplace. Some regulatory measures:

- Providing training for employees
- Providing job required tools and equipment
- Documentation of illnesses, injuries and employee access to these documents
- Visual publication of health and safety practices in the workplace



Videos

Watch the following video to learn about signs that should be displayed in the workplace

<https://www.youtube.com/watch?v=7Kl-jBbSxTU>

Environmental Stewardship

The entrepreneur exercises Environmental Stewardship by using conservatory and sustainable practices in the management of the business that contributes to the protection of the natural environment and its resources.

International and government organisations have implemented laws to regulate the use of hazardous chemicals, materials pollutants, and excessive noise. Environmental management and sustainability practices have been implemented and enforced by corporations.



Videos

Video on environmental stewardship

www.nepa.gov.jm

Insurance

Entrepreneurs should obtain insurance for their business. Insurance is a form of protection against risks undertaken by the business. It is a contract engaged by business with an insurance company that guarantees compensation in the event of a specified loss or accident. This allows the venture to safeguard the business against any severe financial impact on the business.

The main types of insurance are:

1. Property insurance – insurance against business possessions in case of natural disasters, fires or burglary.

2. Liability insurance – protection for the business in the event of injury or damage resulting from the business' actions.
3. Workers compensation – rewards employees in the event of job-related injury or illness.



Videos

<https://www.youtube.com/watch?v=hLSFGQVPJMI>

<https://www.youtube.com/watch?v=8owt8KaP69U> Topic – Factors to consider if insuring your business is worthwhile.



Assignments

1. Describe THREE actions an entrepreneur can to establish a business venture legally.
2. Explain TWO benefits of implementing environment stewardship practices.
3. Why legal considerations important to an entrepreneur?



Assessments

Case Study:

John Wayne the Marine Engineer

John Wayne is an engineer and an entrepreneur. John started his own company in 2014. He decided to offer marine engineering services to yacht and boat owners in Antigua & Barbuda. John had plans to trademark his business with the intention of expanding his services regionally and internationally.

From his 28 years of experience in the engineering field, John Wayne had an idea for a new innovation that would assist maintaining the efficiency of the engines whilst on the sea. He wanted to execute this invention on a few clients before patenting his invention; however, he was wary of someone stealing his idea.

John met with his attorney who advised him to apply for the relevant intellectual protection for his business before going to the client with a proposal of his new innovation. The application process can take 6-12 months or possibly longer. John Wayne has to make a decision regarding the protection of his business.

1. List THREE types of intellectual property protection. (3)
2. Should John Wayne continue the business without intellectual property protection? Give TWO reasons to support your response (4)
3. What is a trademark?
4. Explain ONE benefit that can be gained from implementing environmental stewardship practices (3)



Lesson Summary

Entrepreneurs “...are those person, business owners who seek to generate value, through the creation or expansion of economic activity, by identifying and exploiting new products, processes or markets” OECD, 2007. The combination of entrepreneurship and innovation results in innovative entrepreneurship: new firms based on new innovative ideas.⁵⁵ The literature indicates that entrepreneurs and intrapreneurs are problem solvers, creative and innovators. Here is another opportunity for students to evaluate their business venture, reflect on the problems their venture propose to solve, how creative and innovative are their solutions. What changes can they make to improve their product?

Lesson 3 - Ethics and Social Responsibility

Introduction

It is in the best interest of a company to operate ethically. Trustworthy companies are better at attracting and keeping customers, talented employees, and capital. Those tainted by questionable ethics suffer from dwindling customer bases, employee turnover, and investor mistrust.⁵⁶ Business Ethics covers the areas of moral principles and decision making, governance issues and codes of conduct for a business. Business actions will then be judged by not that which is efficient or effective but by that which is “morally defensible” (Wozniak 2011 pp 304). We understand that business ethics as a concept is mutating, changing in the context of new technologies, new ways of resource mobilisation and utilisation, evolving societal practices and growing towards a perpetually connected global business network. Growing universal awareness of the finiteness of natural resources, the growing wealth divide, and the pervasive presence of businesses in the individual citizen's life through technologies such as big data and cloud computing, bring forth business ethics to the forefront of the conversation on societal norms.⁵⁷

⁵⁵ Adapted from Science Direct, (2012). Retrieved from <http://www.sciencedirect.com/science/article/pii/S2212567112001517> (CC BY ND NC)

⁵⁶ Adopted from <http://open.lib.umn.edu/exploringbusiness/chapter/2-1-misgoverning-corporations-an-overview/> (CC-BY-NC-SA) 01/1/17

⁵⁷ Adopted from <http://www.sciencedirect.com/science/article/pii/S2212567114001750> (CC-BY-NC-ND) 03/01/2017



Outcomes

At the end of the lesson, students should be able to:

1. Define business ethics and explain what it means to act ethically in the business.
2. Explain how they can recognize an ethical organisation.
3. Identify ethical issues that they might face in business, and analyze rationalizations for unethical behavior.
4. Define and elaborate the major arguments in favor of corporations having social and environmental responsibilities

What Is Ethics?

Students probably already know what it means to be ethical: to know right from wrong and to know when they are practicing one instead of the other. At the risk of oversimplifying, then, we can say that business ethics is the application of ethical behavior in a business context. Acting ethically in business means more than simply obeying applicable laws and regulations: It also means being honest, doing no harm to others, competing fairly, and declining to put their own interests above those of their company, its owners, and its workers. If you are in business, you obviously need a strong sense of what is right and what is wrong (not always an easy task). You need the personal conviction to *do* what is right, even if it means doing something that's difficult or personally disadvantageous.⁵⁸

What Is Social Responsibility?

Corporate social responsibility deals with actions that affect a variety of parties in a company's environment. A socially responsible company shows concern for its stakeholders—anyone who, like owners, employees, customers, and the communities in which it does business, has a “stake” or interest in it. We will discuss corporate responsibility later in the chapter. At this point, we will focus on ethics.

How Can You Recognize an Ethical Organisation?

One goal of anyone engaged in business should be to foster ethical behavior in the organizational environment. How do we know when an organisation is behaving ethically? Most lists of ethical organisational activities include the following criteria:

⁵⁸ Adopted from <http://open.lib.umn.edu/exploringbusiness/chapter/2-1-misgoverning-corporations-an-overview/> (CC-BY-NC-SA) 03/01/2017

- Treating employees, customers, investors, and the public fairly
- Making fairness a top priority
- Holding every member personally accountable for his or her action
- Communicating core values and principles to all members
- Demanding and rewarding integrity from all members in all situations (Axelrod, 2004)

Whether you work for a business or for a non-profit organisation, you probably have a sense of whether your employer is ethical or unethical. Employees at companies that consistently make *Business Ethics* magazine's list of the "100 Best Corporate Citizens" regards the items on the previous list as business as usual in the workplace. Companies that routinely win good-citizenship awards include Procter & Gamble, Hewlett-Packard, Intel, Avon Products, Cisco Systems, and Merck³.

By contrast, employees with the following attitudes tend to suspect that their employers are not as ethical as they should be:

- They consistently feel uneasy about the work they do.
- They object to the way they are treated.
- They are uncomfortable about the way coworkers are treated.
- They question the appropriateness of management directives and policies (Axelrod, 2004).⁵⁹



Assignments

Is Honesty Academic?

Just as businesses have codes of conduct for directing employee behavior in job-related activities, so, too, do colleges and universities have codes of conduct to guide students' academic behaviour. They are called various things—*honor codes*, *academic integrity policies*, *policies on academic honesty*, *student codes of conduct*—but they all have the same purpose: to promote academic integrity and to create a fair and ethical environment for all students.

At most schools, information on academic integrity is available from one of the following sources:

- The school Web site (probably under the tab "Dean of Students" or "Student Life")
- The student handbook
- Printed materials available through the Dean of Students' office

⁵⁹ Adopted from <http://open.lib.umn.edu/exploringbusiness/chapter/2-1-misgoverning-corporations-an-overview/> (CC-BY-NC-SA) 03/01/2017

Locate information on your school’s academic integrity policies and answer the following questions:

1. What behaviors violate academic integrity?
2. What happens if you are accused of academic dishonesty?
3. What should you do if you witness an incident of academic dishonesty?⁶⁰

How can you make sure that you do the right thing in the business world? How should you respond to the kinds of challenges that you will be facing? Because your actions in the business world will be strongly influenced by your moral character, let’s begin by assessing your current moral condition.

Which of the following best applies to you (select one)?

1. I am always ethical.
2. I am mostly ethical.
3. I am somewhat ethical.
4. I am seldom ethical.
5. I am never ethical.

Now that you have placed yourself in one of these categories, here are some general observations. Few people put themselves below the second category. Most of us are ethical most of the time, and most people assign themselves to category number two—“I am *mostly* ethical.” Why do not more people claim that they are *always* ethical? Apparently, most people realize that being ethical all the time takes a great deal of moral energy. If you placed yourself in category number two, ask yourself this question: How can I change my behavior so that I can move up a notch? Unfortunately, practicing this philosophy might be easier in your personal life than in the business world. Ethical challenges arise in business because business organisations, especially large ones, have multiple stakeholders and because stakeholders make conflicting demands. Making decisions that affect multiple stakeholders is not easy even for seasoned managers; and for new entrants to the business world, the task can be extremely daunting. Many managers need years of experience in an organisation before they feel comfortable making decisions that affect various stakeholders. You can, however, get a head start in learning how to make ethical decisions by looking at two types of challenges that you’ll encounter in the business world: *ethical dilemmas* and *ethical decisions*.⁶¹

⁶⁰ Adopted from <http://open.lib.umn.edu/exploringbusiness/chapter/2-1-misgoverning-corporations-an-overview/> (CC-BY-NC-SA) 03/01/2017

⁶¹ Adopted from <http://open.lib.umn.edu/exploringbusiness/chapter/2-2-the-individual-approach-to-ethics/> (CC-BY-NC-SA) 3/1/17

Ethical Dilemmas

An ethical dilemma is a morally problematic situation: You have to pick between two or more acceptable but often opposing alternatives that are important to different groups. Experts often frame this type of situation as a “right-versus-right” decision. It is the sort of decision that Johnson & Johnson (known as J&J) CEO James Burke had to make in 1982 (Kaplan, 2012). On September 30, twelve-year-old Mary Kellerman of Chicago died after her parents gave her Extra-Strength Tylenol. That same morning, twenty-seven-year-old Adam Janus, also of Chicago, died after taking Tylenol for minor chest pain. That night, when family members came to console his parents, Adam’s brother and his wife took Tylenol from the same bottle and died within forty-eight hours. Over the next two weeks, four more people in Chicago died after taking Tylenol. The actual connection between Tylenol and the series of deaths was not made until an off-duty fireman realized from news reports that every victim had taken Tylenol. As consumers panicked, J&J pulled Tylenol off Chicago-area retail shelves. Researchers discovered Tylenol capsules containing large amounts of deadly cyanide. Because the poisoned bottles came from batches originating at different J&J plants, investigators determined that the tampering has occurred after the product had been shipped.

So J&J was not at fault. However, CEO Burke was still faced with an extremely serious dilemma: Was it possible to respond to the tampering cases without destroying the reputation of a highly profitable brand? Burke had two options:

He could recall only the lots of Extra-Strength Tylenol that were found to be tainted with cyanide. This was the path followed by Perrier executives in 1991 when they discovered that cases of bottled water had been poisoned with benzene. This option favored J&J financially but possibly put more people at risk.

Burke could order a nationwide recall—of all bottles of Extra-Strength Tylenol. This option would reverse the priority of the stakeholders, putting the safety of the public above stakeholders’ financial interests.

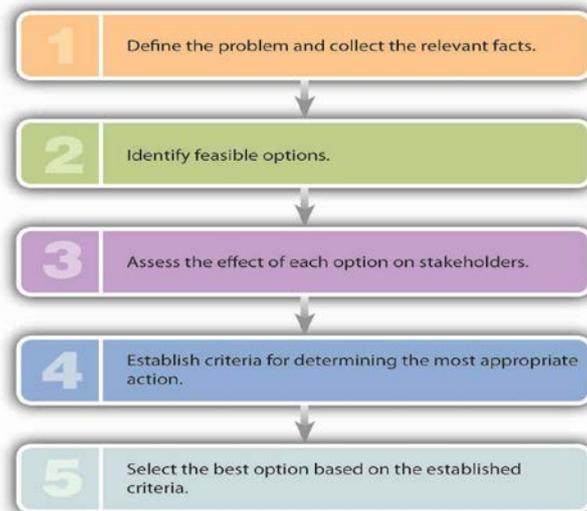
Burke opted to recall all 31 million bottles of Extra-Strength Tylenol on the market. The cost to J&J was \$100 million, but public reaction was quite positive. Less than six weeks after the crisis began, Tylenol capsules were reintroduced in new tamper-resistant bottles, and by responding quickly and appropriately, J&J was eventually able to restore the Tylenol brand to its previous market position. When Burke was applauded for moral courage, he replied that he’d simply adhered to the long-standing J&J credo that put the interests of customers above those of

other stakeholders. His only regret was that the tamperer was never caught (Weber, 1999).

If you are wondering what your thought process should be if you are confronted with an ethical dilemma, you could do worse than remember the mental steps listed in [Figure 1. “How to Face an Ethical Dilemma”](#)—which happen to be the steps that James Burke took in addressing the Tylenol crisis:

1. **Define the problem:** How to respond to the tampering case without destroying the reputation of the Tylenol brand.
2. **Identify feasible options:** (1) Recall only the lots of Tylenol that were found to be tainted with cyanide or (2) order a nationwide recall of all bottles of Extra-Strength Tylenol.
3. **Assess the effect of each option on stakeholders:** Option 1 (recalling only the tainted lots of Tylenol) is cheaper but puts more people at risk. Option 2 (recalling all bottles of Extra-Strength Tylenol) puts the safety of the public above stakeholders’ financial interests.
4. **Establish criteria for determining the most appropriate action:** Adhere to the J&J credo, which puts the interests of customers above those of other stakeholders.
5. **Select the best option based on the established criteria:** In 1982, Option 2 was selected, and a nationwide recall of all bottles of Extra-Strength Tylenol was conducted.⁶²

Figure 1. How to Face an Ethical Dilemma⁶³



⁶² Adopted from <http://open.lib.umn.edu/exploringbusiness/chapter/2-2-the-individual-approach-to-ethics/> (CC-BY-NC-SA) 3/1/17

⁶³ <http://open.lib.umn.edu/exploringbusiness/chapter/2-2-the-individual-approach-to-ethics/>

Ethical Decisions

In contrast to the “right-versus-right” problem posed by an ethical dilemma, an ethical decision entails a “right-versus-wrong” decision—one in which there is a right (ethical) choice and a wrong (unethical or illegal) choice. When you make a decision that’s unmistakably unethical or illegal, you have committed an ethical lapse. Betty Vinson, for example, had an ethical lapse when she caved into her bosses’ pressure to cook the WorldCom books. If you are presented with what appears to be this type of choice, asking yourself the questions in [Figure 2. “How to Avoid an Ethical Lapse”](#) will increase your odds of making an ethical decision.

Ask yourself:

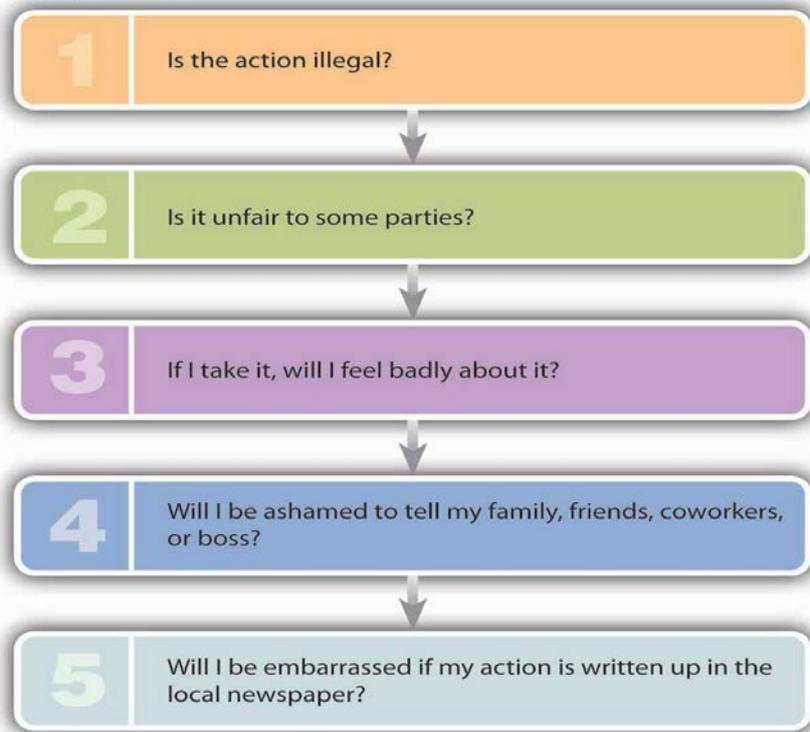


Figure 2. How to Avoid an Ethical Lapse⁶⁴

To test the validity of this approach, let’s take a point-by-point look at Betty Vinson’s decisions:

1. Her actions were clearly illegal.

⁶⁴ <http://open.lib.umn.edu/exploringbusiness/chapter/2-2-the-individual-approach-to-ethics/>

2. They were unfair to the workers who lost their jobs and to the investors who suffered financial losses (and also to her family, who shared her public embarrassment).
3. She definitely felt bad about what she had done.
4. She was embarrassed to tell other people what she had done.
5. Reports of her actions appeared in her local newspaper (and just about every other newspaper in the country).⁶⁵



Activity

Activity

Explain the difference between an ethical dilemma and an ethical decision. Then provide an example of each. Describe an ethical lapse and provide an example.⁶⁶

Code of Ethics

Many companies use the phrases 'ethical code' and 'code of conduct' interchangeably, but it may be useful to make a distinction. A code of ethics will start by setting out the values that underpin the code and will describe a company's obligation to its stakeholders. The code is publicly available and addressed to anyone with an interest in the company's activities and the way it does business. It will include details of how the company plans to implement its values and vision, as well as guidance to staff on ethical standards and how to achieve them. However, a **code of conduct** is generally addressed to and intended for employees alone. It usually sets out restrictions on behavior and will be far more compliance or rules focused than value or principle focused.⁶⁷ It is clear in this definition that business ethics is related to moral norms and values. At this point, it is necessary to ask if companies have moral norms and values as individuals do. This is why companies now provide ethical codes or codes of conduct and expect workers of all levels to obey these codes when they make a decision as a part of their jobs. For example, according to Facebook code of conduct, employees are not allowed to accept any gifts of substantial value from partners. Thus, this code provides an idea as to what is right and wrong in the offices of Facebook. As a result, business ethics is not related to a company's moral

⁶⁵ Adopted from <http://open.lib.umn.edu/exploringbusiness/chapter/2-2-the-individual-approach-to-ethics/> (CC-BY-NC-SA) 3/1/17

⁶⁶ Adopted from <http://open.lib.umn.edu/exploringbusiness/chapter/2-2-the-individual-approach-to-ethics/> (CC-BY-NC-SA) 3/1/17

⁶⁷ Adopted from https://en.wikipedia.org/wiki/Ethical_code (CC-BY-SA) 3/1/17

obligations to its stakeholders but ethical behaviors expected from employees.⁶⁸

Corporate Social Responsibility (CSR)

The title corporate social responsibility has two meanings. First, it is a general name for any theory of the corporation that emphasizes both the responsibility to make money and the responsibility to interact ethically with the surrounding community. Second, corporate social responsibility is also a specific conception of that responsibility to profit while playing a role in broader questions of community welfare.

As a specific theory of the way corporations interacts with the surrounding community and larger world, corporate social responsibility (CSR) is composed of four obligations:

1. The **economic responsibility** to make money. Required by simple economics, this obligation is the business version of the human survival instinct. Companies that do not make profits are—in a modern market economy—doomed to perish. Of course, there are special cases. Nonprofit organisations make money (from their own activities as well as through donations and grants) but pour it back into their work. Also, public/private hybrids can operate without turning a profit. In some cities, trash collection is handled by this kind of organisation, one that keeps the streets clean without (at least theoretically) making anyone rich. For the vast majority of operations, however, there have to be profits. Without them, there's no business and no business ethics.
2. The **legal responsibility** to adhere to rules and regulations. Like the previous, this responsibility is not controversial. What proponents of CSR argue, however, is that this obligation must be understood as a proactive duty. That is, laws are not boundaries that enterprises skirt and cross over if the penalty is low; instead, responsible organisations accept the rules as a social good and make good faith efforts to obey not just the letter but also the spirit of the limits. In concrete terms, this is the difference between the driver who stays under the speed limit because he cannot afford a traffic ticket and one who obeys because society as a whole is served when we all agree to respect the signs and stop lights and limits. As against that model of behavior, a CSR

⁶⁸ Adopted from

<http://www.sciencedirect.com/science/article/pii/S1877042813039426> (CC-BY-NC-ND) 3/1/17

vision of business affirms that society's limits will be scrupulously obeyed, even if the fine is only one dollar.

3. The **ethical responsibility** to do what is right, even when not required by the letter or spirit of the law. This is the theory's keystone obligation, and it depends on a coherent corporate culture that views the business itself as a citizen in society, with the kind of obligations that citizenship normally entails. When someone is racing his or her Porsche along a country road on a rainy summer's night and encounters another driver stopped on the roadside with a flat, there's a social obligation to do something, though not a legal one. The same logic can work in the corporate world. Many industrial plants, produce as an unavoidable part of their fabricating process, poisonous waste. The law governing toxic waste disposal was ambiguous, but even if the companies were not legally required to enclose their poisons in double-encased, leakproof barrels, is not that the right thing to do so as to ensure that the contamination will be safely contained? True, it might not be the right thing to do in terms of pure profits, but from a perspective that values *everyone's* welfare as being valuable, the measure could be recommendable.
4. The **philanthropic responsibility** to contribute to society's projects even when they are independent of the particular business. A lawyer driving home from work may spot the local children gathered around a makeshift lemonade stand and sensed an obligation to buy a drink to contribute to the neighborhood project. Similarly, a law firm may volunteer access to their offices for an afternoon every year, so some local schoolchildren may take a field trip to discover what lawyers do all day. An industrial chemical company may take the lead in rehabilitating an empty lot into a park. None of these acts arise as obligations extending from the day-to-day operations of the business involved. They are not like the responsibility a chemical firm has for safe disposal of its waste. Instead, these public acts of generosity represent a view that businesses, like everyone in the world, have some obligation to support the general welfare in ways determined by the needs of the surrounding community.⁶⁹

The Moral Requirement Argument

The moral requirement that business goals go beyond the bottom line to include the people and the world we all share is built on the following arguments:

⁶⁹Adopted from <http://2012books.lardbucket.org/books/business-ethics/s17-02-three-theories-of-corporate-so.html> (CC-BY-NC-SA) 03/01/17

- Corporations are already involved in the broad social world and the ethical dilemmas defining it. For example, factories producing toxic waste are making a statement about the safety and well-being of those living nearby every time they dispose of the toxins. If they follow the cheapest—and least safe—route in order to maximize profits, they *are not* avoiding the entire question of social responsibility; they are saying with their actions that the well-being of townspeople does not matter too much. That is an ethical stance. It may be good or bad, it may be justifiable or not, but it is definitely ethics. Choosing, in other words, not to be involved in surrounding ethical issues *is* an ethical choice. Finally, because companies are inescapably linked to the ethical issues surrounding them, they are involved with some form of corporate social responsibility whether they like it or not.
- Corporations, at least well-established, successful, and powerful ones can be involved in the effective resolution of broad social problems, and that ability implies an obligation. Whether we are talking about a person or business, the possession of wealth and power is also a duty to balance that privilege by helping those with fewer resources. Many accept the argument that individuals who are extraordinarily rich have an obligation to give some back by, say, creating an educational foundation or something similar. That is why people say, “To whom much is given, much is expected.” Here, what is being argued is that the same obligation applies to companies.
- Corporations rely on much more than their owners and shareholders. They need suppliers who provide materials, employees who labor, a town where the workplace may be located, consumers who buy, air to breathe, water to drink, and almost everything. Because a business relies on all that, the argument goes, it is automatically responsible—to some extent—for the welfare and protection of those things.
- Because businesses cause problems in the larger world; they are obligated to participate in the problems’ resolution. What kinds of problems are caused? Taking the example of an industrial chemical factory, toxic waste *is* produced. Even though it may be disposed of carefully, that does not erase the fact that barrels of poison are buried somewhere, and a threat remains, no matter how small. Similarly, companies that fire workers create social tensions. The dismissal may have been necessary or fully justified, but that does not change the fact that problems are produced, and with them

comes a responsibility to participate in alleviating the negative effects.⁷⁰

The notion of corporate social responsibility, Friedman asserts, is not only misguided; it is dangerous because it threatens to violate individual liberty. Stronger, the violation may ultimately lead to socialism, the end of free market allocation of resources because rampant political forces take control in the boardroom.

The movement to socialism that Friedman fears comes in two steps:

1. Environmental activists, social cause leaders, and crusading lawyers will convince at least a handful of preening business executives that working life is not about individuals expressing their freedom in a wide-open world; it is about serving the general welfare. The notion of corporate social responsibility becomes a mainstream concern and wins wide public support.
2. By the way forced open by activists, the risk is that government will follow: the institution originally set up to regulate business life while guaranteeing the freedom of individuals will fall into the custom of imposing liberty-wrecking rules. Under the weight of these intrusive laws, working men and women will be forced to give up on their own projects and march to the cadence of government-dictated social welfare projects. Hiring decisions, for example, will no longer be about companies finding the best people for their endeavors; instead, they will be about satisfying social goals defined by politicians and bureaucrats. Friedman cites as an example the hiring of felons. Obviously, it is difficult for people coming out of jail to find good jobs. Just as obviously, it is socially beneficial for jobs to be available to them. The problem comes when governments decide that the social purpose of reinserting convicts is more important than protecting the freedom of companies to hire anyone they choose. When that happens, hiring quotas will be imposed—corporations will be forced to employ certain individuals. This intrusive workplace rule will be followed by others. All of them will need to be enforced by investigating agents and disciplining regulators. As their numbers grow and their powers expand, freedom will be squeezed.⁷¹

⁷⁰ Adopted from <http://2012books.lardbucket.org/books/business-ethics/s17-04-should-corporations-have-social-responsibility.html> (CC-BY-NC-SA) 03/01/17

⁷¹ Adopted from <http://2012books.lardbucket.org/books/business-ethics/s17-04-should-corporations-have-social-responsibility.html> (CC-BY-NC-SA) 03/01/17

Good Corporate Governance

The Corporate governance system is best understood as the set of fiduciary and managerial responsibilities that binds a company's management, shareholders, and the board within a larger, societal context defined by legal, regulatory, competitive, economic, democratic, ethical, and other societal forces.

Social Entrepreneurship

The social entrepreneur is a mission-driven individual who uses a set of entrepreneurial behaviours to deliver a social value to the less privileged, all through an entrepreneurially oriented entity that is financially independent, self-sufficient, or sustainable.

This definition combines four factors that make social entrepreneurship distinct from other forms of entrepreneurship. Social entrepreneurs:

1. are *mission-driven*. They are dedicated to serve their mission of delivering a social value to the underserved.
2. act *entrepreneurially* through a combination of characteristics that set them apart from other types of entrepreneurs (see Table 3).
3. act within *entrepreneurially oriented organisations* that have a strong culture of innovation and openness.
4. act within *financially independent organisations* that plan and execute earned-income strategies.

The objective is to deliver the intended social value while remaining financially self-sufficient. This is achieved by blending social and profit-oriented activities to achieve self-sufficiency, reduce reliance on donations and government funding, and increase the potential of expanding the delivery of proposed social value ([Bacq et al., 2011](#)).

Characteristics of Social Entrepreneurship

Although the use of the term social entrepreneur is growing rapidly, the field of social entrepreneurship lacks rigour and is in its infancy compared to the wider field of entrepreneurship. Success stories of individuals solving complex social problems are being used to legitimize the field of social entrepreneurship. For example, in 2004, Stanford University launched Social E-Lab as part of its Entrepreneurial Design for Extreme Affordability course, which promotes the use of entrepreneurship principles to solve social and environmental problems.

The public often holds social entrepreneurs in high regard because of the multitude of social needs they satisfy and the improved life quality they bring to affected societies.⁷²



Summary

Lesson Summary

Now that you have examined the social and ethical responsibilities of an entrepreneur, do you consider ethics as an important factor as an entrepreneur? In the next lesson, scrutinize new venture planning and creation

⁷² Adopted from <https://timreview.ca/article/523> (CC-BY) 03/01/2016

Module 2 – New Venture Planning and Creation

Module Introduction

The focus of this module is to developed an understanding of how business ideas are generated. At the end of this module you should be able to identify different methods of generating business ideas and opportunity identification; examine business concepts; identify different resources essential for business success; and how to implement and manage a business venture.



On completion of this Module, students should:

1. understand the importance of a market research and feasibility analysis
2. appreciate the process of determining the viability of a venture
3. be aware of the components of a business model and a business plan
4. understand the importance of start-up capital and financial statements in venture creation
5. understand the importance of a business model and a business plan.

Lesson 1 - Market Research

Introduction

In this chapter, you will learn about taking that idea you have for a business and determining whether it will be profitable and become your business venture. Are you excited? The process and importance of conducting a market research will be discussed. Enjoy your lesson as you embark upon building a sustainable business venture.



In this lesson, students should be able to:

1. *Define* the term market research
2. *Differentiate* between primary and secondary data

3. *Describe* the market research process
4. *Understand* the importance of a market research
5. *Conduct* a market research for a venture
6. *Evaluate* competitive advantage

Before you begin

Consider the following:

What are you most passionate about?

Is my idea realistic for a venture opportunity?

Who are my competitors?

Is there any product or service closely linked to your hobby?

Observe your surroundings? Is there a consumer needs not being met?

What is market research?

Market research involves the collection and analysing of information need to make business decisions regarding potential customers and identifying their preferences. The entrepreneur is able to develop strategies for creating and influencing demand for the product. The entrepreneur creates a product that satisfies the consumer and delivers a good or service which helps to maintain customer relations. This approach is referred to as the marketing concept.

Reasons and Benefits of Marketing Research

Entrepreneurs may perceive market research as a tedious process. However, it is important to comprehend the usefulness of research and the benefits associated with market planning. Market research provides avenues of insight for the entrepreneur into the demand for the product and the challenges which may be encountered during the entrepreneurial process and increase of sales. Market research can be conducted by the entrepreneur or researchers within the company. Some businesses may decide to employ or contract company that specializes in market research. The entrepreneur obtains information of the business' strengths and weakness, information about competitors and data about consumers. The entrepreneur will be able to determine the characteristics and demographics of the potential target market. Research can be used to monitor and evaluate the actions previously implemented to assess the progress of strategy in achieving the objective. This information will assist in developing an effective plan which for increasing revenue and distribution of the product to consumers. In addition, it is also beneficial for an entrepreneur who is seeking an investor for his business.

Types of Data

There are two types of data that can be used in the research process. Based on the type of information the entrepreneur may require, there is the option of using primary or secondary data. Both can be used depending on the research objective. These are described as:

Primary data – collection of new data for a specific purpose and target market. This information can be sourced through interviews, focus groups, surveys and observation of potential or existing customers.

Secondary data – the usage of data collected in a previous or other purpose and not the proposed research investigated. Secondary data can be sourced from magazines, business reports, government offices, and journals.

Market Research can help the entrepreneur to:

1. Identify problems
2. Understand the changing market
3. Focus or develop strategies to keep existing customers
4. Improve the quality of decision making



Video

Watch the video to reinforce your understanding of market research.

https://www.youtube.com/watch?v=2-q2vwa_n2I

Market research focuses on the business environment, potential customers and competitors. It is crucial for the entrepreneur to be attentive to these areas as it would help in measuring the market demand for the product and enabling customer satisfaction.

Business Environment – the entrepreneur, should conduct a PESTLE analysis that would assess the impact of the political, economic, social, technological, legal and environmental factors that could impact the business.

Customers – it is important to evaluate the customers' needs and ensure there is a demand for your product in order to ensure the venture's sustainability.

Competitor – market research allows the entrepreneur identify competitors. Entrepreneurs/management are able to make strategic plans that are viable and would contribute to increasing sales and market share.

The market research process will guide you in deciding if the venture is feasible and shows profitability.

Steps in Market Research

1. Problem identification/ Identify research objectives
2. Determine the research design
3. Identify data types and sources
4. Collect data
5. Organise/collate data
6. Analyse data
7. Report findings

Reading



Reading

Additional Reading

Read the following section of ‘Market Research’ in Principles of Marketing for an in-depth discussion of the steps. (OER text)

<http://www.oercommons.org/courses/developing-new-products-and-services/view>

Key elements of Market Research

The research design must request information from the customer about various elements which will help the entrepreneur to achieve customer satisfaction.

Product characteristics:

The product features valued by the potential consumer must be clearly identified

Definition of market:

The size of the market helps the entrepreneur to decide whether he will operate in a mass market or choose niche marketing. Asses your target market. This consists of a potential number of customers who may purchase your product.

Expected sales trends

Market research provides the entrepreneur with information in understanding consumer patterns and behaviour. The entrepreneur is able to know how trends can affect purchases and improve the accuracy of projected sales.

Customer analysis

Market campaigns can be designed to suit the target market when the entrepreneur obtains information from the research. New strategies can be evolved for ways to improve customer satisfaction and reduce wastage of resources and maximize the marketing plan.

Promotional strategy

The market research will allow the entrepreneur to create a customer profile and learn about what influences behaviour and spending power. Once the entrepreneur identifies the target market, a promotional strategy can be developed to launch information on the communications and product information that will be used to create product awareness.

Nature and level of competition

Competitors may already be present in the market. The entrepreneur should observe and become knowledgeable of competitors. This will assist the organisation in decision making in developing sustainable business strategies. A competitor analysis will provide information on the impact or influence the competitor may have on the venture. Develop and incorporate proper strategic planning to place your business ahead of the competitor in the market.

Cost-benefit analysis approach to market research

In this instance, the entrepreneurs assess the expected benefits of an opportunity and detract the expected costs. Once the benefits exceed the cost, the entrepreneurial venture is worthwhile.



Video

Watch the following video that shows why market research is important
<https://www.youtube.com/watch?v=1Fja06iCIE0>



Reflection

Identify three areas you should research to aid in understanding your market

How can a market research assist and entrepreneur in obtaining capital?
Why is it important to know what your competitors are doing?



Assignments

1. What is the purpose of conducting a market research?
2. Explain THREE negative effects should a business choose not to conduct a market research.
3. Evaluate the advantages and disadvantages of using secondary data of a market research for a new venture.



Assessments

Answer the following questions to test your knowledge on the information covered.

Answer true or false

1. A market research should only be done at the start of a business
2. Collecting research data can guide an entrepreneur in selecting a target market
3. Market research does not tell you who your competitors are
4. Secondary data is given by potential competitors
5. Market research is only conducted when there is a problem

6 Market research

- (a) Does not include global factors
- (b) Increases sales
- (c) Occurs at the start of a venture
- (d) All of the above

Ans. B

7. The first stage before gathering data is

- (a) Determine research methods
- (b) Identify target market
- (c) Obtain research resources
- (d) Identify research objectives

Ans. D

8. _____ is information that already exists somewhere, having been collected for another purpose.

- (a) Primary data
- (b) External information
- (c) Secondary data
- (d) Experimental information

Ans. c

9. Primary research

- (a) Involves a focus group
- (b) Requires direct contact with people
- (c) Must have a questionnaire
- (d) Collected for a specific purpose

Ans. D

10 An entrepreneur decides to outsource a project to a marketing research company to determine if the business should launch a new product into a new market. The entrepreneur would expect the research company to:

- (a) provide market research that relies on secondary data
- (b) provide a definitive go/no-go launch recommendation
- (c) recommend the use of a syndicated service of new product success and failure rates

(d) recommend a custom or standardized new product evaluation study

Ans. D

Case Study

Smooth Smoothies

Ronnie was a painter who enjoyed making fruit smoothies for his family. His family enjoyed his smoothies and encouraged him to open a smoothie bar. Ronnie had knowledge in business as he was a sole proprietor for 20 years. With skills in time management, creativity, and customer service, Ronnie felt that it would not be hard to operate a smoothie shop. He decided to try this new venture opened “Smooth Smoothies” within 5 weeks of registering his business and obtaining the relevant food documents. Ronnie was able to use savings from his paint shop to start the business. He sourced local fruits from the market as the main ingredients for his smoothies. He was certain the business would be profitable, and he would gain a return on his investment.

Smooth Smoothies was located on Cloud Street, on the outskirts of Sky Town. There were no other smoothie stores within a 5-mile radius. However, there were many fast food stores in town which sold ice-cream smoothies, local juices and sodas.

For the first 6 months, the business barely made break-even. Sometimes, customers complained that Smooth Smoothies was too far to walk from town, and sometimes the fruits had a sour taste. Ronnie ignored the customers’ complaints as he felt there was nothing wrong with them. After the first year, Ronnie decided to close Smooth Smoothies for as he was not making the profit, he expected.

Questions:

1. Define the term ‘market research’. (2)
2. Discuss TWO ways in which market research would have contributed to the success of Smooth Smoothies.(4)
3. Identify TWO factors that may have caused the decline in sales for Smooth Smoothies.(4)



Summary

Lesson Summary

Well done! You have reached the end of this lesson. You learnt about the importance and processes of conducting a market research to determine if there is a market or demand for your business. Get ready for your next lesson in feasibility analysis!

Lesson 2 - Feasibility Analysis

Introduction

In the lesson, we will examine what a feasibility analysis as an entrepreneur is. A feasibility study aims to objectively and rationally uncover the strengths and weaknesses of an existing business or proposed venture, opportunities and threats present in the environment, the resources required to carry through, and ultimately the prospects for success. In its simplest terms, the two criteria to judge feasibility are cost required and value to be attained.



At the end of the lesson, students should be able to:

1. Explain feasibility analysis
2. Conduct a feasibility analysis for a venture
3. Distinguish between market research and feasibility analysis

A well-designed feasibility study should provide a historical background of the business or project, a description of the product or service, accounting statements, details of the operations and management, marketing research and policies, financial data, legal requirements and tax obligations. Generally, feasibility studies precede technical development and project implementation.⁷³

The focus of this unit will be for students to develop a clear understanding of the purpose of feasibility analysis and its benefits. The unit will also profile the key elements of a feasibility analysis such as personality feasibility or individual's SWOT profile, management, operational, financial, marketing, time, industry, and cultural feasibility. Finally, students will learn to distinguish the features of market research and feasibility analysis.

Purpose of a Feasibility Analysis

A feasibility study aims to objectively and rationally uncover the strengths and weaknesses of an existing business or proposed venture, opportunities and threats present in the environment, the resources required to carry through, and ultimately the prospects for success. In its

⁷³ https://en.wikipedia.org/wiki/Feasibility_study CC BY-SA.

simplest terms, the two criteria to judge feasibility are cost required and value to be attained.

A well-designed feasibility study should provide:

1. a historical background of the business or project,
2. a description of the product or service,
3. accounting statements,
4. details of the operations and management, marketing research and policies, financial data, legal requirements and tax obligations.

Generally, feasibility studies precede the technical development and project implementation.

A feasibility study evaluates the project's potential for success; therefore, perceived objectivity is an important factor in the credibility of the study for potential investors and lending institutions. It must, therefore, be conducted with an objective, unbiased approach to provide information upon which decisions can be based.

Technical feasibility

This assessment is based on an outline design of system requirements, to determine whether the company has the technical expertise to handle completion of the project. When writing a feasibility report, the following should be taken into consideration:

- A brief description of the business to assess more possible factors which could affect the study
- The part of the business being examined
- The human and economic factor
- The possible solutions to the problem

At this level, the concern is whether the proposal is both technically and legally feasible (assuming moderate cost).

The technical feasibility assessment is focused on gaining an understanding of the present technical resources of the organisation and their applicability to the expected needs of the proposed system. It is an evaluation of the hardware and software and how it meets the need of the proposed system.

Legal feasibility

Legal feasibility determines whether the proposed system conflicts with legal requirements, e.g. a data processing system must comply with the

local data protection regulations and if the proposed venture is acceptable in accordance with the laws of the land.

Operational feasibility

Operational feasibility is the measure of how well a proposed system solves the problems and takes advantage of the opportunities identified during scope definition and how it satisfies the requirements identified in the requirements analysis phase of system development.

The operational feasibility assessment focuses on the degree to which the proposed development projects fits in with the existing business environment and objectives with regard to development schedule, delivery date, corporate culture and existing business processes.

To ensure success, desired operational outcomes must be imparted during design and development. These include such design-dependent parameters as reliability, maintainability, supportability, usability, product ability, disposability, sustainability, affordability, and others. These parameters are required to be considered at the early stages of design if desired operational behaviours are to be realised. A system design and development requires the appropriate and timely application of engineering and management efforts to meet the previously mentioned parameters. A system may serve its intended purpose most effectively when its technical and operating characteristics are engineered into the design. Therefore, operational feasibility is a critical aspect of systems engineering that needs to be an integral part of the early design phases.

Schedule feasibility

A project will fail if it takes too long to be completed before it is useful. Typically this means estimating how long the system will take to develop, and if it can be completed in a given time period using some methods like payback period. Schedule feasibility is a measure of how reasonable the project timetable is. Given our technical expertise, are the project deadlines reasonable? Some projects are initiated with specific deadlines. It is necessary to determine whether the deadlines are mandatory or desirable.

Market and real estate feasibility

Market feasibility studies typically involve testing geographic locations for a real estate development project and usually involve parcels of real estate land. Developers often conduct market studies to determine the best location within a jurisdiction, and to test alternative land uses for given parcels. Jurisdictions often require developers to complete feasibility studies before they approve a permit application for retail, commercial, industrial, manufacturing, housing, office or mixed-use project. Market

Feasibility takes into account the importance of the business in the selected area.

Resource feasibility

This involves questions such as how much time is available to build the new system, when it can be built, whether it interferes with normal business operations, type and amount of resources required, dependencies, and developmental procedures with company revenue prospectus.

Financial feasibility

In the case of a new project, financial viability can be judged on the following parameters:

- Total estimated cost of the project
- Financing of the project in terms of its capital structure, debt to equity ratio and promoter's share of total cost
- Existing investment by the promoter in any other business
- Projected cash flow and profitability

The financial viability of a project should provide the following information:

- Full details of the assets to be financed and how liquid those assets are.
- Rate of conversion to cash-liquidity (i.e. how easily can the various assets be converted to cash?).
- Project's funding potential and repayment terms.
- Sensitivity in the repayments capability to the following factors:
 - Mild slowing of sales.
 - Acute reduction/slowing of sales.
 - Small increase in cost.
 - Large increase in cost.
 - Adverse economic conditions.

Market research studies

This is one of the most important sections of the feasibility study as it examines the marketability of the product or services and convinces readers that there is a potential market for the product or services. If a significant market for the product or services cannot be established, then there is no project. Typically, market studies will assess the potential sales of the product, absorption and market capture rates and the project's timing.

The feasibility study outputs the feasibility study report, a report detailing the evaluation criteria, the study findings, and the recommendations.⁷⁴

SWOT analysis (alternatively SWOT Matrix) is an acronym for strengths, weaknesses, opportunities, and threats and is a structured planning method that evaluates those four elements of an organisation, project or business venture. A SWOT analysis can be carried out for a company, product, place, industry, or person. It involves specifying the objective of the business venture or project and identifying the internal and external factors that are favorable and unfavorable to achieve that objective. The degree to which the internal environment of the firm matches with the external environment is expressed by the concept of strategic fit.

- Strengths: characteristics of the business or project that give it an advantage over others
- Weaknesses: characteristics of the business that place the business or project at a disadvantage relative to others
- Opportunities: elements in the environment that the business or project could exploit to its advantage
- Threats: elements in the environment that could cause trouble for the business or project



Figure 3. [SWOT](#) Analysis⁷⁵

Identification of SWOTs is important because they can inform later steps in planning to achieve the objective. First, decision-makers should consider whether the objective is attainable, given the SWOTs. If the objective is not attainable, they must select a different objective and repeat the process.

⁷⁴ https://en.wikipedia.org/wiki/Feasibility_study CC BY SA.

⁷⁵ https://en.wikipedia.org/wiki/Feasibility_study CC BY SA

Users of SWOT analysis must ask and answer questions that generate meaningful information for each category (strengths, weaknesses, opportunities, and threats) to make the analysis useful and find their competitive advantage.⁷⁶



Lesson Summary

In this lesson, you examined the different elements of a feasibility analysis and the benefits of this process in the establishment of any business venture. As you continue with your study on entrepreneurship, you will continue to expand your knowledge on the significance of feasibility studies to your business success.

⁷⁶ https://en.wikipedia.org/wiki/SWOT_analysis CC BY-SA.

Lesson 3 - Start-up capital and Financial Statements

Introduction

The term ‘start-up’ has many definitions due to the variety of usages in government, industry, and academia. We identify ‘start-ups’ as newly created firms (New firms; less than one year of age) that move from the idea stage to seeking finance in order to lay down the basic structure of the firm and start operations.⁷⁷ There are several options to receive finance for your business enterprise apart from applying for a business loan. These options include family members, venture funding, angel funding, grants, and bequest. The entrepreneur is also responsible for ensuring that these funds are reported correctly to derive the financial position of the business. Therefore, the elements of the various financial statements and cash flow statement will also be examined in this unit.



Students should be able to:

1. Identify sources of funding
2. Discuss the elements of various financial statements
3. Prepare a cash flow statement
4. Identify various savings and investment options

Entrepreneurial finance is the study of value and resource allocation, applied to new ventures. It addresses key questions which challenge all entrepreneurs: how much money can and should be raised; when should it be raised and from whom; what is a reasonable valuation of the startup; and how should funding contracts and exit decisions be structured.⁷⁸

The first step in raising capital is to understand how much capital you need to raise. Successful businesses anticipate their future cash needs, make plans and execute capital acquisition strategies well before they find themselves in a cash crunch.

Three axioms guide start-up fundraising:

⁷⁷ <https://industry.gov.au/Office-of-the-Chief-Economist/Research-Papers/Documents/Research-Paper-8-2015.pdf> CC BY-SA.

⁷⁸ https://en.wikipedia.org/wiki/Entrepreneurial_finance CC BY-SA.

- As businesses grow, they often go through several rounds or stages of financing. These rounds are targeted to specific phases of the company's growth and require different strategies and types of investors.
- Raising capital is an ongoing issue for every venture.
- Capital acquisition takes time and needs to be planned accordingly.

Four critical determinants of the financial need of a venture are generally distinguished:

- Determination of projected sales, their growth, and the profitability level
- Calculation of start-up costs (one-time costs)
- Estimation of recurring costs
- Projection of working capital (inventory, credit and payment policies. This determines the cash needed to maintain the day-to-day business)⁷⁹



Video

Types of Financing

Sources of finance

<https://www.youtube.com/watch?v=D1G8Y1Ob3Co>⁸⁰

Equity financing

Equity financing refers to the sale of an ownership interest (e.g. shares in an enterprise) to raise funds for business purposes. Equity financing spans a wide range of activities in scale and scope, from a few thousand dollars raised by an entrepreneur from friends and family, to initial public offerings (IPOs) running into the billions by companies like Google and Facebook.⁸¹

Debt financing

Debt financing refers to funds borrowed by a firm for working capital or capital expenditures by selling bonds, bills, or notes to individual and/or institutional investors. The individuals or institutions lending the money thus become creditors of the firm and often receive a security that the principal and interest on the debt will be repaid. Security involves a form of collateral as an assurance the loan will be repaid, to be forfeited to satisfy

⁷⁹ https://en.wikipedia.org/wiki/Entrepreneurial_finance CC BY-SA.

⁸⁰ Rawat, H. (2009) <https://www.youtube.com/watch?v=D1G8Y1Ob3Co>

⁸¹ <https://industry.gov.au/Office-of-the-Chief-Economist/Research-Papers/Documents/Research-Paper-8-2015.pdf> CC BY-SA.

payment of the debt if the debtor defaults on the loan.⁸² Sources of debt financing include loans, venture funding, and angel funding.

Angel Funding

Angel funding is the practice of high-net-worth individuals investing their own time and money in new businesses with the goal of profiting from their long-term growth. Such investments are characterized by very high levels of risk as most companies are in the earliest stages and will likely fail. Angel investors are different from venture capitalists (VCs) in that VCs invest other people's money. Motivations are another important distinction between the two; angels are typically interested in more than just receiving a financial return. Personal interest, the desire to give back, and the thrill of being involved with an innovative company are just a few of the reasons why people decide to become angel investors.⁸³

Angel investors are typically experienced professionals who can offer wisdom and guidance to the entrepreneur and have the patience to wait for normal company maturation. Angels can facilitate new business connections that help start-ups grow, and they can offer insights based on deep knowledge of an industry. They provide support and motivation to entrepreneurs to persevere when launching and growing a business inevitably becomes very challenging.⁸⁴

Venture capital

Venture Capital is a specialised form of equity finance used to finance costly, high-risk, high-return technology-based innovative firms at the pre-seed, seed, start-up, and early expansion stages of commercialisation. The funds are used to develop a company's ideas to the stage where their commercial potential is sufficiently proven for the venture capitalist to sell its equity in the company to another party.⁸⁵

Venture capitalists tend to finance firms during the early stages (when growth is rapid) and cash out of the venture once it is established. Venture capital funds typically operate with a ten-year model, where investments and divestments of portfolio companies must occur within that period to generate returns for institutional investors. At that time, the business owner

⁸² <https://industry.gov.au/Office-of-the-Chief-Economist/Research-Papers/Documents/Research-Paper-8-2015.pdf> CC BY-SA.

⁸³ https://www.infodev.org/infodev-files/angelgroups_guidbook_final_0.pdf CC BY-SA.

⁸⁴ <https://industry.gov.au/Office-of-the-Chief-Economist/Research-Papers/Documents/Research-Paper-8-2015.pdf> CC BY-SA.

⁸⁵ <https://industry.gov.au/Office-of-the-Chief-Economist/Research-Papers/Documents/Research-Paper-8-2015.pdf> CC BY-SA.

may take the company public, repurchase the investor's stock, merge, be bought by another firm, or in some circumstances liquidates the firm. Most venture capital investment realisations are by way of a trade sale

Venture capital can stimulate innovation, spur entrepreneurship, and enhance productivity growth. The venture capital sector is an important component of national innovation systems, playing an important role in driving innovation and supporting skills development by providing finance and other support to turn novel ideas into innovative outputs.⁸⁶



Video

This video examines the different types of funding for start-up and small business such as loans, grants, venture capital, angel funding, and family. <https://www.youtube.com/watch?v=-99iZFahYZg>⁸⁷

Grants

There are lots of grants out there, and many of them are ideal for tech start-ups looking for a funding boost, especially if your business is very innovative or specific. This is free money – you do not have to pay a grant back – and the prestige. Grants are especially good for businesses in niche industries, where there's often less competition for the money. However, grant proposals can take a long time to put together, there can be quite a lot of competition, and the money has to be used for a specific purpose. It is rare that a grant can fund the business alone – you'll usually be expected to match at least part of the funding with your own finance.⁸⁸

Purpose of Accounting

The purpose of accounting is to provide a means of recording, reporting, summarizing and interpreting economic data.

“The primary purpose of accounting is to identify and record all activities that impact the organisation financially. All activities, including purchases, sales, the acquisition of capital and interest earned from investments, can be classified in monetary terms and posted to a specified account as an accounting record. These transactions typically are

⁸⁶ <https://industry.gov.au/Office-of-the-Chief-Economist/Research-Papers/Documents/Research-Paper-8-2015.pdf> CC BY-SA.

⁸⁷ Costa, C. (2015) Funding Sources Available for Startups and Small Businesses. Available at: <https://www.youtube.com/watch?v=-99iZFahYZg>

⁸⁸ <https://www.virginstartup.org/how-to/alternative-funding-tech-startups> CC BY-SA.

recorded in ledgers and journals and are part of the process known as the accounting cycle.” ([ehow 1999-2001](#))

Types of Accounting Information

An accounting information system provides data to help decision makers both outside and inside the business. Decision makers outside the business are affected in some way by the performance of the business. Decision makers inside the business are responsible for the performance of the business. For this reason, accounting is divided into two categories:

- financial accounting for those outside; and
- managerial accounting for those inside.⁸⁹

Management Accounts

Management accounting refers to the processes and procedures implemented for internal decision making and reporting within an organisation. It provides information that is useful in running a business by internal users, usually accomplished through custom designed reports. These are produced as often as a business wants them (usually monthly). They can be prepared using the business’s own internal policies and bookkeeping/financial management system. Internal users, Senior and Middle Management use accounting information to run a business. Employees utilize accounting information to determine a business’s profitability and profit sharing.

Management account information or reports should:

- Relate to the part of the business for which the manager is responsible. For example, a Production Manager wants information on costs of production but not on advertising.
- Involve planning for the future. For instance, a budget would show financial plans for the coming year.
- Meet two tests:
 - the accounting information must be useful and relevant; and
 - it must not cost more to gather and process than it is worth.

⁸⁹ http://oasis.col.org/bitstream/handle/11599/2463/2011_VUSSC_Intro-Accounting.pdf?sequence=1&isAllowed=y

Managerial accounting generates information that managers can use to make sound decisions. The four major types of internal management decisions are:

1. **Financial Decisions**—determine what amount of capital (funds) are needed to run the business and whether to secure these funds from owners or creditors. In this sense, capital means money used by the business to purchase resources such as machinery and buildings and to pay expenses of conducting the business.
2. **Resource Allocation Decisions**—identify how the total capital of a business is to be invested, such as the amount of machinery to be purchased in any one year.
3. **Production Decisions**—decides what products are to be produced, by what means, and when.
4. **Marketing Decisions**—establishes selling prices and advertising budgets; determining the location of a business's markets and how to reach them.⁹⁰

Financial Accounts

Financial accounting refers to the fundamental guidelines, policies, procedures and regulations mandated by the General Accepted Accounting Principles (GAAP), which was established by the Financial Standards Board (FASB) and/or government regulators. It provides information designed to satisfy the needs of external users. This reporting is done in the form of financial statements. These accounts are usually produced annually. They are based on historical information and are rarely used internally. Financial accounts are used by external users for several reasons.

The external users of accounting information fall into six groups; each has different interests in the business depending on how you are financially structure and thus will want answers to unique questions. The groups and some of their possible questions are:

- **Owners and Prospective Owners.** Has the business earned satisfactory income on its total investment? Should an investment be made in this business? Should the present investment be increased, decreased, or

⁹⁰ http://oasis.col.org/bitstream/handle/11599/2463/2011_VUSSC_Intro-Accounting.pdf?sequence=1&isAllowed=y

retained at the same level? Can the business install costly pollution control equipment and still be profitable?

- **Creditors and Lenders.** Should a loan be granted to the business? Will the business be able to pay its debts as they become due?
- **Employees and their Unions.** Does the business have the ability to pay increased wages? Is the business financially able to provide long-term employment for its workforce?
- **Customers.** Does the business offer useful products at fair prices? Will the business survive long enough to honour its product warranties?
- **Governments.** Is the business, such as a local public utility, charge a fair rate for its services? How much tax does the business owe?
- **The General Public.** Is the business providing useful products and gainful employment for the local citizens without causing serious environmental problems?⁹¹

An accounting concept is nothing but a basic assumption about the environment in which the business operates and accounting functions. It is an assumption that is well recognized and accepted by the accounting professionals. It, therefore, gains acceptability among the entire accounting people. However, it is not a fact. It is the building block on which the entire accounting structure rests. They are general in nature and present a philosophy with regard to the manner business transactions must be recorded.⁹²

⁹¹ http://oasis.col.org/bitstream/handle/11599/2463/2011_VUSSC_Intro-Accounting.pdf?sequence=1&isAllowed=y

⁹² <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19912>

Accounting Assumptions

Separate Entity

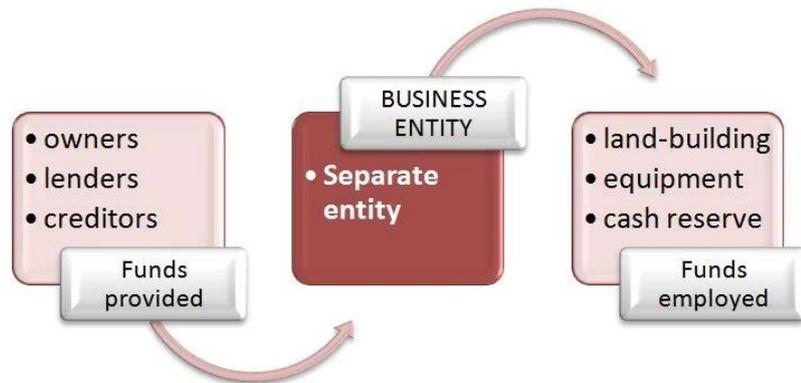


Figure 4. Separate Entity⁹³

The entity postulate assumes that both business and businessman are different for accounting purposes. Thus, for accounting purposes, the business is considered as a unit or entity that is separate from all the people that are related to it or transact with it either directly or indirectly. This is an important concept as it justifies considering every transaction from the business point of view for recording purposes. For example, capital introduced by the owner of the business into the business increases the assets as well as owings of the business to the owner. Although the business belongs to the owner, and the total of his personal and business worth in terms of net assets owned by him remains the same, yet he is able to analyse the growth of the business by recording them separately. So, when the owner introduces his personal assets in the business, they are recorded as business assets separately in the books of the business, and not in the name of the owner. However, if the owner uses some of the business assets for his personal use, say payment of his personal electricity bill from office cash, it is treated as drawings made by him from the business. In this way, this concept enables the accountants to distinguish between personal and business transactions.⁹⁴

⁹³ <http://2.bp.blogspot.com/-u-EpPJzPTvQ/Th5ZhDS5Pnl/AAAAAAAAAPQ/dnPzZ9428ZA/s1600/accounting-entity-assumption.jpg>

⁹⁴ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19913> (BY NC SA)

Going Concern

Going concern refers to the assumption that the life of business will be fairly large. It suggests that the business is run with the objective of continuing it for a long number of years, and it not intended to be closed in the near future. It assumes that the business has an unlimited life, extending to an indefinite period until it is liquidated. It is important for the interested parties to know that the business is run for a long period of time so that they are induced to enter into various contracts with the enterprise. Such an assumption is made by every interested party, even if the life of a business cannot be known with certainty. However, an enterprise is not considered to be a going concern if there is a clear evidence or specific information about its end. For example, when the venture is for a specific purpose, such as setting up of a stall in an exhibition or fair, the business comes to an end on the completion of fair or exhibition.⁹⁵

Money Measurement

Money is considered as a common basis for recording business transactions. According to this concept, such transactions alone can be recorded in the books of account that can be measured in terms of money. In the absence of common measuring unit (i.e. money) it is not possible to add or subtract various business events.⁹⁶

Time Period

As per going concern concept, the business is assumed to have an indefinite life. However, the proprietor of the business cannot wait for such a long period for the determination of income. Such a measurement of income at the end of the life of business would render useless information as well as it will be too late to take corrective steps at that time. Therefore, accountants choose some convenient period of time to measure the income or to know the results of business transaction known as accounting period.

Thus, accounting period refers to the span of time at the end of which financial statements are prepared to represent the results of the operations of the business during the relevant period and financial position at the end of that relevant period. The accounting period varies in time intervals such as a month, quarter, and year. However, the year is the most common accounting period as a result of established business practices traditions and government requirements.⁹⁷

⁹⁵ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19915> (BY NC SA)

⁹⁶ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19914> (BY NC SA)

⁹⁷ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19916> (BY NC SA)

Accounting Principles

Historical Cost

The cost concept requires that the assets should be recorded at the exchange price or acquisition cost. Since the original or acquisition cost relates to the past, it is also referred to as historical cost. Historical cost is recognised as the appropriate valuation basis for recognition of all goods and services, expenses cost, and equities. For the purposes of recording in accounting, all business transactions are measured in terms of actual prices at the time of occurrence of the transaction.

For example, if a business entity purchases a machine for Rs. 5,00,000 from a builder friend. The actual worth of the machinery is Rs. 6,00,000. This asset would be recorded in the books at Rs 5,00,000 not at Rs. 6,00,000 because for the business entity actual cost of the asset is Rs 5,00,000 i.e. the price paid for it. The basis for all future transactions relating to this building would be its cost i.e. Rs. 5,00,000. For example, the depreciation will be charged at Rs. 5,00,000, not at Rs. 6,00,000.

Further historical cost is considered more relevant than any other value of asset i.e. market value. The identification of the market value involves following problems:

(i) One has to make a choice about the value prevailing in the market. At the same point in time, two different market values exist in any market: the one at which the asset can be sold and one at which the asset can be purchased.

(ii) The accountant has to keep a record of changes in market price of the asset as the market keeps on fluctuating. Suppose there are 50 dealers in the market dealing in sale or purchase of a particular asset. There may be 100 different values (50 sale values and 50 purchase values) of that asset. Now the question is which value in the most appropriate.

(iii) Moreover, it is not always feasible to keep track of the market to determine the correct value.

Thus, the justification for recording fixed assets at historical cost is that the historical cost is most objective reliable, definite and it is also free from personal bias.

However, this concept suffers from the following limitations:

(i) Items which do not carry any cost are ignored in accounting. Thus goodwill aroused on account of favourable location, brand name, knowledge, technological skill built inside the enterprise are not recorded in the books of account.

(ii) The actual information required by the management, investors, creditors, etc. may be current value and not the historical costs.

(iii) During inflation, if the depreciation based on the historical cost of earlier year is charged against revenue at current prices, then income figure may be distorted.⁹⁸

Matching

The matching principle in financial accounting is the process of matching accomplishments or revenues with efforts or expenses to a particular period for which the income is being determined. This concept emphasizes which items of costs are expenses in a given accounting period. Costs are reported as expenses in the accounting period in which the revenues associated with those costs are reported. For example, when the sales value of some goods is reported as revenue in a year, then the cost of those goods would be reported as an expense in the same year.

The matching concept needs to be fulfilled only after accrual concept has been completed by the accountant. First, revenues are measured in accordance with the accrual concept, and then costs are associated with these revenues.⁹⁹

Realization of Income

Business enterprises utilise resources to earn revenue by sale of goods or rendering of services. According to AS -9 issued by ICAI, “Revenue is the gross inflow of cash receivables or other considerations arising in the course of an enterprise from the sale of goods, from the rendering of services and from holding of assets. Revenue is measured by the changes made to customers or clients for goods supplied and services rendered to them and by the changes and rewards arising from the provision of assets. It excludes amounts collected on behalf of third parties such as certain taxes.” Thus revenue is considered as being realized or earned on the date when the sale process is complete, and transfer of title or ownership takes place.¹⁰⁰

Dual Aspect

Financial accounting is transaction based. Of course, we consider only those transactions and events which involve financial element. In every type of business, there are numerous transactions. For example, purchase of goods from several suppliers, sell to various customers for cash or on

⁹⁸ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19920> (BY NC SA)

⁹⁹ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19926> (BY NC SA)

¹⁰⁰ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19924> (BY NC SA)

credit, payment to suppliers, collection from customers, payment of salaries and wages, payment of rent and taxes, etc. In each of the above transactions, there are two aspects to be recorded from the point of view of the entity. For example – if there is the sale of goods – it involves two aspects, one is the delivery of goods and other is the receipt of cash (in the case of cash sale) or the acknowledgement of the debt from the customer (in the case of credit sale). The recognition of two aspects for every transaction is known as dual aspect analysis. The method of recording transactions on the basis of the concept of duality is known as ‘Double Entry Book Keeping.’ Every transaction is recorded under the following heads under this double entry system of bookkeeping while holding the following equation true at all times:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

In accounting terminology, resources are referred to as assets, obligations towards the owners are referred to as capital, and obligations towards the outsiders is referred to as liabilities. The total of assets, and the total of obligations to owners and outsiders must agree.

This equation holds good at any point of time because of double entry system of bookkeeping. In double entry system for every transaction, two entries are made one entry consists of a debit to one or more accounts, and another entry consists of credit to one or more accounts. However, the total amount debited always equals the total amount credited.¹⁰¹

Accounting Conventions

Materiality In order to make financial statements more meaningful and to minimize costs, the accountant should report only the information which is material. Thus, accounting should focus on material facts and resources should not be wasted in recording and analysing immaterial and insignificant facts. Materiality is an implicit guide for the accountant in deciding what should be disclosed in the financial statements. However, it is difficult to define the term materiality. Most definitions of materiality stress the role of accountants’ judgment in interpreting what is and what is not material at the same time stressing its importance. According to American Accounting Association (AAA), “an item should be regarded as material if there is a reason to believe that knowledge of it would influence the decision of informed investor.”¹⁰²

¹⁰¹ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19919>

¹⁰² <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19931>

Conservatism Every business enterprise wants to play safe in the world of uncertainty. These are following two principal rules that are related to the convention of prudence:

- (i) The accountant should not anticipate profits and should provide for all losses.
- (ii) When in doubt, the accountant must prefer that method of accounting which will not lead to any overestimation of assets and/or income.
- (iii) When applied to business income, this convention results in recognition of all losses that have occurred or liable to occur and to admit the gains only when they have been realised.¹⁰³

Consistency Uniformity in accounting methods and practices over a period of time is necessary in order to enable the management to analyze the records and draw correct inferences about the working of the enterprise. The comparison of financial statements of one accounting period with that of the other cannot be made unless they are prepared on the basis of consistent methods. For example, if the income statement for the current year shows higher earnings than the preceding year, the user is entitled to assume that the business operations have been more profitable provided there is no change in the accounting procedure adopted by the enterprise. The rationale for this convention is that frequent changes in accounting treatment would make the income statement and balance sheet unreliable to end users; there are many examples in which a change in accounting method may bring different results. For instance, different methods of charging depreciation will result in different amounts of depreciation to be written off the fixed assets over the useful life of the asset. A change of method of charging depreciation will affect the depreciation amount and consequently the net profits of the enterprise. The figures of net profit do not become comparable in that case. If there is inconsistency in the record keeping, it may bring about considerable influence on the income reported as well as the value of assets in the balance sheet.¹⁰⁴

Full Disclosure Under this convention, it is required that the accounts must be honestly prepared and all material information must be disclosed therein. Accountants are unanimous that there should be a full, fair and adequate disclosure. Full disclosure means the complete and comprehensive presentation of information i.e. nothing is omitted. Fair disclosure means that accounting principles have been applied in a fair manner so as to report the true and fair view of the results of the business.

¹⁰³ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19929>

¹⁰⁴ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19930>

Adequate disclosure means that anything which influences the decision of the user must always be reported. Thus, disclosure should not be taken to imply that every small piece of information must find a place in the financial statements, rather provides that there must be adequate disclosure of material information to the interested parties that is required by them and will influence their decision making. For example, a firm is depreciating its assets on a straight-line basis for last two years. It changes the method to written down value method with retrospective effect. The firm must disclose this fact as a part of accounting policies as 'Notes to Accounts' forming part of financial statements. Similarly, contingent liabilities and market value of investments are also shown as notes to financial statements.

The concept of disclosure also applies to events occurring after the balance sheet date and the date on which the financial statements are authorised for issue. Such events include bad debts, destruction of plant and equipment due to natural calamities, etc. Such events are likely to have a substantial influence on the earning and financial position of the enterprise.¹⁰⁵

The accounting cycle

The accounting cycle is a series of steps that is followed to ensure that the records of a business are true and fair. Each business transaction goes through these steps. Let's have a look at these steps in detail.

¹⁰⁵ <http://vle.du.ac.in/mod/book/view.php?id=10997&chapterid=19932>



Figure 5 Accounting Cycle

Step 1 - Collecting and analyzing data from source documents.

When a transaction occurs; a document is produced. Most of the time, these documents are external to the business (e.g. purchase orders, sales slips, etc.). However, they can also be internal documents, such as inter-office sales, cheques, bills from providers, etc. These documents are referred to as source documents. Some additional examples of source documents include:

- The receipt you get when you purchase something at the store.
- Interest you earned on your savings account which is documented in your monthly bank statement.
- The monthly electric utility bill that comes in the mail.
- The telephone bill.
- Invoices from other service providers, contractors, etc.

Step 2 – Journalizing transactions.

The source documents are recorded in a Journal. This is also known as a book of first entry. The journal records both sides of the transaction recorded in the source document. These write-ups are known as Journal entries.

The Journal entries are then transferred to a Ledger. The group of accounts (described earlier) is called ledger. A ledger is also known as a book of accounts. The purpose of a Ledger is to bring together all of the transactions for a similar activity. For example, if a business has one bank account, then all transactions that include cash would then be maintained in the Cash Ledger. This process of transferring the values is known as a posting.

Once the entries have all been posted, the Ledger accounts are added up in a process called Balancing. Balancing implies that the sum of all Debits equals the sum of all Credits.

Step 4 – Unadjusted Trial Balance.

A particular working document called an unadjusted trial balance is created. This lists all the balances from all the accounts in the Ledger. Notice that the values are not posted to the trial balance, they are merely copied.

At this point, accounting happens. The accountant produces a number of adjustments, which make sure that the values comply with accounting principles. These values (such as depreciation of equipment) are then passed through the accounting system resulting in an adjusted trial balance. This process continues until the accountant is satisfied.

Steps 5 – Prepare adjustments.

Period-end adjustments (usually quarterly) are required to bring accounts to their proper balances after considering transactions and/or events not yet recorded. Under accrual accounting, revenue is recorded when earned and expenses when they are incurred. An entry may be required at the end of the period to record revenue that has been earned but not yet recorded on the books. Similarly, an adjustment may be required to record expense that may have been incurred but not yet recorded.

Step 6 – Prepare an adjusted trial balance.

This step is similar to the preparation of the unadjusted trial balance, but this time the adjusting entries are included. Correction of any errors must be made.

Step 7 - Prepare Financial Statements.

[Financial statements](#) are drawn from the trial balance and are presented in the following forms:

- [Income statement](#): prepared from revenue, expenses, gains and losses

- **Balance sheet:** prepared from assets, liabilities and equity accounts
- **Statement of retained earnings:** prepared from net income and dividend information
- **Cash flow statement:** derived from the other financial statement using either the direct or indirect method.

Finally, all the revenue and expense accounts are closed.

Step 8 – Closing entries.

Revenues and expenses are accumulated and reported by period, monthly, quarterly, or yearly. To prevent them not being added to or co-mingled with revenues and expenses of another period, they need to be closed out—that is, given zero balances at the end of each period. Their net balances, which represent the income or loss for the period, are transferred into owners' equity. Once revenue and expense accounts are closed, the only accounts that have balances are the asset, liability, and owners' equity accounts. These balances are carried forward to the next period.

Step 9 – Prepare post-closing trial balance.

The purpose of this final step is two-fold: to determine that all revenue and expense accounts have been closed properly and to test the equality of debit and credit balances of all the balance sheet accounts, that is, assets, liabilities and owners' equity.

Statement of Cash Flow

A Statement of Cash Flow is an analysis of sources of cash that flowed into the business together with how cash was allocated, for the accounting period.

The information is grouped by functional department, because Cash can be freed up from anywhere (such as getting customers to pay faster or paying suppliers more slowly), not just from Sales or the Finance Department.¹⁰⁶



Video

Understanding cash flow¹⁰⁷

<https://www.youtube.com/watch?v=LbLcXZ-rSQ0>

¹⁰⁶<http://glossary.income-outcome.com/gb/scf.html>

¹⁰⁷<https://www.youtube.com/watch?v=LbLcXZ-rSQ0>

A cash flows statement provides information beyond that available from other financial statements such as the Income Statement and the Balance Sheet. It is important information because cash flow is essential to the continued operation of a business. The main purpose of the statement, according to the Financial Accounting Standard Board (FASB) is to provide:

- Information about the changes of an entity cash or cash equivalents in the accounting period.
- Information about a company borrowing and debts repayment activities.
- The company sale and repurchase of its ownership securities.
- Other factors affecting the company's liquidity and solvency.

The normal format of The Cash Flow Statement is:

Statement of Cash Flows for the period

	Debit +/-	Credit +/-
Cash flows from operating activities Cash receipts from customers Cash paid to suppliers and employees	Balance c/d	
Cash flow from investing activities		
Cash flow from financing activities		
Net increase/decrease/Change in the cash and cash equivalents		
Cash and cash equivalents at the beginning of period		
Cash and cash equivalents at the end of period		

Each of the above headings will have further details, such as Cash flow from operations with an increase in account receivables, accounts payables, cash receipts from customers, payment for goods sold and operating expenses. The investing cash flow includes capital expenditures for long-term assets, sales of assets and investing in joint ventures, etc. Financing cash flow includes debts financing, dispensing ownership funds and borrowings.

When activities that do not involve cash they are not normally disclosed on the statement, BUT the Standard requires such transactions to be disclosed by way of footnotes or on a separate schedule.

The importance of the Cash Flow Statement for investment decision making includes:

- Regular operations are sustainable or not.
- Sufficient cash generated to pay debts or not.
- The likelihood that the company needs further financing.
- Can unexpected obligations or opportunities be taken up by the company without difficulty?¹⁰⁸

Income Statements

Comprehensive income, the broadest measure of performance, captures the extent management increased net assets during a reporting period, other than transactions with owners and accounting changes and restatements.

Comprehensive income has two components: net profit (loss) and other comprehensive income.

- Net profit (loss) is the accounting measure users of financial statements tend to place the most reliance on when assessing performance.

Other comprehensive income (OCI) is comprised of items standard setters have decided not to include in net profits, primarily because these items are transient and result from factors largely outside a company's influence.

- Under IFRS, income statements have two primary elements: income and expenses. Under U.S. GAAP, revenues, gains, expenses, and losses are all considered primary elements of income statements.
- Because the definitions of income and expenses are based on changes in assets or liabilities, measurement and recognition decisions associated with income statements depend on measurement and recognition decisions associated with assets and liabilities. Thus, all the uncertainty, judgments, and risks associated with balance-sheet measures affect income measures.¹⁰⁹

¹⁰⁸ <http://www.opentextbooks.org.hk/ditatopic/19444> (CC BY SA)

¹⁰⁹

http://www.navigatingaccounting.com/sites/default/files/Posted/Chapters/Ch_03_is/2%20Wis/1_is/Documents/Acrobat/is_wis_is_lob_key_takeaways.pdf (CC BY NC SA)

Statement of Financial Position (Balance Sheet)

The primary purpose of a balance sheet is to report an organisation's assets and liabilities at a particular point in time. The format is quite simple. All assets are listed first—usually in order of liquidity¹—followed by the liabilities. A picture is provided of each future economic benefit owned or controlled by the company (its assets) as well as its debts (liabilities).

A typical balance sheet is reported in [Figure 3.5 “Balance Sheet”](#) for Davidson Groceries. Note that the assets are divided between current (those expected to be used or consumed within the next year) and noncurrent (those expected to remain within the company for longer than a year). Likewise, liabilities are split between current (to be paid during the next year) and noncurrent (not to be paid until after the next year). This labelling aids financial analysis because Davidson Groceries’ current liabilities (\$57,000) can be subtracted from its current assets (\$161,000) to arrive at a figure often studied by interested parties known as working capital (\$104,000 in this example). The current assets can also be divided by current liabilities ($\$161,000/\$57,000$) to determine the company’s current ratio (2.82 to 1.00), another figure calculated by many decision makers as a useful measure of short-term operating strength.

The balance sheet shows the company’s financial condition on one specific date. All the other financial statements report events occurring over a period of time (often a year or a quarter). The balance sheet discloses assets and liabilities as of the one specified date.¹¹⁰

¹¹⁰ <http://open.lib.umn.edu/financialaccounting/chapter/3-4-reporting-a-balance-sheet-and-a-statement-of-cash-flows/> (CC BY NC SA)

Davidson Groceries Balance Sheet, December 31, 2XX4		
<u>Assets</u>		
Current Assets		
Cash	\$22,000	
Accounts Receivable	24,000	
Inventory	103,000	
Prepaid Rent	<u>12,000</u>	
Total Current Assets		\$161,000
Noncurrent Assets		
Land	210,000	
Equipment (net)	155,000	
Buildings (net)	<u>680,000</u>	
Total Noncurrent Assets		<u>1,045,000</u>
Total Assets		<u>\$1,206,000</u>
<u>Liabilities and Stockholders' Equity</u>		
<u>Liabilities</u>		
Current Liabilities		
Accounts Payable	\$33,000	
Salaries Payable	9,000	
Insurance Payable	<u>15,000</u>	
Total Current Liabilities		\$57,000
Noncurrent Liabilities		
Note Payable—Third National Bank	300,000	
Note Payable—State Bank	<u>220,000</u>	
Total Current Liabilities		<u>520,000</u>
Total Liabilities		\$577,000
<u>Stockholders' Equity</u>		
Capital Stock	\$179,000	
Retained Earnings	<u>450,000</u>	
Total Stockholders' Equity		<u>\$629,000</u>
Total Liabilities and Stockholders' Equity		<u>\$1,206,000</u>

Figure 6 – Balance Sheet¹¹¹

Considerable information is included on the balance sheet presented in Figure 6 “Balance Sheet”. Assets such as cash, inventory, and land provide future economic benefits for a company. Liabilities for salaries, insurance, and the like reflect debts that are owed at the end of the year. The \$179,000 capital stock figure indicates the amount of assets

¹¹¹ <http://open.lib.umn.edu/financialaccounting/chapter/3-4-reporting-a-balance-sheet-and-a-statement-of-cash-flows/> (CC BY NC SA)

that the original owners contributed to the business. The retained earnings balance of \$450,000 was computed earlier and identifies the portion of the net assets generated by the company's own operations over the years. For convenience, a general term such as "stockholders' equity" or "shareholders' equity" encompasses the capital stock and the retained earnings balances.

Why does the balance sheet balance? This agreement cannot be an accident. The asset total of \$1,206,000 is exactly the same as the liabilities (\$577,000) plus the two stockholders' equity accounts (\$629,000—the total of capital stock and retained earnings). Thus, assets equal liabilities plus stockholders' equity. What creates that equilibrium?

The balance sheet will always balance unless a mistake is made. This is known as the accounting equation:

Assets = liabilities + stockholders' equity.

Or if the stockholders' equity account is broken down into its component parts,

Assets = liabilities + capital stock + retained earnings.

This equation stays in balance for one simple reason: assets must have a source. If a business or other organisation has an increase in its total assets, that change can only be caused by

- (a) an increase in liabilities such as money being borrowed,
- (b) an increase in capital stock such as additional money being contributed by stockholders, or
- (c) an increase created by operations such as a sale that generates a rise in net income. There are no other ways to increase assets.

One way to understand the accounting equation is that the left side (the assets) presents a picture of the future economic benefits that the reporting company holds. The right side provides information to show how those assets were derived (from liabilities, from investors, or from operations). Because no assets are held by a company without a source, the equation (and, hence, the balance sheet) must balance.

Assets = the total source of those assets¹¹²

Break even analysis

- Breakeven analysis is a method of determining the level of sales at which the company will break even (have no profit or loss).
- The following information is used in calculating the breakeven point: fixed costs, variable costs, and contribution margin per unit.
- Fixed costs are costs that do not change when the amount of goods sold changes. For example, rent is a fixed cost.
- Variable costs are costs that vary, in total, as the quantity of goods sold changes but stay constant on a per-unit basis. For example, sales commissions paid based on unit sales are a variable cost.
- Contribution margin per unit is the excess revenue per unit over the variable cost per unit. **Contribution = Sales – Variable cost**

Contribution per unit = selling price – variable cost per unit

- The breakeven point in units is calculated with this formula: fixed costs divided by contribution margin per unit (selling price per unit less variable cost per unit).¹¹³

A break-even analysis determines at which point your revenues from sales equal your costs. It also tells you the amount of revenue your business needs to generate and the number of units it must sell to break even before your business can become profitable.

Determining Costs

The first step is to determine the costs to manufacture your product or offer your service. Once you know your costs, you can calculate your break-even point.

Definition of Fixed and Variable Costs

Variable costs are the expenses that vary with the amount of services rendered or goods produced. They depend on the operations of the business. They include costs of raw materials used for production, wages, and utilities.

For example, the cost of labourers to offload a container of goods may vary with the volume of goods in the container or the number of loaded

¹¹² <http://open.lib.umn.edu/financialaccounting/chapter/3-4-reporting-a-balance-sheet-and-a-statement-of-cash-flows/> (CC BY NC SA)

¹¹³ <http://jsmith.cis.byuh.edu/books/an-introduction-to-business-v2.0/s14-06-breakeven-analysis.html>

containers available for offloading. In this case cost of labour depends on the volume of operations of the business.

Definition of Fixed Costs - costs that remain constant despite increases or decreases in sales or volumes of production. Fixed costs include the cost of rent of office premises or operating licenses for the year.

Definition of Unit - is a quantity used as a standard measurement of “output” for a product or service. Units are used to measure volume, costs or price. They include kilograms, boxes, or units of a currency like shillings.

Calculating Variable Costs

Calculating variable costs is trickier than calculating fixed costs because it requires isolating costs of all inputs used in producing *one unit* of a good. Therefore, if you are offering a training service, you will need to calculate all costs related to providing that training. This might include a contracted trainer's fee, materials, space (if you plan to rent space outside your regular office), snacks you will provide, etc. Reusable supplies, such as pens, need to be costed by their *estimated life span*, or their total cost divided by the number of times you can use them.

You may also calculate variable costs by subtracting fixed costs from total costs.

Variable costs = total costs – fixed costs.

Formula for Calculating Break-Even Units

To determine how many units must be produced and sold to break even, use the following formula:

$$\frac{\text{Fixed costs (FC)}}{\text{Selling Price (SP) - Variable cost per unit (VC)}} = \text{Number of units needed to break even (\#BE)}$$

$$\frac{\text{FC} \dots}{(\text{SP} - \text{VC})} = \text{BE (units)}$$

Results of the break-even analysis can help you to:

1. Establish the profitability of your business.
2. Establish your firm's capacity to meet the demand for its products and make a profit.
3. Establish whether there is sufficient market for this quantity of service or products.
4. Test whether the marketing plan can support the firm to sell the quantity needed to break-even at the selling price established.

5. Determine how long it will take your business to make a profit. If you lose money for a year or two will you eventually make a profit? *If not, you are in the wrong business?*¹¹⁴

Savings and investment options

Saving is income not spent or deferred consumption. Methods of saving include putting money aside in, for example, a deposit account, a pension account, an investment fund, or as cash. Saving also involves reducing expenditures, such as recurring costs. In terms of personal finance, saving generally specifies low-risk preservation of money, as in a deposit account, versus investment wherein risk is a lot higher; in economics more broadly, it refers to any income not used for immediate consumption.¹¹⁵

Investment generally results in acquiring an asset, also called an investment. If the asset is available at a price worth investing, it is normally expected either to generate income or to appreciate in value, so that it can be sold at a higher price (or both).

Investors generally expect higher returns from riskier investments. Financial assets range from low-risk, low-return investments, such as high-grade government bonds, to those with higher risk and higher expected commensurate reward, such as emerging markets stock investments.¹¹⁶

Stock and bonds

Bonds and stocks are both securities, but the major difference between the two is that (capital) stockholders have an equity stake in the company (i.e., they are owners), whereas bondholders have a creditor stake in the company (i.e., they are lenders). Being a creditor, bondholders have priority over stockholders. This means they will be repaid in advance of stockholders but will rank behind secured creditors in the event of bankruptcy. Another difference is that bonds usually have a defined term, or maturity, after which the bond is redeemed, whereas stocks are typically outstanding indefinitely. An exception is an irredeemable bond, such as a consol, which is a perpetuity, that is, a bond with no maturity.¹¹⁷

¹¹⁴

<https://docs.google.com/document/d/1LEb1qEscpzvAGckOK8WUgmoGOckmZ8vJhnu0dC-RTB0/preview>

¹¹⁵ <https://en.wikipedia.org/wiki/Saving>

¹¹⁶ <https://en.wikipedia.org/wiki/Investment>

¹¹⁷ [https://en.wikipedia.org/wiki/Bond_\(finance\)](https://en.wikipedia.org/wiki/Bond_(finance)) (CC BY SA)



Summary

Lesson Summary

In this lesson, you examined various options of start-up capital for your business venture. You also reviewed different components of financial statement that are prepared to derive the financial position of your business. In the next lesson, you will study business models and the components of various business models

Lesson 4 – Developing the Business Model

Introduction

The idea of resources usually leads us to think of only money. In this section, we will examine how to access the available resources and how to put it to work.

We will seek to answer the following questions:

- 1 How do we start a small business?
- 2 What do we need to start a business?
- 3 How do we access resources?
- 4 Is partnering to access resources a good idea?



At the end of the lesson, students should be able to:

1. Explain the components of a business model
2. Develop a business model for a business plan

Description of a business model

Models are simplified representations of things in the real world. You are already familiar with many kinds of models. You had played with a model airplane or boat when you were a child. You may have seen models of buildings, dams, or other construction projects built by architects to show the sponsors of a project how a completed building will look after it is built. In the same way, a business model lets an entrepreneur try out different ways to put together the components of his or her business and evaluate various options before implementing the one that looks the best.¹¹⁸

Business models can be approached from two perspectives. A general perspective defines a business model as any type of conceptual framework explaining how to organise and evolve a business venture. On the other hand, specific circumstances guide business modeling. For instance, industries such as tourism, banking in the services sector, or automobile or shoe manufacturing demand specific models that take into account critical variables found within the industry's specific environment.

¹¹⁸ <https://www.boundless.com/users/235420/textbooks/business-fundamentals/business-models-and-marketing-an-overview-3/business-models-and-marketing-an-overview-18/what-is-a-business-model-87-15390/>

One definition from the general perspective is provided by Alex Osterwalder:

A business model is a conceptual tool that contains a set of elements and their relationships and allows expressing the business logic of a specific firm. It is a description of the value a company offers to one or several segments of customers and of the architecture of the firm and its network of partners for creating, marketing, and delivering this value and relationship capital, to generating profitable and sustainable revenue streams.¹¹⁹

A business model describes the rationale of how an organisation creates, delivers, and captures value, in economic, social, cultural or other contexts. The process of business model construction is part of business strategy. In theory and practice, the term *business model* is used for a broad range of informal and formal descriptions to represent core aspects of a business, including purpose, business process, target customers, offerings, strategies, infrastructure, organisational structures, sourcing, trading practices, and operational processes and policies including culture.¹²⁰

COMPONENTS OF A BUSINESS MODEL

1. VALUE PROPOSITION (how do you create value?)

A value proposition is a statement which clearly identifies clear, measurable and demonstrable benefits consumers get when buying a particular product or service. It should convince consumers that this product or service is better than others on the market. This proposition can lead to a competitive advantage when consumers pick that particular product or service over other competitors because they receive greater value. Capon and Hulbert linked the success of firms in the marketplace to the value provided to customers. They introduced a principle of customer value, with customer insights driving the company's marketing activities. Customer value should also drive investment and production decisions because customers perceive value on the benefits of the product or service they receive. Consequently, as the environment changes, and the customer experience and their desires change, the value they seek changes. As a result, companies are pressured to invest more resources in marketing research in order to gain deep customer insights, improve the value proposition.

¹¹⁹ <https://www.boundless.com/users/235420/textbooks/business-fundamentals/business-models-and-marketing-an-overview-3/business-models-and-marketing-an-overview-18/what-is-a-business-model-87-15390/>

¹²⁰ https://en.wikipedia.org/wiki/Business_model

Consumers are always looking around for the best possible deal for the best quality and how these products or services will contribute to their success. The value proposition is the promise that the business will give the consumer to assure best possible value. The value proposition is a creative statement that depicts the unique selling point. Without this statement, you lose an opportunity to tell consumers why they should pick you over competitors. An important goal in a business is to convince customers that they are getting many more benefits. Coming from a customer's perspective, buyers are not only asking how this product is different to one they may already be using but what value this product or service may have. Customers are looking for answers that may improve or replace products or services. Customers will never buy a product or service if they do not feel like they are receiving the best possible deal. Therefore, the value proposition is important to businesses and their success.

When creating a value proposition, it is important to think about these key questions: What is the product or service? Who is the target market? What value does the product or service provide? How is this different from competitors? Many businesses that can answer these will have a relatively strong value proposition as they know how their product or service differentiates from competitors. But it is more than just understanding and recognizing what makes them different; it is about creating a statement that engages customers in purchasing goods or service. There are many benefits that the value proposition can have on a business. These benefits include a strong differentiation between the company and its competitors, increase in quantity, better operations efficiency and increase in revenue. By also creating a more personal and honest relationship with consumers through the value proposition also gives them another reason to choose you. These benefits will help the business grow and succeed in the market.¹²¹

Standardize or customize?

When planning on producing a new product and/or service, the key factor is the product and service design. Successful designs come down to these basic principles: translate customers' wants and needs, refine existing products and services, develop new products and services, formulate quality goals, formulate cost targets, construct and test prototypes, document specifications, and translate products and service specification into process specifications. The process of design has certain steps that include motivation, ideas for improvement, organisational capabilities, and forecasting. In the product process innovations, research and development play a significant role. Because of the influence a product and service design can have on an organisation, the design process is encouraged to be tied in with the organisation's strategy and take into account some key

¹²¹ https://en.wikipedia.org/wiki/Value_proposition

considerations such as technological changes, the competitive market, and economic and demographic changes are some market opportunities and threats that all organisations must be aware of when planning a product and service design. Companies choose various ways to design their products and the type of services they provide. Which include: *standardization, mass customization, delayed differentiation, modular design, and robust design*. Deciding which method to use is very important along with deciding the company's target market. Deciding the right method establishes good productivity and efficient way for operations.¹²²

Mobile-phone maker Nokia went a step further in localizing its phones to different markets. The company uses local designers to create mobile-phone handset models that are specifically appropriate for each country. For example, the handsets designed in India are dust resistant and have a built-in flashlight. The models designed in China have a touch screen, stylus, and Chinese character recognition.¹²³

Direct or indirect distribution?

A marketing channel is a set of practices or activities necessary to transfer the ownership of goods and to move goods, from the point of production to the point of consumption and, as such, which consists of all the institutions and all the marketing activities in the marketing process. There are basically four types of marketing channels:

- Direct selling;
- Selling through intermediaries;
- Dual distribution; and
- Reverse channels

Direct Selling

Direct selling is the marketing and selling of products directly to consumers away from a fixed retail location. Peddling is the oldest form of direct selling. Modern direct selling includes sales made through the party plan, one-on-one demonstrations, and personal contact arrangements as well as internet sales.

¹²² <https://ids355.wikispaces.com/Ch.+4+Product+and+Service+Design>

¹²³ <http://2012books.lardbucket.org/books/challenges-and-opportunities-in-international-business/s18-03-standardized-or-customized-pro.html>

Industry representative, the World Federation of Direct Selling Associations (WFDSA), reports that its 59 regional member associations accounted for more than US\$114 Billion in retail sales in 2007, through the activities of more than 62 million independent sales representatives. According to the WFDSA, consumers benefit from direct selling because of the convenience and service benefits it provides, including personal demonstration and explanation of products, home delivery, and generous satisfaction guarantees.

Selling Through Intermediaries

A marketing channel where intermediaries such as wholesalers and retailers are utilized to make a product available to the customer is called an indirect channel.

The most indirect channel you can use (Producer/manufacturer --> agent --> wholesaler --> retailer --> consumer) is used when there are many small manufacturers and many small retailers and an agent is used to help coordinate a large supply of the product.

Dual Distribution

Dual distribution describes a wide variety of marketing arrangements by which the manufacturer or wholesalers uses more than one channel simultaneously to reach the end user. They may sell directly to the end users as well as sell to other companies for resale. Using two or more channels to attract the same target market can sometimes lead to channel conflict.

An example of dual distribution is business format franchising, where the franchisors, license the operation of some of its units to franchisees while simultaneously owning and operating some units themselves.

Reverse Channels

If you have read about the other three channels, you would have noticed that they have one thing in common -- the flow. Each one flows from producer to intermediary (if there is one) to consumer.

Technology, however, has made another flow possible. This one goes in the reverse direction and may go -- from consumer to intermediary to the beneficiary. Think of making money from the resale of a product or recycling. There is another distinction between reverse channels and the

more traditional ones -- the introduction of a beneficiary. In a reverse flow, you won't find a producer. You'll only find a User or a Beneficiary.¹²⁴

Internal manufacturing or outsourcing?

Insourcing is the commencement of performing a business function that could be contracted out internally: either with the help of a third-party provider who performs the task on-site or by conducting said task independently. Insourcing is also defined as bringing a third party outsourcer to work inside a company's facility. For example, an IT outsourcing provider may be hired to service a company's IT department while working inside the company's facilities.¹²⁵

Outsourcing involves the contracting out of a business process (e.g. payroll processing, claims processing) and operational, and/or non-core functions (e.g. manufacturing, facility management, call center support) to another party. Outsourcing sometimes involves transferring employees and assets from one firm to another, but not always. Outsourcing is also the practice of handing over control of public services to private enterprise.

Reasons for outsourcing

Companies primarily outsource to reduce certain costs — such as peripheral or "non-core" business expenses, high taxes, high energy costs, excessive government regulation/mandates, production and/or labor costs. The incentive to outsource may be greater for U.S. companies due to unusually high corporate taxes and mandated benefits, like social security, Medicare, and safety protection (OSHA regulations).

Digital Outsourcing

Many think of outsourcing as it relates to manufacturing (e.g. the "made in China" label on the product you buy). However, outsourcing of white collar work has grown rapidly since the early 21st century. The digital workforce of countries like India and China are only paid a fraction of what would be a minimum wage in the US. Outsourcing has also expanded to include many different countries; Costa Rica has become a big source for outsourcing work as it offers the advantage of a highly educated labor force, a large bilingual population, stable democratic government, shares similar time zones with the United States, and it takes only a few hours to travel between Costa Rica and the US. Companies such as Intel, Procter &

¹²⁴ <https://www.boundless.com/marketing/textbooks/boundless-marketing-textbook/marketing-channels-11/marketing-channels-in-the-supply-chain-76/types-of-marketing-channels-387-4051/>

¹²⁵ <https://en.wikipedia.org/wiki/Insourcing>

Gamble, HP, Gensler, Amazon, and Bank of America have big operations in Costa Rica.¹²⁶

BENEFICIARY (for whom do you create value?)

Business to Business versus Consumer Marketing: Similarities and Differences

Consumer marketing, or business-to-consumer (B2C) marketing, sales are made to individuals who are the final decision-makers, though they may be influenced by family members or friends. A business marketing, or business-to-business (B2B) marketing, sale is made to a business or firm.

Buyer Behavior

Whereas emotional factors play a large role in B2C purchases, B2B purchasing decisions tend to be less emotional and more task-oriented than consumer buyer markets. Business customers often look for specific product attributes such as the economy in cost and use, productivity, and quality. Additionally, B2B purchasers generally spend more money, as the buying process tends to be more complex and lengthy.

Buyer-Customer Relationship

While consumer marketing is aimed at large groups through mass media and retailers, the negotiation process between the buyer and seller is more personal in business marketing. Sales representatives and marketers are often assigned to market to individuals who act as influencers or decision-makers in the customer organisation. The bulk of a consumer's interaction with a brand typically happens via an advertisement, promotion, or transaction. In contrast, B2B marketing can include numerous meetings between the seller and buyer before a transaction occurs.

For example, B2B marketers often present products and their benefits in private presentations to key decision-makers. The B2B organisations may also invite prospects and customers to be public or private events to facilitate further conversations. As a result, confidence and trust are gradually built between the seller and buyer over a period of time. Significant time and money are spent during the evaluation and selection process, resulting in strong brand loyalty among B2B customers.

¹²⁶ <https://en.wikipedia.org/wiki/Outsourcing>

Communications Channels

Although on the surface the differences between business and consumer marketing may seem obvious, there are more subtle distinctions between the two, with substantial ramifications. The evaluation and selling process for B2B purchases are longer and more complex than consumer purchases. However, business marketing generally entails shorter and more direct channels of distribution to target audiences. Different aspects of the promotional mix can be easily personalized due to the relationship between a B2B salesperson and the individual buyer.

Customer Event

Promotional channels such as events provide ways for B2B sellers to move prospects along the buying process.

Most business marketers commit only a small part of their promotional budgets to general advertising, usually through direct marketing efforts and trade publications. For example, a business marketer may allocate spending to banner advertising or paid search. Similar to consumer ads, these advertisements lead to landing pages, where marketing messaging aims to convince web visitors to submit a form, download a brochure, or register for a webcast. While business advertising is limited, it helps generate leads that marketing can pass along to sales representatives.

Similarities between business-to-consumer and business-to-business Marketing

Marketing to a business and marketing to an individual are similar in terms of the fundamental principles of marketing. Both business-to-consumer and business-to-business marketing objectives reflect the fundamental principles of the marketing mix, and in both situations, the marketer must always:

- Successfully match product or service strengths with the needs of a specific target market
- Position and price products or services to align products and service offerings with the market
- Communicate and sell products or services so that they effectively demonstrate value to the target market.¹²⁷

¹²⁷ <https://www.boundless.com/marketing/textbooks/boundless-marketing-textbook/business-to-business-marketing-5/business-markets-44/b2b-vs-consumer-marketing-similarities-and-differences-221-4828/>

Local, Regional or International Markets

As one would expect, the size and location of a company's market vary greatly. Local marketers are concerned with customers that tend to be clustered tightly around the marketer. The marketer is able to learn a great deal about the customer and make necessary changes quickly. Naturally, the total potential market is limited. There is also the possibility that a new competitor or environmental factor will put a local marketer out of business.

Regional marketers cover a larger geographic area that may necessitate multiple production plants and a more complex distribution network. While regional marketers tend to serve adjoining cities, parts of states or entire states, dramatic differences in demand may still exist, requiring extensive adjustments in marketing strategy.

National marketers distribute their product throughout a country. This may involve multiple manufacturing plants, a distribution system, including warehouses and privately owned delivery vehicles, and different versions of the marketing "mix" or overall strategy. This type of marketing offers tremendous profit potential but also exposes the marketer to new, aggressive competitors.

International marketers operate in more than one country. As will become clear later in this book, massive adjustments are normally made in the marketing mix in various countries. Legal and cultural differences alone can greatly affect a strategy's outcome. As the US market becomes more and more saturated with US-made products, the continued expansion into foreign markets appears inevitable, greatly affect a strategy's outcome. As the US market becomes more and more saturated with US-made products, the continued expansion into foreign markets appears inevitable.

Global marketing differs from international marketing in some very definite ways. Whereas international marketing means a company sells its goods or services in another country, it does not necessarily mean that the company has made any further commitments. Usually, the product is still manufactured in the home country, sold by their people, and the profits are taken back to that country. In the case of Honda Motors, for example, it means building manufacturing plants in the US, hiring local employees, using local distribution systems and advertising agencies, and reinvesting a large percentage of the profits back into the US.¹²⁸

¹²⁸ <https://www.boundless.com/users/235420/textbooks/business-fundamentals/marketing-on-a-global-scale-6/the-role-of-marketing-in-the-firm-a-basis-for-classification-27/local-regional-national-international-and-global-marketers-135-15438/>

General or niche Market

General Market

An attractive market has the following characteristics:

It is sizeable enough to be profitable given your operating cost. Only a tiny fraction of the consumers in China can afford to buy cars. However, because the country's population is so large (nearly 1.5 billion people), more cars are sold in China than in Europe (and in the United States, depending on the month). Three billion people in the world own cell phones. But that still leaves three billion who do not.

It is growing. For example, the middle class of India is growing rapidly, making it a very attractive market for consumer products companies. People under thirty make up the majority of the Indian population, fueling the demand for "Bollywood" (Indian-made) films.

It is not already swamped by competitors, or you have found a way to stand out in a crowd. IBM used to make PCs. However, after the marketplace became crowded with competitors, IBM sold the product line to a Chinese company called Lenovo.

Either it is accessible, or you can find a way to reach it. Accessibility, or the lack of it, could include geographic accessibility, political and legal barriers, technological barriers, or social barriers. For example, to overcome geographic barriers, the consumer products company Unilever hires women in third-world countries to distribute the company's products to rural consumers who lack access to stores.

You have the resources to compete in it. You might have a great idea to compete in the wind-power market. However, it is a business that is capital intensive. What this means is that you will either need a lot of money or must be able to raise it. You might also have to compete with the likes of T. Boone Pickens, an oil tycoon who is attempting to develop and profit from the wind-power market.

It "fits in" with your firm's objectives and mission. Consider TerraCycle, which has made its mark by selling organic products in recycled packages. Fertilizer made from worm excrement and sold in discarded plastic beverage bottles is just one of its products. It wouldn't be a good idea for TerraCycle to open up a polluting, coal-fired power plant, no matter how profitable the market for the service might be.

Video Clip

Yogurt, Anyone? I Mean, Any Woman?

[\(click to see video\)](#)

Are women an attractive target market for yogurt sellers? The maker of this humorous YouTube video thinks so. (She seems to imply they are the only market.)¹²⁹

Niche Market

From a marketing perspective, a **niche** is a well-defined segment of a larger market. Because it is difficult to be all things to all people, marketers craft niches to suit their needs and business needs and resources. The more specifically you can delineate your niche, the easier it is to target your marketing content and communications to meet your audience's needs as well as your own. Of course, the downside of niche marketing is that it reduces your potential customer base.

Crafting a well-delineated niche strategy can help you create more effective marketing campaigns. In my experience, taking the time to understand a target market enables you to maximize your promotions because you know your audience's behaviors and hot buttons.

While marketing seven book clubs, I found that selling into a set of focused niche markets enabled me to maximize profitability because I could target promotions based on past buyer behavior and needs. For example, since mystery books are highly consumable, I was able to sell these readers more books by promoting related titles. By contrast, science fiction readers love collecting things, so I increased revenues by offering special, related non-book products. Ironically, my peers who marketed general fiction had to segment their audience to increase sales. Without having a well-defined niche, their marketing was too broad-based to be extremely effective.

Here are **seven steps to help you craft your niche** to ensure business success.

1. **Define your business goals.** Start by determining what you want to accomplish. Are you looking to build your brand or maximize your audience size?
2. **Understand your audience and their needs.** To this end, it is helpful to create a marketing persona to know better your target market, their needs and the tradeoffs they are willing to make. Go beyond the superficial demographics to understand how your target market makes purchase decisions, what motivates them and who influences their choices.

¹²⁹ <http://2012books.lardbucket.org/books/marketing-principles-v1.0/s08-03-selecting-target-markets-and-t.html>

3. **Determine your product's strengths and weaknesses.** Assess where your products fulfill your customers' needs (including additional content, training, and support) and where the products fall short. Assuming that your product is perfect won't help you craft better marketing content. Answer the question, "What attracts customers to my product?" If you do not know the answer, ask your prospects and customers.
4. **Examine close product substitutes.** Do not assume consumers, especially in today's connected era, think only in terms of other brands of the same product. They've broader viewpoints that incorporate social input and a willingness consider a wider range of substitute options. In my experience, marketers tend to have blinders when it comes to alternatives for their product offering. In my book marketing days, I couldn't talk about libraries where readers could borrow books for free or Costco that sold bestsellers for half price. My management didn't want to focus on these alternatives.
5. **Take the pulse of the social media conversation related to your offering.** Listen to what is being said about your product set on various social media venues. What do prospects like and dislike about your product category? Develop a social media persona to understand better where your audience congregates on social media and how they use these venues.
6. **Analyze your competitors.** When selecting your competitors, think in terms of people who sell the same product as well as broader retailers like Walmart, Amazon, eBay and Apple. Consider relevant geographic locations as well as online and mobile product options. Understand how they define their market and how it relates to their target audience, brand, and pricing. Where are there gaps in the category for your product/offering and brand?
7. **Price your offering.** Consider how your competitors have priced their products. How does your product compare in terms of pricing and branding? What sets your product apart from the competition? How does this help you price your product?

A **niche** market provides an organisation with the opportunity to uniquely fulfill the needs of its members based on their interests, past behavior, and role in the purchase process. It enables marketers to tailor their content and communications to better resonate with their audience and drive them to buy. Once you have defined your market segment, use it to guide the creation of your marketing and promotions. As part of this process,

continually test new tactics targeted for your niche and measure your results.¹³⁰

OPERATIONS (what is your internal source of advantage?)

Defining Business Capability

A business capability is what a company needs to be able to do to execute its business strategy. Another way to think about capabilities is a collection of people, process, and technology gathered for a specific purpose. Capability management uses the organisation's customer value proposition to establish performance goals for capabilities based on value. It reduced inefficiencies in capabilities that contribute low customer impact, and focus efficiencies in areas with high financial leverage while preserving or investing in capabilities for growth.

Capability vs. process

A process is how the capability is executed. Much of the reengineering revolution, or business process reengineering, focused on how to redesign business processes.

Business vs. organisational capability

An organisation capability refers to the way systems and people in the organisation work together to get things done. The way leaders foster shared mindsets, orchestrate talent, encourage speed of change, collaborate across boundaries, and learn and hold each other accountable define the company's culture and leadership edge.

Capability vs. competency

Although often used interchangeably, "capability" and "competency" are quite different. Individuals have competencies while organisations have capabilities. Both competencies and capabilities have technical and social elements.

	Individual	Organization
Technical	Functional Competencies	Business Capabilities
Social	Leadership Competencies	Organizational Capabilities

Competencies and Capabilities

Individuals have competencies while organisations have capabilities.¹³¹

At the intersection of the individual and the technical, employees bring functional skills and competencies such as programming, cost accounting,

¹³⁰ <http://heidcohen.com/niche-marketing-7-steps-to-define-your-audience/>

¹³¹ <https://www.boundless.com/marketing/textbooks/boundless-marketing-textbook/the-marketing-environment-3/internal-factors-30/company-capabilities-159-4045/images/competencies-and-capabilities/> (CC BY SA)

electrical engineering, etc. At the intersection of the individual and the social, leaders also have a set of competencies or skills such as setting a strategic agenda, championing change, and building relationships. At the intersection of the organisational and the technical are business capabilities. For example, a financial service firm must know how to manage risk and design innovative products.

Organisation capabilities include talent management, collaboration, and accountability. They are the underlying DNA, culture, and personality of a firm, integrating all the other parts of the firm and bringing it together. When a group of leaders has mastered certain competencies, organisation capabilities become visible. For example, when a group of leaders master "turning vision into action" and "aligning the organisation," the organisation a whole shows more "accountability."

Capability value contribution

Firms should assess the capabilities necessary to operate the business by examining the financial impact as well as the customer impact.

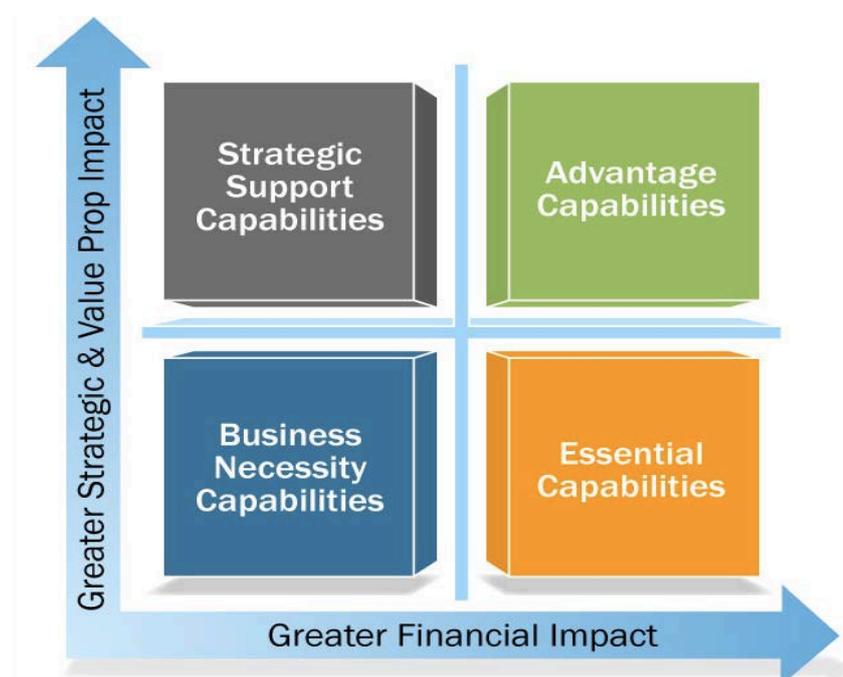


Figure 7. Capability Value Contribution to Strategy¹³²

¹³² <https://www.boundless.com/marketing/textbooks/boundless-marketing-textbook/the-marketing-environment-3/internal-factors-30/company-capabilities-159-4045/images/capability-value-contribution-to-strategy/> (CC BY SA)

Different capabilities have different financial and strategic impacts. Some capabilities directly contribute to the customer value proposition and have a high impact on company financials. These "advantage capabilities" are shown in the upper right.

Some capabilities directly contribute to the customer value proposition and have a high impact on company financials. These "advantage capabilities" are shown in the upper right. Value contribution is assured when performance is among the best in peer organisations at an acceptable cost. In the top left quadrant, strategic support capabilities have a high contribution in direct support of advantage capabilities. Value contribution is assured when performed above industry parity at a competitive cost. Other capabilities shown in the bottom right are essential. They may not be visible to the customer, but contribute to company's business focus and have a big impact on the bottom line. Value contribution is assured when performed at industry parity performance below competitors' cost.¹³³



Assignments

Assignment

<http://diytoolkit.org/tools/business-model-canvas/>¹³⁴

Click on the link above to view a 'Business Model Canvas.'

1. Watch the video located on the page.
2. Use the guidelines provided from the chart (at the top of the page) along with the information provided in this section to do the following:
 - (a) Conceptualize a business model relevant to Antigua and Barbuda (2 marks)
 - (b) Describe the product and or service offered. (3 marks)
 - (c) Describe the type of consumers and or businesses that will form your target market? (3 marks)
 - (d) Are you seeking to satisfy a general market or a niche market? Explain. (3 marks)
 - (e) Will the product be standardized or customized? Identify four factors that will determine this? (6 marks).
 - (f) What distribution channel(s) will be used for customer access? (3 marks)

¹³³ <https://www.boundless.com/marketing/textbooks/boundless-marketing-textbook/the-marketing-environment-3/internal-factors-30/company-capabilities-159-4045/>

¹³⁴ <http://diytoolkit.org/tools/business-model-canvas/>

(g) Provide two examples of two types of local businesses that may be potential links in the distribution channel identified in (e) above. (2 marks)

(h) Justify your business operations using the following headings:

- Technology and capital equipment requirements. (6 marks)
- Resources (whether natural, human competencies and other physical resources not identified above). (6 marks)
- Estimate the amount of finance required to start this business venture, outlining specific monetary allocations for each major functional area. (5 marks)
- What is the projected revenue for first two years of operation? (1 mark).

Income Generation

A business can generate income in using several strategies.

Operating Leverage

KEY POINTS

- As operating leverage increases, more sales are needed to cover the increased fixed costs.
- High levels of fixed costs increase business risk, which is the inherent uncertainty in the operation of the business.
- Operating leverage also increases forecasting risk. Therefore, even a small error made in forecasting sales can be magnified into a major error in forecasting cash flows.
- Measures used to interpret operating leverage include the ratio of fixed costs to total costs, the ratio of fixed costs to variable costs, and Degree of Operating Leverage (DOL).

TERMS

- fixed cost business expenses that are not dependent on the level of goods or services produced by the business
- variable cost
- a cost that changes with the change in volume of activity experienced by an organisation

Defining Operating Leverage

Operating leverage can be defined, simply, as the degree to which a firm incurs a combination of fixed and variable costs. Specifically, it is the use of fixed costs over variable costs in production. For example, replacing production workers (variable cost) with robots (fixed cost). Operating leverage is also a measure of how revenue growth translates into growth in operating income.

Example of Operating Leverage

Factory automation with industrial robots for metal die casting.

Recall that variable costs are those that change alongside the volume activity of a business, and fixed costs are those that remain constant regardless of volume. Utilizing operating leverage will allow variable costs to be reduced in favor of fixed costs; therefore, profits will increase more for a given increase in sales. This is, of course, after the breakeven point has been reached. In other words, because variable costs are reduced, each sale will contribute a higher profit margin to the company.

$$\frac{FC}{TC} = \frac{FC}{FC + VC}$$

Fixed and Variable Costs

Fixed costs and variable costs, together, comprise total costs.

As operating leverage increases, more sales are needed to cover the increased fixed costs. Therefore, companies with low output would not benefit from increased operating leverage. Moreover, high levels of fixed costs increase business risk, which is the inherent uncertainty in the operation of the business. Manufacturing companies tend to invest heavily in fixed assets. Therefore, operating leverage is used much more than financial leverage for these types of firms. Operating leverage also increases forecasting risk. Therefore, even a small error made in forecasting sales can be magnified into a major error in forecasting cash flows.

Interpreting Operating Leverage

Various measures can be used to interpret operating leverage. These include the ratio of fixed costs to total costs, the ratio of fixed costs to variable costs, and the Degree of Operating Leverage (DOL). All of these measures depend on sales. The ratios of fixed cost to total costs and fixed costs to variable costs tell us that if the unit variable cost is constant, then as sales increase, operating leverage decreases. The DOL tells us, as a percentage, that for a given level of sales and profit, a company with higher fixed costs has a higher contribution margin - the marginal profit per unit sold. Therefore, its operating income increases more rapidly with sales than a company with lower fixed costs (and correspondingly lower contribution margin).¹³⁵

Contribution Margin

Contribution margin (CM), or dollar contribution per unit, is the selling price per unit minus the variable cost per unit. “Contribution” represents the portion of sales revenue that is not consumed by variable costs and so contributes to the coverage of fixed costs. This concept is one of the key building blocks of break-even analysis.

¹³⁵ <https://www.boundless.com/finance/textbooks/boundless-finance-textbook/capital-structure-13/thinking-about-operating-leverage-105/defining-operating-leverage-447-3799/>

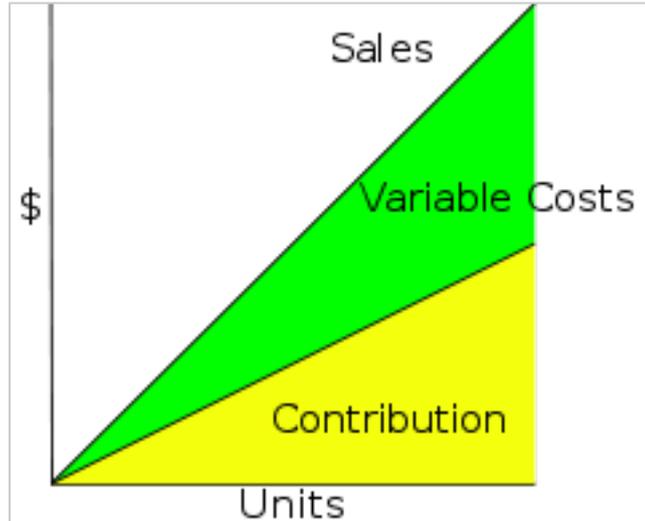


Figure 8 Decomposing Sales as Contribution plus Variable Costs In the Cost-Volume-Profit Analysis model, costs are linear in volume¹³⁶

In cost-volume-profit analysis, a form of management accounting, contribution margin—the marginal profit per unit sale—is a useful quantity in carrying out various calculations, and can be used as a measure of operating leverage. Typically, low contribution margins are prevalent in the labor-intensive tertiary sector while high contribution margins are prevalent in the capital-intensive industrial sector.

Purpose

Cost-Volume-Profit Analysis, where it simplifies calculation of net income and, especially, break-even analysis.

Given the contribution margin, a manager can easily compute breakeven and target income sales and make better decisions about whether to add or subtract a product line, about how to price a product or service and about how to structure sales commissions or bonuses.

Contribution margin analysis is a measure of operating leverage; it measures how growth in sales translates to growth in profits.

The contribution margin is computed by using a contribution income statement, a management accounting version of the income statement that

¹³⁶ ¹³⁶https://en.wikipedia.org/wiki/Contribution_margin CC BY SA

has been reformatted to group together a business's fixed and variable costs.

Contribution is different from gross margin in that a contribution calculation seeks to separate out variable costs (included in the contribution calculation) from fixed costs (not included in the contribution calculation) on the basis of economic analysis of the nature of the expense, whereas gross margin is determined using accounting standards. Calculating the contribution margin is an excellent tool for managers to help determine whether to keep or drop certain aspects of the business. For example, a production line with positive contribution margin should be kept even if it causes negative total profit when the contribution margin offsets part of the fixed cost. However, it should be dropped if contribution margin is negative because the company would suffer from every unit it produces.

The contribution margin analysis is also applicable when the tax authority performs tax investigations, by identifying target interviewees who have unusually high contribution margin ratios compared to other companies in the same industry.¹³⁷

Fixed and Flexible Pricing

The term fixed price is a phrase used to mean the price of a good or a service is not subject to bargaining. The term commonly indicates that an external agent, such as a merchant or the government, has set a price level, which may not be changed for individual sales. In the case of governments, this may be due to price controls.

Bargaining is very common in many parts of the world, outside of retail stores in Europe or North America or Japan, this makes this an exception from the general norm of pricing in these areas.

A fixed-price contract is a contract where the contract payment does not depend on the amount of resources or time expended by the contractor, as opposed to cost-plus contracts. These contracts are often used in military and government contractors to put the risk on the side of the vendor, and control costs.

Historically, when fixed-price contracts are used for new projects with untested or developmental technologies, the programs may fail if

¹³⁷ https://en.wikipedia.org/wiki/Contribution_margin CC BY SA

unforeseen costs exceed the ability of the contractor to absorb the overruns. In spite of this, such contracts continue to be popular. Fixed-price contracts tend to work when costs are well known in advance.¹³⁸

Variable pricing is a pricing strategy for products. Traditional examples include auctions, stock markets, foreign exchange markets, bargaining, electricity, and discounts. More recent examples, driven in part by reduced transaction costs using modern information technology, include yield management and some forms of congestion pricing. Increasingly, sport venues, such as AT&T Park in San Francisco, have employed variable pricing to capture the most revenue possible out of consumers and fans.

Due to advances in technology, another variant of variable pricing, called "real-time pricing," has arisen. In some markets, events occur so fast that there is insufficient time to either set a fixed price or engage in lengthy negotiations. By the time you have all the information to determine a price, everything has changed. Examples include airline tickets, stock markets, and foreign exchange markets. In each case, prices can change in less than a second. By linking all the market participants through internet connections, price changes are disseminated instantly as they occur.

A variant of real-time pricing is an online auction business model (such as eBay). All participants can view the price changes soon after they occur (technically this is not quite real time pricing because there is a delay built into the eBay system). Traditional auctions are inefficient because they require bidders (or their representatives) to be physically present. By solving this problem, online auctions reduce the transaction costs for bidders, increase the number of bidders, and increase the average bid price.

Sales are a traditional example of discriminatory pricing. During the Christmas shopping season, prices are high. Come the new year there are sales. Other examples of sales occur on various goods such as appliances and cars. Electronics, clothes washers/dryers, etc. typically have a season of the year where sales occur. Cars are sold at discounts before the new model year. Discriminatory pricing is not always bad. It helps people who will/can not pay "list" or even street price an opportunity to buy at a better price if they are willing to wait and/or to buy older models. At the same time, it helps merchants clear out old stock and/or items that they misjudged the market for.

¹³⁸ https://en.wikipedia.org/wiki/Fixed_price

This kind of price discrimination is largely and widely used by rental car companies. Usually, those firms need to know what your country of residence is so they can adjust the price. Depending on the answer you can get significantly different quotes for the same vehicle, date and time of rental. It is also true when accessing the rental car site through the .com main site.

Electricity real-time pricing allows charging higher prices when demand is highest, which is expected to reduce actual use during peak demand periods, which increases production costs because it drives the expansion of costly equipment.¹³⁹

Revenue Sources - Revenue Model

A revenue model is a framework for generating revenues. It identifies which revenue source to pursue, what value to offer, how to price the value, and who pays for the value.^[1] It is a key component of a company's business model.^[2] It primarily identifies what product or service will be created in order to generate revenues and the ways in which the product or service will be sold.

Without a well-defined revenue model, that is, a clear plan of how to generate revenues, new businesses will more likely struggle due to costs which they will not be able to sustain. By having a clear revenue model, a business can focus on a target audience, fund development plans for a product or service, establish marketing plans, begin a line of credit and raise capital.

Types of revenue models

The type of revenue model that is available to a firm depends, in large part, on the activities the firm performs, and how it charges for those. Various models by which to generate revenue include:

Production model

¹³⁹ https://en.wikipedia.org/wiki/Variable_pricing CC BY SA

In the production model, the business that creates the product or service sells it to customers who value and thus pay for it. An example would be a company that produces paper, who then sells it to either the direct public or to other businesses, who pay for the paper, thus generating revenue for the paper company.

Manufacturing model

Manufacturing is the production of merchandise using labour, materials, and equipment, resulting in finished goods. Revenue is generated by selling the finished goods. They may be sold to other manufacturers for the production of more complex products (such as aircraft, household appliances or automobiles), or sold to wholesalers, who in turn sell them to retailers, who then sell them to end users and consumers. Manufacturers may market directly to consumers, but generally do not, for the benefits of specialization.

Construction model

Construction is the process of constructing a building or infrastructure. Construction differs from manufacturing in that manufacturing typically involves mass production of similar items without a designated purchaser, while construction typically takes place on location for a known client, but may be done speculatively for sale on the real estate market.

Rental or leasing model

Renting is an agreement where a payment is made for the temporary use of a good, service or property owned by another. A gross lease is when the tenant pays a flat rental amount, and the landlord pays for all property charges regularly incurred by the ownership. Things that can be rented or leased include land, buildings, vehicles, tools, equipment, furniture, etc.

Advertising model

The advertising model is often used by Media businesses which use their platforms where content is provided to the customer as an advertising space. Possible examples are newspapers and magazines which generate revenue through the various adverts encountered in their issues. Internet

businesses which often provide services will also have advertising spaces on their platforms. Examples include Google and Taobao. Mobile applications also use this specific revenue model to generate revenues. By incorporating some ad space, many popular apps such as Twitter and Instagram have strengthened their mobile revenue potential after previously having no real revenue stream.

Commission model

The commission model is similar to the markup model as it is used when a business charges a fee for a transaction that it mediates between two parties. Brokerage companies or auction companies often use it as they provide a service as intermediaries and generate revenue through commissions on the sales of either stock or products.

E-commerce model

This revenue model is the implementation of any of the other revenue models online.

Fee-for-service model

In the fee-for-service model, unlike in the subscription model, the business only charges customers for the amount of service or product they use. Many phone companies provide pay as you go services whereby the customer only pays for the amount of minutes he actually uses.

Licensing model

With the licensing model, the business that owns a particular content retains copyright while selling licenses to third parties. Software publishers sell licenses to use their programs rather than straight-out sell copies of the program. Media companies also obtain their revenues in this manner, as do patent holders of particular technologies.

Software licensing model

Rather than selling units of software, software publishers generally sell the right to use their software through a limited license which defines what the purchaser can and cannot do with it.

Markup model

In the markup model, unlike with previous models, the business buys a product or service and increases its price before reselling it to customers. This model characterises wholesalers and retailers, who buy products from manufacturers, mark up their prices, and resell them to end customers.

Wholesale

Wholesaling, jobbing, or distributing is the sale of goods or merchandise to retailers; to industrial, commercial, institutional, or other professional business users; or to other wholesalers and related subordinated services. In general, it is the sale of goods to anyone other than the end-consumer. Wholesaling can be implemented online via electronic transactions.

Retail

Retail is the process of selling consumer goods or services to customers through multiple channels of distribution to earn a profit. Demand is identified and then satisfied through a supply chain. Attempts are made to increase demand through advertising.

Brick and mortar retail

Conventional retail or brick and mortar retail are selling products from a physical sales outlet or store.

Mail order

The mail order revenue model and distribution method entail sending goods by mail delivery. The buyer places an order for the desired products with the merchant through some remote method such as by telephone call or website. Then, the products are delivered to the customer, typically to a home address, but occasionally the orders are delivered to a nearby retail location for the customer to pick up. Some merchants also allow the goods to be shipped directly to a third party consumer, which is an effective way for someone to buy a gift for an out-of-town recipient.

E-tail

E-tail is on-line retail. Retail is the process of selling consumer goods and/or services directly to end-consumers to earn a profit. Demand is created through promotion, and by satisfying consumers' wants and needs effectively (which generates word-of-mouth advertising).

In the 21st century, an increasing amount of retailing is e-tailing, done online using electronic payment and delivery via a courier or postal mail. Via e-tail, the customer can shop and order through the internet, and the merchandise is dropped at the customer's doorstep. This format is ideal for customers who do not want to travel to retail stores and are interested in home shopping.

The online retailer may handle the merchandise directly, or use the drop shipping technique in which they accept the payment for the product but the customer receives the product directly from the manufacturer or a wholesaler.

Subscription model

In the subscription model, the business provides a product or service to a customer who in return pays a pre-determined fee at contracted periods of time to the business. The customer will be required to pay the fee until the contract with the business is terminated or expires, even if he is not utilising the product or service but is still adhering to the contract. Possible examples are flat-rate cellular services, magazines, and newspapers.

Revenue Streams

A revenue stream is an amount of money coming into a business or organisation from a particular source. A revenue model describes how a business generates revenue streams from its products and services. They are resultantly a key aspect of the revenue model. They are generated through the use of the revenue model components listed in the section above. Businesses continually seek new ways of generating revenues, thus new revenue streams. Finding a new revenue stream has gradually taken on a distinct and specialized meaning in certain contexts to mean a new, novel, undiscovered, potentially lucrative, innovative, and creative means of generating income or exploiting a potential. This approach, in particular, can especially be applied to new technology and internet businesses which find extremely innovative ways of generating revenues, often ways which seemed not to be possible. As a result, technology-based businesses are

constantly updating their revenue models in order to remain competitive. Advertising can be seen as a component of the revenue model, however, when the business is advertising its own products, this would result in a cost for the business which is the exact opposite of revenue. On the other hand, advertising can lead to an increase in sales thus revenue over a period of time. For the majority of businesses which will add value to a product or service that will be purchased by a customer, advertising is often a component of their business plan. Expenditure for this particular component is forecasted as it can generate greater revenues over periods of time.¹⁴⁰



Assignments

1. Define the term operating leverage.
2. Explain the relationship between operating leverage and fixed costs.
3. Distinguish between fixed and variable costs.
4. Define the revenue model.
5. Discuss the ways in which the revenue model is used to generate income.

Growth Subsistence

"Subsistence" means supporting oneself at a minimum level; in a subsistence economy, economic surplus is minimal and only used to trade for basic goods, and there is no industrialization.

In the history of the world, before the first cities, all humans lived in a subsistence economy. As urbanization, civilization, and division of labor spread, various societies moved to other economic systems at various times. Some remain relatively unchanged, ranging from uncontacted peoples to poor areas of developing countries, to some cultures that choose to retain a traditional economy.

Capital can generally be defined as assets invested with the expectation that their value will increase, usually because there is the expectation of profit, rent, interest, royalties, capital gain or some other kind of return. However, this type of economy cannot usually become wealthy by virtue of the system, and instead, requires further investments to stimulate

¹⁴⁰ https://en.wikipedia.org/wiki/Revenue_model

economic growth. In other words, a subsistence economy only possesses enough goods to be used by a particular nation to maintain its existence and provides little to no surplus for other investments.¹⁴¹

Income model

- See revenue model

Growth model

Stages of growth strategy

There are three stages in implementing a growth planning process which is based on three basic questions:

1. "Where are we now?"
2. "Where do we want to go?"
3. "How do we get to here?"^[5]

Strategic analysis: referred to the environment (which could either be internal, external and marketing) where the business operated. It also looked at the resources possessed by the business or that it could possibly have and at the expectations and objectives of its main stakeholders and owners.

Strategic choice: it basically generates options which have to do with the strategic analysis. This process evaluates the options based on acceptability, feasibility, and suitability and then selects the suitable strategy

Strategic implementation: this process focuses on achieving the correct organisational structure, planning the resources (physical and financial) and sorting out the systems and the people by implementing the change process. This process has been developed, and it can be considered one of the few "big company" management theories which can be used effectively and simply.

¹⁴¹ https://en.wikipedia.org/wiki/Subsistence_economy CC BY SA

Most businesses have a growth strategy which is based on "acquisitions and partnerships that create shareholder value by creating or reinforcing platforms for long-term growth."

Growth Sustainability

When a business is in a high-growth industry, it is able to maintain high growth rates for a longer period of time. However, many investors take this high growth as granted which usually lead to much slower growth rates once the industry stops booming. It is believed that 65% of acquisitions which businesses buy in order to grow in size have destroyed more value than they actually created, an acquisition can't be a substitute for a growth platform.

New growth platforms help companies grow as they created families of products, services, and businesses and extended their capabilities into multiple new domains. The NGPs acted as a method of growth in which each business was acquiring new capabilities and further market knowledge. The size of the growth platform is strategic to the corporation. Small scaled businesses can only have an NGP when provided through a partnership or government funding. Usually, these exist in the agricultural sector and improve the knowledge and infrastructure ensuring better food security.

New growth platforms (NGPs)

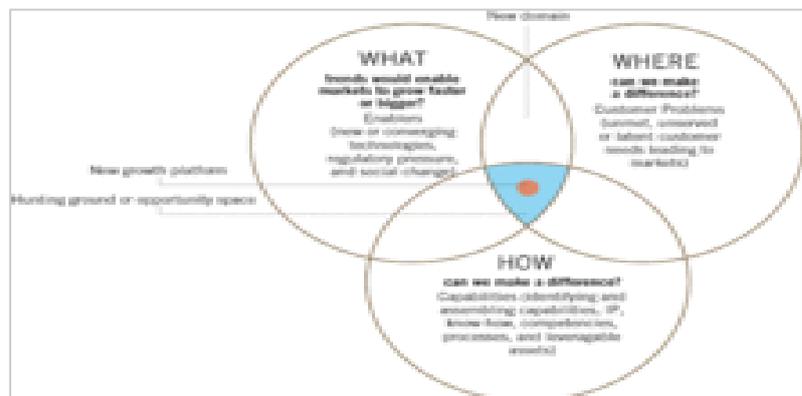


Figure 9 Growth Platforms¹⁴²

¹⁴² https://en.wikipedia.org/wiki/Growth_platforms CC BY SA

Opportunities for building NGPs lie at the intersection of a company's actual or potential capability set, unmet customer needs, and forces of change in the broader environment.

Creating a new growth platform

Rediscovering the technology and the talent present in an organisation a company or exploring its external networks, a business is able to find capabilities needed to create a new growth platform. Then a company should evaluate the potential capabilities which it needs to develop. Companies tend to undermine the number of possible growth platforms that could be created to increase customer needs. This is a consequence of senior managers not thinking more broadly and only thinking about a product or service that would beat the competition. After identifying suitable new areas of growth, a business needs to quantify and evaluate the opportunities to generate the lines of the business. In order to meet a new or uncovered customer need a new growth platform has to form as a result of a force of change which includes new technologies, social pressures or changes in the legal system.

Possible places for growth

In order to generate an opportunity for sustained growth, a business needs to widen its capabilities into innovative domains. NGPs provide a structure for creating business processes, services and even families of products. The size of each NGP is essential to the strategy of the organisation. A successful NGP requires "a well-tried process, high-quality information, and external insights – often from well outside the company's own market space."

Difficulties in finding a new growth platform

Some studies have shown that more than 90% of companies are not able to find new possible sources of growth. Through the understanding of these difficulties, it makes it simpler to deal with the problem. Many argue that poor processes and skills lead to this high failure rate. Consequently, the main advice given to these companies is to be willing to take more risks and do the same "approaches used in the venture capital industry and build a pipeline of new businesses." It has been detected that the success of companies lies in new growth areas which have existing mindsets fitting

the critical success factors of the business. Therefore, failure results when the company involves with factors that do not fit when the company is trying to grow in different new areas. The low success rate of finding a new growth platform can also be explained by the shortage of opportunities theory, which suggests a new way of resolving the problem. This theory proposes that "efforts to generate additional ideas or to experiment with a portfolio of new ventures are likely to be fruitless." In addition, failure can also be caused by less risk aversion and more broadmindedness of entrepreneurship. In order to resolve this issue, the corporate mindsets need to change or to invest only in cases that match with what is needed having a high chance of succeeding.

Examples of growth platforms

Examples of strategic growth platforms which in these cases are using specific and innovative product areas or entering into a new distribution channel:

- In order to increase growth, Apple Computers targeted “personal music systems” using its personal business of computers
- IBM invented the term "e-business" and used it as the organizing theme of what the company did during the late 1990s

Examples of tactical growth platforms include specific new sales force programmes or a new emphasis on the advertising for the year.¹⁴³



Assignments

Assignment

Fill in the blanks

1. _____ means supporting oneself at a minimum level
2. _____ referred to the environment where the business operated. It also looked at the resources possessed by the business or that it could possibly have and

¹⁴³ https://en.wikipedia.org/wiki/Growth_platforms CC BY SA

at the expectations and objectives of its main stakeholders and owners.

3. _____ is the process which evaluates the options based on acceptability, feasibility and suitability and then selects the suitable strategy.
4. _____ is the process which focuses on achieving the correct organisational structure, planning the resources (physical and financial) and sorting out the systems and the people by implementing the change process.
5. _____ is defined as able to maintain high growth rates for a longer period of time.



Summary

Lesson Summary

There are different factors that impact the performance of any business venture. In this lesson, we examine the financial, physical, and human resources and their impact on business success. We also reviewed the internal and external environment for success. In the next lesson, we will investigate the implementation and management of business ventures.

Lesson 5 - Implementing and managing the venture

Introduction

If you want to start a business, you must prepare a business plan. This essential document should tell the story of your business concept, provide an overview of the industry in which you will operate, describe the goods or services you will provide, identify your customers and proposed marketing activities, explain the qualifications of your management team, and state your projected income and borrowing needs.¹⁴⁴



At the end of the lesson, students should be able to:

1. Discuss the importance of planning for your business
2. Benefits of the business plan
3. identify the key sections of a business plan

A **business plan** is a formal statement of business goals, reasons they are attainable, and plans for reaching them. It may also contain background information about the organisation or team attempting to reach those goals.

Business plans may target changes in perception and branding by the customer, client, taxpayer, or larger community. When the existing business is to assume a major change or when planning a new venture, a 3 to 5-year business plan is required since investors will look for their investment return in that timeframe.¹⁴⁵

Purpose of a Business Plan

The business plan is a plan or blueprint for the company, and it is an indispensable tool in attracting investors, obtaining loans, or both. Remember, too, that the value of your business plan is not limited to the planning stages of your business and the process of finding start-up money. Once you have acquired start-up capital, do not just stuff your plan in a drawer. Treat it as an ongoing guide to your business and its operations, as

¹⁴⁴ <http://open.lib.umn.edu/exploringbusiness/chapter/5-6-the-business-plan/> (CC BY NC SA)

¹⁴⁵ https://en.wikipedia.org/wiki/Business_plan

well as a yardstick by which you can measure your performance. Keep it handy, update it periodically, and use it to assess your progress.

The most common use of a business plan is persuading investors, lenders, or both, to provide financing. These two groups look for different things. Investors are particularly interested in the quality of your business concept and the ability of management to make your venture successful. Bankers and other lenders are primarily concerned with your company's ability to generate cash to repay loans. To persuade investors and lenders to support your business, you need a professional, well-written business plan that paints a clear picture of your proposed business.

Sections of the Business Plan

Though formats can vary, a business plan generally includes the following sections: executive summary, description of proposed business, industry analysis, mission statement and core values, management plan, goods or services and (if applicable) production processes, marketing, global issues, and financial plan. Let's explore each of these sections in more detail. (*Note:* More detailed documents and an Excel template are available for those classes in which the optional business plan project is assigned.)

Executive Summary

The executive summary is a one- to a three-page overview of the business plan. It is actually the most important part of the business plan: it is what the reader looks at first, and if it doesn't capture the reader's attention, it might be the only thing that he or she looks at. It should, therefore, emphasize the key points of the plan and get the reader excited about the prospects of the business.

Even though the executive summary is the first thing read, it is written *after* the other sections of the plan are completed. An effective approach in writing the executive summary is to paraphrase key sentences from each section of the business plan. This process will ensure that the key information of each section is included in the executive summary.

Description of Proposed Business

Here, you present a *brief* description of the company and tell the reader why you are starting your business, what benefits it provides, and why it will be successful. Some of the questions to answer in this section include the following:

- What will your proposed company do? Will it be a manufacturer, a retailer, or a service provider?
- What goods or services will it provide?
- Why are your goods or services unique?
- Who will be your main customers?
- How will your goods or services be sold?

- Where will your business be located?

Because later parts of the plan will provide more detailed discussions of many of these issues, this section should provide only an overview of these topics.

Industry Analysis

This section provides a brief introduction to the industry in which you propose to operate. It describes both the current situation and the future possibilities, and it addresses such questions as the following:

- How large is the industry? What are total sales for the industry, in volume and dollars?
- Is the industry mature or are new companies successfully entering it?
- What opportunities exist in the industry? What threats exist?
- What factors will influence future expansion or contraction of the industry?
- What is the overall outlook for the industry?
- Who are your major competitors in the industry?
- How does your product differ from those of your competitors?

Mission Statement and Core Values

This portion of the business plan states the company's *mission statement* and *core values*. The mission statement describes the purpose or *mission* of your organisation—its reason for existence. It tells the reader what the organisation is committed to doing. For example, one mission statement reads, “The mission of Southwest Airlines is a dedication to the highest quality of customer service delivered with a sense of warmth, friendliness, individual pride, and company spirit” (Southwest Airline’s, 2011).

Core values are fundamental beliefs about what is important and what is (and is not) appropriate in conducting company activities. Core values are not about profits, but rather about ideals. They should help guide the behavior of individuals in the organisation. Coca-Cola, for example, intends that its core values—leadership, passion, integrity, collaboration, diversity, quality, and accountability—will let employees know what behaviors are (and aren't) acceptable (The Coca-Cola Company, 2011).

Management Plan

Management makes the key decisions for the business, such as its legal form and organisational structure. This section of the business plan should outline these decisions and provide information about the qualifications of the key management personnel.

A. Legal Form of Organization

This section identifies the chosen legal form of business ownership: sole proprietorship (personal ownership), partnership (ownership shared with one or more partners), or corporation (ownership through shares of stock).

B. Qualifications of Management Team and Compensation Package

It is not enough merely to have a good business idea: you need a talented management team that can turn your concept into a profitable venture. This part of the management plan section provides information about the qualifications of each member of the management team. Its purpose is to convince the reader that the company will be run by experienced, well-qualified managers. It describes each individual's education, experience, and expertise, as well as each person's responsibilities. It also indicates the estimated annual salary to be paid to each member of the management team.

C. Organisational Structure

This section of the management plan describes the relationships among individuals within the company, listing the major responsibilities of each member of the management team.

Goods, Services, and the Production Process

To succeed in attracting investors and lenders, you must be able to describe your goods or services clearly (and enthusiastically). Here, you describe all the goods and services that you will provide the marketplace. This section explains why your proposed offerings are better than those of competitors and indicate what market needs will be met by your goods or services. In other words, it addresses a key question: *What competitive advantage* will the company's goods and services have over similar products on the market?

This section also indicates how you plan to obtain or make your products. Naturally, the write-up will vary, depending on whether you are proposing a service company, a retailer, or a manufacturer. If it is a service company, describe the process by which you'll deliver your services. If it is a retail company, tell the reader where you'll purchase products for resale.

If you are going to be a manufacturer, you must furnish information on product design, development, and production processes. You must address questions such as the following:

- How will products be designed?

- What technology will be needed to design and manufacture products?
- Will the company run its own production facilities, or will its products be manufactured by someone else?
- Where will production facilities be located?
- What type of equipment will be used?
- What are the design and layout of the facilities?
- How many workers will be employed in the production process?
- How many units will be produced?
- How will the company ensure that products are of high quality?

Marketing

This critical section focuses on four marketing-related areas—target market, pricing, distribution, and promotion:

1. *Target market.* Describe future customers and profile them according to age, gender, income, interests, and so forth. If your company sells to other companies, describe your typical business customer.
2. *Pricing.* State the proposed price for each product. Compare your pricing strategy to that of competitors.
3. *Distribution.* Explain how your goods or services will be distributed to customers. Indicate whether they will be sold directly to customers or through retail outlets.
4. *Promotion.* Explain your promotion strategy, indicating what types of advertising you'll be using.

In addition, if you intend to use the Internet to promote or sell your products, also provide answers to these questions:

- Will your company have a Web site? Who will visit the site?
- What will the site look like? What information will it supply?
- Will you sell products over the Internet?
- How will you attract customers to your site and entice them to buy from your company?

Global Issues

In this section, indicate whether you'll be involved in international markets, by either buying or selling in other countries. If you are going to operate across borders, identify the challenges that you'll face in your global environment, and explain how you'll meet them. If you do not plan initially to be involved in international markets, state what strategies, if any, you'll use to move into international markets when the time comes.

Financial Plan

In preparing the financial section of your business plan, specify the company's cash needs and explain how you'll be able to repay debt. This information is vital in obtaining financing. It reports the amount of cash needed by the company for start-up and initial operations and provides an overview of proposed funding sources. It presents financial projections,

including expected sales, costs, and profits (or losses). It refers to a set of financial statements included in an appendix to the business plan.¹⁴⁶

A business plan is an essential roadmap for business success. This living document generally projects 3-5 years ahead and outlines the route a company intends to take to grow revenues.

Needed components:

1. Executive Summary: a snapshot of your business plan as a whole and touches on your company profile and goals
2. Company Description: provides information on what you do, what differentiates your business from others, and the markets your business serves
3. Market Analysis: showcases your research on your industry, market, and competitors
4. Organisation and Management: details the structure of your business and how it will be managed
5. Service or Product Line: tells the story of how your product or service will be exactly what your customers need
6. Marketing and Sales: outlines the marketing and sales strategy of your business
7. Funding Request: if you are seeking funding for your business, this is the section to outline that request
8. Financial Projections: make a plan for where you see your company in five years
9. Appendix: if you have additional documents like permits or leases, these can be included here¹⁴⁷

Definition

A business plan is a written document covering all aspects of a business, beginning with the objectives of the business and explaining in detail how the business will be run.

The business plan is a roadmap outlining every aspect of the proposed venture. It describes the what, how, where and why with regard to the new venture and is thus a structured guideline for achieving your objectives.

¹⁴⁶ <http://open.lib.umn.edu/exploringbusiness/chapter/5-6-the-business-plan/>

¹⁴⁷ <http://guides.lib.utexas.edu/c.php?g=571735&p=4046547> (CC BY NC)

Where Does The Business Plan Fit Into The Whole Context Of Planning A Business?

The business plan is the first formal planning instrument, because:

- it organises all the information gathered by the entrepreneur with the market research done earlier;
- it helps the entrepreneur to set realistic goals and make logical decisions;
- simply put, it is the business's pathway to success if an entrepreneur uses it to help him or her manage the business.

If you are considering starting your own business, the business plan will guide you on what areas you have to address in setting up your enterprise. It further guides you to decide whether you should go ahead with your business idea or not.

The question that all of you will ask now is how to draw up a business plan. Let us look at the basic structure of the business plan starting with a brief explanation of its different components.

Basic Components of a Business Plan

It is essential for any entrepreneur to know what basic elements should be included in a business plan, as well as what a good business plan should look like. The exact points that you include in a business plan can vary depending on your needs and specific situation. However, there are a few main sections or components that should always be included. Let's briefly look at the different components of a business plan.

Background/Introduction

This section of your plan involves giving a full description of your business such as the name, type of ownership and detailed description of the qualities and/or skills that the entrepreneur possesses. This section also includes your vision statement, mission, goals, and objectives.¹⁴⁸

Market

Market research is the process of finding out if there is a market for a specific product or service.

¹⁴⁸ <http://open.lib.umn.edu/exploringbusiness/chapter/5-6-the-business-plan/>

Input materials

After conducting the market research, you will know what your customers want. You then have to find out what input materials you need for the business, where to get them and what they cost.

Location

There are a number of factors that will influence your choice of a location for a business. To find a location is not easy and you have to consider the following:

- Is it close to the market?
- Are the input materials close by?
- Are there skilled workers in that vicinity?
- Are there services like electricity available?

Technical Planning

This part of a business plan must determine the business' requirements with regard to equipment, land and buildings and infrastructure. That means the owner must put down in writing what is needed for the specific business, e.g., a saw, a sewing machine, etc. A detailed list of all equipment with their specifications as well as offers from suppliers must accompany the business plan.

Is there a building available? Does it have running water and electricity? Are there facilities for waste disposal? These are also questions that need to be tackled in this part of the business plan.

Marketing

Your marketing plan provides a description of your target market and your marketing mix. In this part of the business plan, you have to explain how you are going to use the (four) 4 P's (product, price, place, and promotion) to let people know about your product.

Production

This section includes methods that will be followed in manufacturing the product or service. Remember to give thought to quality control standards and methods. Suppliers are important to the success of your business, and your relationship with them should be discussed.¹⁴⁹

¹⁴⁹ <http://open.lib.umn.edu/exploringbusiness/chapter/5-6-the-business-plan/>

Organisation/Management

An organisational plan shows the number of people that will be employed and their responsibilities. Experience has shown that entrepreneurs often need a good management team to manage and grow the business and therefore the need to appoint people who have the necessary skills.

Finances

A financial plan for your business is very important and needs time and attention. You must be realistic with your financial planning and plan to make a profit. Statistics have shown that many new businesses experience serious financial difficulties in the beginning and fail because no financial planning was done.



Assessments

Read the case study below and answer the questions that follow. This activity might take you about 1h 30 minutes to complete.

Why do we need to have a business plan?

Catina Davis, owner of Pizza World in Antigua, believes in the value of a business plan. Before buying her small business in 2016, she wrote a detailed business plan that analysed the strengths, weaknesses, target markets and growth potential of the business.

With her years of experience, Catina could easily have decided that she did not need to write a business plan, but she realised the importance of it and chose to write one. She said, “I needed to determine if the objectives of my business plan justified the need for another Pizza business in Antigua. To help me decide if I was doing the right thing, I also examined the list of equipment that the business needed and considered where I wanted to have the agency”.

Catina runs a successful business with ten employees and an office that has expanded into two hundred square metres. Catina says, “A business plan allows you to be proactive and gives you a greater chance of success.” Unfortunately, not many entrepreneurs take the time to draw up a business plan, even though it is such an important document.

1. Identify two main purposes of a business plan.
2. Why do so many entrepreneurs not draw up a business plan?
3. Imagine you were Catina and you are considering opening a pizza business in your town.

- (i) What are the most important parts that you should include in your complete business plan?
 - (ii) Prepare a business plan for your business.
4. Explain the uses of the business plan to Catina the entrepreneur, his employees, and financiers.



Summary

Lesson Summary

In this lesson, you examine the elements and importance of a business plan. You completed a review of the various components of a business plan and learnt of the benefits of the plan for the success of your business.

Lesson 6 - Harvesting the Venture

Introduction

In this section, you will learn about the final step of the entrepreneurial process: harvesting the venture. The harvesting strategies include selling the venture, liquidation, mergers, and acquisitions. These options are used by entrepreneurs and investors when they seek to exit a business and recover their initial investment.



Outcomes

At the end of this lesson, students should be able to:

1. Assess the various options of harvesting a venture
2. Compare and contrast the existing strategies

Student Reflection:

When is the right time to leave a business?

As an entrepreneur, do you plan to stop working one day? What will happen to your business?

Harvesting strategies include selling the venture, liquidation, mergers, and acquisitions. These options are used by entrepreneurs and investors when they seek to exit a business and recover their initial investment. Harvesting options are:

Absorption of a new concept into mainstream options:

This occurs when an area/activity of the venture is reduced or removed to recover funds to invest in a new concept or expansion of the product line. It is dependent on the financial feasibility of the project.

Licensing of Rights:

The entrepreneur may choose to sell the business rights. Permission is granted to an individual/company to manufacture, patent, copyright and trademark products using the licensing agreement. The agreement is legal and can be customized based on the access the licensors (entrepreneur) chooses to give the licensee.

Family Succession:

The entrepreneur/founder of the business may consider retirement or from being actively involved in the business and may choose a family member to be a successor.

Initially, family members can be given employment with the company. This provides the opportunity for the founder to mentor and guided participation of the successor in the business for a smooth transition when he takes over.

A written document succession plan should be created to address the new roles of management and structure of the organisations for all parties involved.

Go Public:

A business may decide to sell shares of stock to outside investors. Initial public offerings (IPO) exist when a company sells shares of its stocks to the public for the first time. The method is used to raise capital, however; it can be timely and expensive. Entrepreneurs may choose to go public to gain returns on initial investments. When this happens, a business chooses to sell stock to the public; the business status changes from private to public.

Employee Stock Ownership Plan (ESOP):

This involves an agreement with employees and managers to allocate a portion of their wages towards purchasing company stock from the founder until employees own the company.

Liquidate the Venture:

The entrepreneur may want to leave the venture and will liquidate assets, settle debts and severance employees. This exists when there are no prospective buyers.

Selling the Venture:

The owner may decide to sell the venture to an individual or company. Parties involved should agree on a sale price, transfer of ownership and other legalities of the business.

Mergers and Acquisitions:

An entrepreneur or corporate organisation may decide to purchase the majority or all shares of another business. The organisation may choose

to merge as a strategy for expansion and growth.¹⁵⁰



Assessments

Bert and Danny, two brothers, decided to form a partnership to open a dog kennel. They agreed Tony (Bert's son) would take over the business in 8 years. During the entrepreneurial process, Tony was mentored and guided to take over the business. After 8 years, the partners retired, and Tony was responsible for managing the kennel.

1. What is the harvesting strategy mentioned?
2. Describe the disadvantages of this option.



Assessments

Harvesting the Venture

1. An entrepreneur may choose to fund an employee stock ownership plan:
 - (a) To increase multiple earnings
 - (b) To promote goodwill
 - (c) To exit the business
 - (d) Before filing bankruptcy

2. Placing a picture of Mickey Mouse to sell knapsacks is a form of:
 - (a) Liquidation
 - (b) Franchising
 - (c) Brand licensing
 - (d) Franchise loyalty

3. Franchising is an advantage to the franchisor as:
 - (a) Franchises are inexpensive
 - (b) Selling franchises can improve an unprofitable business
 - (c) The franchisor gains revenue from fees and royalties
 - (d) Legal fees must be paid prior to a franchising agreement

4. An initial public offering occurs:

- (a) When a business has to liquidate due to bankruptcy
- (b) An entrepreneur chooses to franchise the business
- (c) A private company offers a stock sale to the public
- (d) A management buyout occurs

5. A management buyout results:
- (a) Employees purchase stocks in the business (ESOP)
 - (b) The managers of the company take ownership
 - (c) An IPO
 - (d) The owner buys managers' shares

Answer key

- | | |
|------|------|
| 1. C | 4. C |
| 2. C | 5. B |
| 3. C | |



Activity

FRANCHISING QUESTIONS:

What type information should be included in a franchise disclosure document?

What information must be included in a franchise agreement?

List three advantages for an owner franchising the business.

List three disadvantages of franchising a business



Summary

Lesson Summary

On completion of this lesson, you have learnt about mergers, franchising and other harvesting options such as selling the venture, liquidation, and management buyout. An entrepreneur may harvest the venture not solely on the loss of profits, but for other reasons as a serial entrepreneur or retirement. You should be able to consider the most appropriate harvesting option for your business. You have now reached the last module of this course where you will learn about Creativity and Innovation!

Module 3 – Managing, Growing and Harvesting the Venture

Module Introduction

Welcome to the final module of the Entrepreneurship course. Module 3 will prepare you in understanding the different activities that occur at the individual stage as your business grows. The module includes models that can be adapted to show the process of the venture, as the business reaches the final stage, you will learn about analysing the venture and devising strategies and calculate various means of assessing the value of the venture.

Lesson 1 - Venture Life Cycle

Introduction

As humans go through a lifecycle from birth, business goes through a similar cycle. From the conception of the business until it matures, the entrepreneur may encounter varying challenges as it thrives on remaining competitive in the market. The venture life cycle demands entrepreneurs to be innovative in the drive for competitive advantage to increase growth and market share.



At the end of this lesson, students should be able to:

- ❖ Identify the stages of the venture life cycle
- ❖ Explain the business activity that occurs at each stage of the venture life cycle
- ❖ Discuss the purpose of the venture life cycle

Entrepreneurs are able to implement strategic plans applicable and beneficial to the business from understanding the events taking place during the business cycles. The entrepreneur has the opportunity to identify challenges and potential opportunities to develop the business in order to remain competitive. As the business grows, goals and objectives will change during the months and at different stages of the business.

Entrepreneurs must be aware of conditions which may affect the business growth.

The stages of the venture life cycle vary in different texts. However, the initial, growth and maturity process stages remain the same. For example, a venture life cycle stage can take the format:

Stages of the Venture Life Cycle

- Start-up
- Expansion
- Maturity
- Diversification
- Lifestyle
- Capped growth

Another format of a *venture life cycle* may have five stages:

- ✚ New venture development
- ✚ Start-up activities
- ✚ Venture growth
- ✚ Business stabilization
- ✚ Innovation or decline

New venture development: At this stage, the entrepreneur searches for ideas from brainstorming, family, friends, competitors in deciding the type of venture.

Start-up activities: The entrepreneur may then decide to focus on a product or service within a niche market. Building and strengthening resources are important at this stage as it is time to launch the business.

Venture Growth: The business is making revenue and covering its expenses. As customers increase, the business increases its market share and may dominate the market. The industry becomes more competitive; however, in order to maintain market leadership, a strategic approach is explored.

Business Stabilization: The business has matured, and profits are stable. Experience from the prior stages contributes to a structured and sustainable venture over time.

Innovation or Decline: The entrepreneur may decide to implement diversification strategies and offer new products to the market. These strategies will make the business more competitive thus increasing growth and profitability. The entrepreneur or the management team will draw on

resources and human expertise in being more creative and innovative in its product offering.



Video

What diversification strategies are optional? The following video will educate you more on this topic.

<https://www.youtube.com/watch?v=qGtu3wyCmmk>

The venture may decline as sales and profits will eventually start to decrease. Sales may decline due to technological advancement, changes in consumer demand and increased competition. The entrepreneur may choose to exit the market at this stage.

Now that you have learnt about the stages, the video section will highlight growth strategies of the venture life cycle.



Video

Click on the link to watch this video which shows about growing the venture -

<https://www.youtube.com/watch?v=lsIX99ZM69U>

This video shows four growth strategies that can be used by entrepreneurs to grow the venture -

<https://www.youtube.com/watch?v=e56W9-CeBFw>



Reading

Additional Reading

For further reading, you may click on the link for an article that discusses the 7 stages of the business lifecycle.

www.justintimemanagement.com/en/The-7-stages-of-business-life-cycle



Assignments

Case Study

Tiquan Benjwall, an upcoming entrepreneur, attended a seminar on the venture life cycle. The facilitator spoke to attendees on the stages of the venture lifecycle. She addressed the importance of developing the idea, building the venture and growing the venture. She emphasized that the entrepreneur can add value to the product offering by being innovated throughout the venture cycle to reduce the risk of the business declining after maturity. Tiquan learned to utilize the internet to strengthen the innovative phase for improvement of speed and flexibility in customer relations.

1. Identify the THREE stages of the venture life cycle.(3)
2. Explain TWO of the stages in the venture life cycle. (6)
3. Outline THREE positive impacts of the Internet on the development of a venture. (6)

**Summary****Lesson Summary**

You have now reached the end of the lesson which discussed the stages and activities that take place in the venture life cycle. Next, you will learn about venture models.

Lesson 2 - Venture Models

Introduction

This chapter discusses organisational issues owners face while operating and attempting to grow their businesses. We examine four stages of organisational growth, and the choices business owners face when deciding how to manage tasks and responsibilities. Those management decisions shape an organisation's structure, which in turn influences lines of communication and decision-making processes.

The end of the chapter includes a short description of business legal entities. Also, you will find exercises to help you better grasp these concepts and to determine what type of organisational structure and legal entity might best suit your venture.



Outcomes

At the end of this lesson, students should be able to:

- Distinguish between various types of venture models
- Appraise each venture model

Moving from a one-person band to an orchestra

Most businesses start as a one-person band. The owner plays all the instruments, some better than others, but all out of necessity.

Like any musical ensemble, a small business includes many roles. In the beginning, the owners are often the best at making or delivering the product or service. Since they have the most at stake, they often assume a wide variety of roles, including sales, accounting, and much more.

Through a combination of skill, planning, talent, and perhaps luck, some businesses manage to grow. This growth leads to new and changing roles in the business for everyone, including the owner. Of all the roles an owner has in the business, perhaps the most important one is to be the designer for the business.

In the role of chief designer, business owners have three critical duties:

- Provide the vision and direction for the company. Owners set the direction for the values of the company, develop its product and service strategies, and set the tone for its relationships with customers.

- Develop and refine processes and procedures. Owners design the "business model," or the big picture formulas and processes of doing business. In addition, they must fill in the details by analyzing processes and finding bottlenecks.
- Create the organisation's human resource structure. Owners identify the positions and types of people the business needs, and then they find the people to fill those roles. In the words of Jim Collins, author of the bestseller *Good to Great*, "Get the right people on the bus, the wrong people off the bus, and get everyone in the right seats. "

The payoff for a well-designed business is immense. With the clarity of vision, expectations, and processes, and with the right people pulling together, there is a strong foundation for growth. Instead of a grim "never take a day off" grind, the business owner can now enjoy scheduled vacations from time to time. It is also now possible for the owner to think about a profitable exit because a business that can run without the owner is worth a lot more than one that falls apart when he or she is not at the controls.

Owners of a growing business eventually have to decide how to organise employees and delegate authority. This can be a frustrating task for many entrepreneurs. In fact, the majority would rather concentrate on closing sales, producing product, or managing cash. However, they do so at the peril of putting off planning for the future needs of their enterprise.

Start-up Company

A **start-up company** is an entrepreneurial venture which is typically a newly emerged, fast-growing business that aims to meet a marketplace need by developing or offering an innovative product, process or service. A start-up is usually a company such as a small business, a partnership or an organisation designed to rapidly develop a scalable business model.¹⁵¹

¹⁵¹ <https://www.boundless.com/users/235420/textbooks/business-fundamentals/how-to-organize-and-lead-an-entrepreneurial-venture-4/how-to-organize-and-lead-an-entrepreneurial-venture-19/introduction-95-15398/#> (CC BY SA)

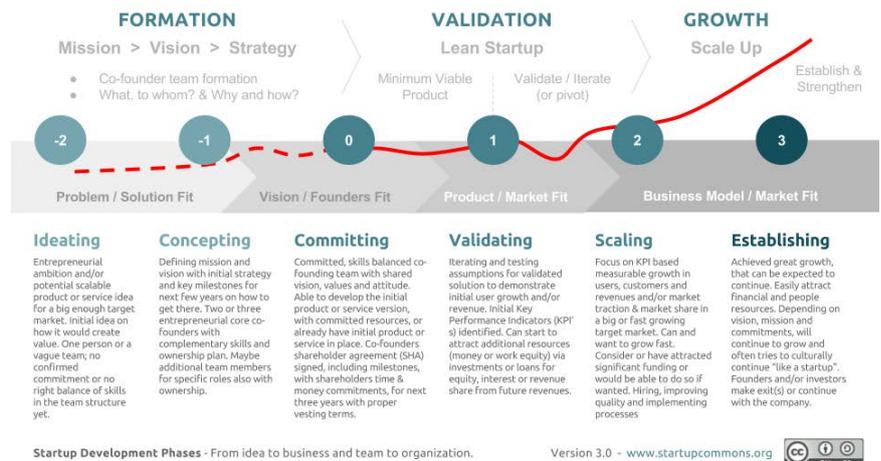


Figure 10 Start-up development phases¹⁵²

Start-up companies can come in all forms and sizes. Some of the critical tasks are to build a co-founder team to secure key competencies, know-how, financial resources and other elements to conduct research on the target market. Typically, a start-up will begin by building a first minimum viable product (MVP), a prototype, to validate, assess and develop the new ideas or business concepts. In addition, start-ups founders do research to deepen their understanding of the ideas, technologies or business concepts and their commercial potential. A Shareholders' Agreement (SHA) is often agreed early on to confirm the commitment, ownership, and contributions of the founders and investors and to deal with the intellectual properties and assets that may be generated by the start-up.

Business models for start-ups usually utilize via a "bottom-up" or "top-down" approach. A company may cease to be a startup as it passes various milestones. In other words, deciding to trade publicly on the stock market in an Initial Public Offering (IPO), or ceasing to exist as an independent entity via a merger or acquisition. Companies may also fail and cease to operate altogether, because of developing disruptive innovations which may not function as expected and for which there may not be market demand, even when the product or service is finally developed. Given that start-ups operate in high-risk sectors, it can also be hard to attract investors to support the product/service development or attract buyers.¹⁵³

¹⁵² https://en.wikipedia.org/wiki/Startup_company (CC BY SA)

¹⁵³ https://en.wikipedia.org/wiki/Startup_company

The size and maturity of the start-up ecosystem where the venture launches and grows have an effect on the volume and success of the business. The start-up ecosystem consists of:

- the individuals: these may include entrepreneurs, venture capitalists, Angel investors, and mentors;
- institutions and organisations such as top research universities and institutes, business schools and entrepreneurship programs operated by universities and colleges, non-profit entrepreneurship support organisations, government entrepreneurship programmes, and services, Chambers of Commerce.
- business incubators; and business accelerators; and
- top-performing entrepreneurial firms and start-ups.

A “strong” entrepreneurship ecosystem in a region must have all of the above elements. Some of the most famous entrepreneurial ecosystems are Silicon Valley in California, where major computer and Internet firms and top universities such as Stanford University create a stimulating start-up environment. Also, Boston (where Massachusetts Institute of Technology is located) and Berlin, home of WISTA (a top research area), numerous creative industries, leading entrepreneurs and start-up firms.

Investors are generally most attracted to new companies distinguished by:

- their strong co-founding team,
- a balanced "risk/reward" profile (in which high risk due to the untested, disruptive innovations is balanced out by high potential returns), and
- "scalability" (the likelihood that a start-up can expand its operations by serving more markets or more customers).

Attractive start-ups generally have lower "bootstrapping" (self-funding of start-ups by the founders) costs, higher risk, and higher potential return on investment. However, a successful stratus is typically more scalable than an established business, in the sense that the start-up has the potential to grow rapidly with a limited investment of capital, labour or land. Given consideration that start-ups are one of the hardest things to master by many serial entrepreneurs and investors, timing has often been the single most important factor for biggest start-up successes.^[5] Additionally, start-ups have several options for funding.

- (1) **Venture capital firms and angel investors** may help start-up companies begin operations, exchanging seed money for

an equity stake in the firm. Moreover, such investors provide financing to a range of start-ups (a portfolio), with the expectation that a very small number of the start-ups will become viable and make money. However, in practice, the founders themselves make use of “bootstrapping,” in which loans initially fund many start-ups or monetary gifts from friends and family in combination with savings and credit card debt to finance the venture.

- (2) **Factoring** is another option, though it is not unique to start-ups.
- (3) **Crowdfunding**, for example, equity crowdfunding, in which the start-up seeks funding from a large number of individuals, typically by pitching their idea on the Internet

Business partnering

Start-ups usually need to form partnerships with other firms to enable their business model to operate. To become attractive to other businesses, a start-up needs to align their internal features, such as management style and products with the market situation. In their 2013 study, Kask and Linton develop two ideal profiles, or also known as configurations or archetypes, for a start-up that are commercializing inventions. The *inheritor* profile calls for a management style that is not too entrepreneurial (more conservative), and the start-up should have an incremental invention (building on a previous standard). This profile is set out to be more successful (in finding a business partner) in a market that has a dominant design (a clear standard is applied in this market). In contrast to this profile is the *originator* who has a management style that is highly entrepreneurial and in which a radical invention or a disruptive innovation (totally new standard) is being developed. This profile is set out to be more successful (in finding a business partner) in a market that does not have a dominant design (established standard). A new start-up should align themselves to one of the profiles when commercializing an invention to be able to find and be attractive to a business partner. By finding a business partner, a start-up will have greater chances to become successful.

Culture



Figure 11 Start-up Ecosystem¹⁵⁴

A strong start-up ecosystem is vital to a thriving local entrepreneurial culture. Furthermore, start-up founders often have a more casual or offbeat attitude in their dress, office space, and marketing, as compared to traditional corporations. Small business owners in the 2010s may wear hoodies, sneakers and other casual clothes to business meetings because some have installed recreational facilities in their offices, such as pool tables, ping-pong tables, and pinball machines. These strategies create an attractive, fun working environment, stimulate team development and team spirit, as well as encourage creativity.

The majority of the casual approaches promote and contribute to a more efficient workplace that is necessary to get the business off the ground. These may include the use of "flat" organisational structures, in which regular employees can communicate with the founders and chief executive officers informally. In a 1960 study, Douglas McGregor stressed that punishments and rewards for uniformity in the workplace are not necessary because some people are born with the motivation to work without incentives. Some initiatives do not use a strict command and control hierarchical structure, with executives, managers, supervisors and employees. In fact, some start-ups offer employees stock options, to increase their "buy in" to the business (as these employees stand to gain if the company is profitable). Removing of stressors allows the workers and researchers in the business to focus less on the work environment around

¹⁵⁴ https://en.wikipedia.org/wiki/Startup_company CC BY SA

them, and more on achieving the task. As a result, it provides employees with the opportunity to achieve something great for their company.

Contritely, the business culture today has evolved to include larger companies aiming at acquiring the innovative minds pioneering start-ups. For example, Google has incorporated such practices with their purchased start-ups by allowing their workers to feel at home in the workplace, even letting them bring their dogs to work. The objective of the cultural changes in the small business workplace, or a company hiring workers from a start-up to do similar work, is to make employees comfortable so they can increase productivity in the office. Some companies even try to hide how large they are to capture a particular demographic, as is the case with Heineken recently.¹⁵⁵

Co-founders

Co-founders are individuals involved in the initial launch of start-up companies. Furthermore, anyone can be a co-founder. Although, an existing company can also be a co-founder, frequently co-founders of start-ups are entrepreneurs, engineers, hackers, venture capitalists, web developers, web designers and others involved in the ground level of a new, often high-tech, venture. Actually, the language of securities regulation in the United States considers co-founders to be "promoters" under Regulation D.

The U.S. Securities and Exchange Commission define the term "Promoter" as any person who, acting alone or in conjunction with one or more other persons, directly or indirectly and takes the initiative in founding and organising the business or enterprise of an issuer. However, not every promoter is a co-founder. In fact, there is no formal, legal definition of what makes an individual a co-founder. The right to call oneself a co-founder can be established through an agreement with one's fellow co-founders or with permission of the board of directors, investors, or shareholders of a start-up company. When there is no definitive agreement (like SHA), disputes relevant to the distinguishing of co-founders can arise.¹⁵⁶

¹⁵⁵ https://en.wikipedia.org/wiki/Startup_company

¹⁵⁶ https://en.wikipedia.org/wiki/Startup_company

Startup investing

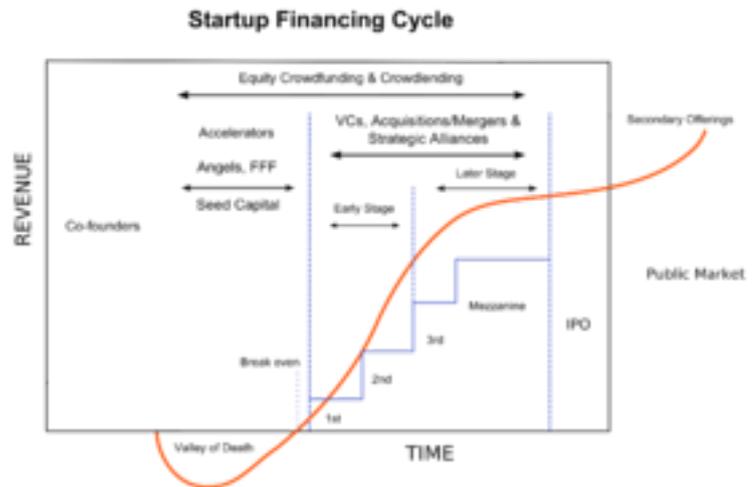


Figure 12 Diagram of the typical financing cycle for a startup company¹⁵⁷

Evolution of investing

After the Great Depression, start-up investing was primarily a word of mouth activity reserved for the friends and family of a small business' co-founders, business angels, and Venture Capital funds. In the United States, this has been the case ever since the implementation of the Securities Act of 1933. Many nations implemented similar legislation to prohibit general solicitation and general advertising of unregistered securities, including shares offered by start-up companies. In 2005, Y Combinator introduced a new accelerator investment model; a combination of fixed terms investment model with fixed period intense boot camp style training program. Moreover, it is used to streamline the seed/early stage investment process with training to be more systematic as well as becoming the trend setter for the future.

Following Y Combinator, many accelerators with similar models have emerged around the world. The accelerator model became very common and widely spread as the key organisations of any Start-up ecosystem. Title II of the Jumpstart Our Business Start-ups Act (JOBS Act), first implemented on September 23, 2013, granted start-ups as well as the co-founders or promoters in the US the right to generally solicit and advertise publicly using any method of communication. Furthermore, the

¹⁵⁷ https://en.wikipedia.org/wiki/Startup_company

satisfaction of the right rested with the condition that only accredited investors can purchase the securities. However, the regulations affecting equity crowdfunding in different countries vary a lot with different levels and models of freedom and restrictions. In many countries, there are no limitations restricting the public from investing in start-ups. Nevertheless, considerations of enforcing other restrictions such as limiting the amount companies seek from investors encircled the mind. Due to positive development and growth of crowdfunding, many countries are actively updating their regulation in regards to crowdfunding.¹⁵⁸

Investing rounds

When investing in an initial business, there are different stages in which the investor can participate. The first round is commonly known as the seed round generally is when the business is still in the very early phase of execution and the product is still in the prototype phase. At this level angel investors will be the ones participating. The next round is called Series A. At this point the company already has traction and may be making revenue. In Series A rounds venture capital firms will be participating alongside angels or super angel investors. The next rounds are Series B, C, and D. These three rounds are the ones leading towards the IPO. Venture capital firms and private equity firms will be participating.

Investing online

The first known investment-based crowdfunding platform for start-ups was launched in Feb. 2010 by Grow VC, followed by the first US based company Profounder launching model for start-ups to raise investments directly on the site. However, Profounder later decided to shut down its business due to regulatory reasons preventing them from continuing, having launched their model for the US markets prior to JOBS Act. With the positive progress of the JOBS Act for crowd investing in the US, equity crowdfunding platforms like Seed Invest and Circle Up started to emerge in 2011 and platforms such as investiere, Companisto, and Seeders in Europe and OurCrowd in Israel. The idea of these platforms is to streamline the process and resolve the two main points that were taking place in the market. The first problem was for start-ups to be able to access capital and to decrease the amount of time that it takes to close a round of financing. The second problem was intended to increase the amount of deal flow for the investor and also to centralize the process.¹⁵⁹

¹⁵⁸ https://en.wikipedia.org/wiki/Startup_company#cite_note-Bloomberg_Businessweek2-19

¹⁵⁹ https://en.wikipedia.org/wiki/Startup_company

Internal start-up

Large or well-established companies often try to promote innovation by setting up "internal start-ups," new business divisions that operate at arm's length from the rest of the company. Examples include Bell Labs, a research unit within Bell Corporation and Target Corporation (which began as an internal start-up of the Dayton's department store chain) and three degrees, a product developed by an internal start-up of Microsoft.¹⁶⁰

Re-starters

Failed entrepreneurs, or restarters, who after some time restart in the same sector with more or less the same activities, have an increased chance of becoming a better entrepreneur. However, some studies indicate that restarters are more heavily discouraged in Europe than in the US.

Trends and obstacles

If a company's value is based on its technology, it is often equally important for the business owners to obtain intellectual property protection for their idea. The newsmagazine *The Economist* estimated that up to 75% of the value of US public companies is now based on their intellectual property (up from 40% in 1980). Often, 100% of a small start-up company's value resonates on its intellectual property. As such, it is important for technology-oriented start-up companies to develop a sound strategy for protecting their intellectual capital as early as possible.

Start-up companies, particularly those associated with new technology, sometimes produce huge returns to their creators and investors—a recent example of such is Google, whose creators became billionaires through their stock ownership and options. However, the failure rate of start-up companies is very high. One common reason for failure is that start-up companies can run out of funding, without securing their next round of investment or before becoming profitable enough to pay their staff. When this happens, it can leave employees without paychecks. Sometimes these companies are purchased by other companies if they are deemed to be viable, but oftentimes they leave employees with very little recourse to recoup lost income for a worked time.

Although there are start-ups created in all types of businesses, and all over the world, some locations and business sectors are particularly associated

¹⁶⁰ https://en.wikipedia.org/wiki/Startup_company CC BY SA

with start-up companies. The internet bubble of the late 1990s was associated with huge numbers of initial internet companies, some selling the technology to provide internet access, others using the internet to provide services. Most of this start-up activity was located in the most commonly known start-up ecosystem - Silicon Valley, an area of northern California renowned for the high level of start-up company activity:

The spark that set off the explosive boom of "Silicon start-ups" in Stanford Industrial Park was a personal dispute in 1957 between employees of Shockley Semiconductor and the company's namesake and founder, Nobel laureate and co-inventor of the transistor William Shockley... (His employees) formed Fairchild Semiconductor immediately following their departure...

After several years, Fairchild gained its footing, becoming a formidable presence in this sector. Its founders began leaving to start companies based on their own latest ideas and were followed on this path by their own former leading employees... The process gained momentum and what had once begun in Stanford's research park became a veritable start-up avalanche... Thus, over the course of just 20 years, a mere eight of Shockley's former employees gave forth 65 new enterprises, which then went on to do the same... ¹⁶¹



Assessments

Assessment

Match the list in column A with the concepts in column B.

Column A	Column B
A. Start-up company	The action of making an investment in an early-stage company. _____
B. Business partnering	Large or well-established companies often try to promote innovation by setting up, new business divisions that operate at <u>arm's length</u> from the rest of the company. _____

¹⁶¹ https://en.wikipedia.org/wiki/Startup_company

C. Co-founder	Failed entrepreneurs who after some time restart in the same sector with more or less the same activities.
D. Start-up investing	An entrepreneurial venture which is typically a newly emerged, fast-growing business that aims to meet a marketplace need by developing or offering an innovative product, process or service.
E. Internal start-ups	Forming partnerships with other firms to enable start-up business models to operate.
F. Re-starts	People involved in the initial launch of startup companies.



Summary

Lesson Summary

You have now reached the end of the lesson which discussed the stages and activities that take place in the venture life cycle. Next, you will learn about venture models.

Lesson 3 – Importance of venture valuation and valuation methods

Introduction

In the previous lesson, you reviewed the venture models and how a venture model can grow. In this lesson, you will continue your probe on venture models with a focus on the valuation of business ventures.



Outcomes

At the end of this lesson, students should be able to:

1. Explain the importance of valuation of ventures
2. Discuss methods used in venture valuation

In finance, valuation analysis is required for many reasons including tax assessment, wills and estates, divorce settlements, business analysis, and basic bookkeeping and accounting. Since the value of goods and services fluctuates over time, valuations are as of a specific date similar to the end of the accounting quarter or year. They may alternatively be mark-to-market estimates of the current value of assets or liabilities as of this minute or this day for the purposes of managing portfolios and associated financial risk (for example, within large financial firms including investment banks and stockbrokers).

Some balance sheet items are much easier to value than others are. Publicly traded stocks and bonds have prices that are quoted frequently and readily available. Other assets are harder to value. For instance, private firms that have no frequently quoted price. Additionally, financial instruments that have prices that are partly dependent on theoretical models of one kind or another are difficult to value. For example, options are generally valued using the Black–Scholes model while the liabilities of life assurance firms are valued using the theory of present value. Intangible business assets, like goodwill and intellectual property, are open to a wide range of value interpretations.

It is possible and conventional for financial professionals to make their own estimates of the valuations of assets or liabilities of interest to them. Their calculations are of various kinds including analyses of companies that focus on price-to-book, price-to-earnings, price-to-cash-flow and present value calculations, and analyses of bonds that focus on credit

ratings, assessments of default risk, risk premia, and levels of real interest rates. All of these approaches may be thought of as creating estimates of value that compete for credibility with the prevailing share or bond prices, where applicable, and may or may not result in buying or selling by market participants. Where the valuation is for the purpose of a merger or acquisition, the respective businesses make further detailed financial information available, usually on the completion of a non-disclosure agreement.

It is important to note that valuation requires judgment and assumptions:

- There are different circumstances and purposes to value an asset (e.g., distressed firm, tax purposes, mergers and acquisitions, financial reporting). Such differences can lead to different valuation methods or different interpretations of the method results
- All valuation models and methods have limitations (e.g., degree of complexity, relevance of observations, mathematical form)
- Model inputs can vary significantly because of necessary judgment and differing assumptions

Users of valuations benefit when key information, assumptions, and limitations are disclosed to them. Then they can weigh the degree of reliability of the result and make their decision.¹⁶²

Asset sale or an entity sale allows for the selling of businesses, and the transferring of their assets. In an asset sale, the entity sells its tangible and intangible assets to the buyer, while the entity's owners retain equity in the entity. On the other hand, in an entity sale, the seller transfers his or her equity to the buyer, who acquires the entity with all of its assets. Where the business is a sole proprietorship, the sale by default will be a sale of assets, because there is no entity apart from the owner. Where the entity is a partnership, LLC or corporation, the buyer and seller will generally have some choice over the selling process of the business.

Structuring a business sale as a sale of assets or as an entity sale depends on a number of factors, regardless of what the buyer is willing to accept. Other crucial factors that will weigh on both the buyer's and seller's choice will be (1) the existence of outstanding liabilities; and (2) the disparate tax effects that would result from the sale of assets when compared with the sale of the business entity. The tax implications are especially important

¹⁶² [https://en.wikipedia.org/wiki/Valuation_\(finance\)#Business_valuation](https://en.wikipedia.org/wiki/Valuation_(finance)#Business_valuation)

where the seller's business is a C Corporation because a sale of assets might result in double taxation. Where the business is converting from an investor-owned or closely held C Corporation to an employee-owned business, the incentive to sell the business' equity to the employees is increased. Unfortunately, tax and liability considerations often pit seller and buyer against one another. For tax purposes, typically, the seller would prefer to transfer equity, while the buyer would prefer to buy a pool of assets. Moreover, where both parties have agreed to an asset sale, the parties' interests often conflict as to how the sales price should be allocated across assets.¹⁶³

Growth Capital

Growth capital (also called **expansion capital** and **growth equity**) is a type of private equity investment. Usually, a minority investment, in relatively mature companies that are looking for capital to expand or restructure operations, enter new markets or finance a significant acquisition without a change of control of the business.

Companies that seek growth capital often do so to finance a transformational event in their lifecycle. These companies are likely to be more mature than venture capital funded companies, able to generate revenue and operating profits but unable to generate sufficient cash to fund major expansions, acquisitions or other investments. Due to the lack of scale, these companies generally can find few alternative conduits to secure capital for growth. Thus, access to growth equity can be critical to pursue necessary facility expansion, sales and marketing initiatives, equipment purchases, and new product development. Growth capital can also facilitate the restructuring of a company's balance sheet, particularly to reduce the amount of debt the company has on its balance sheet.

Although growth capital often structured as preferred equity, certain investors will use various hybrid securities that include a contractual return (i.e., interest payments) in addition to an ownership interest in the company. Often, companies that seek growth capital investments are not good candidates to borrow additional debt, either because of the stability of the company's earnings or because of its existing debt levels.¹⁶⁴

¹⁶³ <http://www.co-oplaw.org/legal-guide-cooperative-conversions/deciding-asset-sale-entity-sale/> CC BY SA

¹⁶⁴ https://en.wikipedia.org/wiki/Growth_capital

What is an ESOP?

An Employee Stock Options Plan (ESOP) is an allocation of shares that will be granted to employees in the future in the form of stock options

- How much equity should we set aside for employees?

A plan for how these options will be distributed:

- How many shares will individual employees receive?
- What terms will govern these grants?

An option is a right (but not an obligation) to purchase a quantity of a company's stock at a set price for a certain period of time. "Options" also refer to several types of securities often issued to start-up employees to provide for effective equity ownership, including:

- Stock options (the right to buy common stock at a set strike price)
- Restricted stock (common stock issued early on to top employees)
- Restricted stock units (a promise to issue common stock in the future)

Appropriate use of these securities will vary based on local regulatory and tax considerations.¹⁶⁵

Common Terms in an Options Package

Number of Shares	The total number of options granted to an employee, and therefore the maximum number of shares that employee has access to
Strike Price	The price the employee must pay to purchase each share if and when the employee chooses to exercise the option
Vesting Schedule	The timeline over which the options become wholly owned and exercisable by the employee (no longer subject to repurchase by the company)
Cliff Period	The trial period during which no vesting occurs; in this period vesting accrues, but the total effect of this vesting is realized immediately after the cliff
Expiration Date	The last date on which the options may be exercised and converted into common shares by the employee

¹⁶⁵

<https://static1.squarespace.com/static/564afbe2e4b07f8c73636439/t/57bae8219de4bba0e8db7a5e/1471866918118/Accion+Venture+Lab+-+ESOP+Best+Practices.pdf> CC

BY SA

Why Issue Options to Employees?

- Attract Talent: options can be used to attract top recruits, particularly engineers, product managers and other technical team members
- Retain Employees: options vest over several years, creating strong incentives for employees to remain employees
- Align Incentives: by making employees equity owners, options align incentives with the long-term goals of the company
- Reward Value Creation: options reward tangible contributions that increase corporate valuation by giving employees a slice of that value
- Encourage Long-term Thinking: options typically pay off only in a liquidity event or exit and thus push employees to build the company for long-term success¹⁶⁷

HOW MUCH TO GRANT

Two Approaches

Top Down

Decide the total amount of equity to be granted; allocate these shares to employees over time

Bottom Up

Decide the appropriate size of individual equity grants by position; issue these shares as employees are hired

In reality, creating an ESOP will require a combination of top-down and bottom-up planning

Figure 14 ACCION-Approaches to ESOP¹⁶⁸

¹⁶⁶

<https://static1.squarespace.com/static/564afbe2e4b07f8c73636439/t/57bae8219de4bba0e8db7a5e/1471866918118/Accion+Venture+Lab+-+ESOP+Best+Practices.pdf> (CC BY SA)

¹⁶⁷

<https://static1.squarespace.com/static/564afbe2e4b07f8c73636439/t/57bae8219de4bba0e8db7a5e/1471866918118/Accion+Venture+Lab+-+ESOP+Best+Practices.pdf>

¹⁶⁸<https://static1.squarespace.com/static/564afbe2e4b07f8c73636439/t/57bae8219de4bba0e8db7a5e/1471866918118/Accion+Venture+Lab+-+ESOP+Best+Practices.pdf>

The Top-Down Process

1. Determine how much equity to set aside for non-founder employees
2. Create a schedule of how this equity will be distributed over time

1. How Much Equity to Set Aside in the ESOP?

Generally **non-founder employees** get 15-20% of the company, with some companies issuing up to 25% (and a current trend toward bigger ESOPs)

<15%

- **Founders** are top managers with functional roles that are not redundant
- **DNA** of the company is in a non-technical industry; no technology emphasis
- **Geographic focus** is on a region that is not considered a startup hub
- **Hiring needs** are primarily administrative or back-office team members

20%

- **Founders** are top managers, but hire others to fill key technical or functional roles
- **DNA** of the company is in applying technology to a non-technical industry
- **Geographic focus** is either wholly or partially in a startup hub
- **Hiring needs** are primarily sales and marketing team members

25%

- **Founders** are not top managers in the business, or plan to step aside
- **DNA** of the company is in technology, engineering, or data science
- **Geographic focus** is in a leading startup hub such as SF, NYC or Boston
- **Hiring needs** are primarily engineering, development, or technical team members

There are no hard and fast rules, but by **looking your company's founders, its DNA, its geographic focus, and its hiring needs** you can begin to benchmark how much equity to set aside for the ESOP

ACCION

Figure 15 [ACCION](#)

2. A Typical Distribution Schedule

Seniority	Equity Allocation
First 10 Employees	10%
Next 20 Employees	5%
Next 50 Employees	5%

- Early-stage equity grants are always a negotiation, but generally:
 - CTO: 1-5%
 - Key Developer or Engineer: 1-2%
 - Other Functional Team Member: 0.5-1.5%
 - No non-founding member of the senior team should receive over 10%

Figure 16 [ACCION](#)

The Bottom-Up Process

1. Segment your human resources
2. Create pay multipliers for each job function
3. Determine the dollar value of an options grant
4. Determine the current share price
5. Calculate options grants

1. Segment Your Human Resources

Segment	Roles	Award in % or \$?
Founders	Co-Founders	%
Founding Team	Technical & Product	%
Early-Stage Hires	Senior Team (C-Level)	\$
	Directors / VPs	\$
	Functional / Technical Team	\$
	Support Team	\$

- Think about the early-stage team in three segments
 - **Founders**: the founding partners in the business
 - **Founding Team**: the people you hire to build your product
 - **Early-Stage Hires**: the team you build as you raise capital
- As early as possible, begin communicating options grants in terms of dollars rather than percentages

ACCION

Figure 17 [ACCION](#)

2. Establish Pay Multipliers for Each Role

Segment	Roles	Award in % or \$?	Options Multiplier (Multiple of Salary)
Founders	Co-Founders	%	--
Founding Team	Technical & Product	%	Negotiated
Early-Stage Hires	Senior Team (C-Level)	\$	0.5x – 1.0x base salary
	Directors / VPs	\$	0.25x – 0.5x base salary
	Functional / Technical Team	\$	0.1x – 0.25x base salary
	Support Team	\$	0.0x – 0.1x base salary

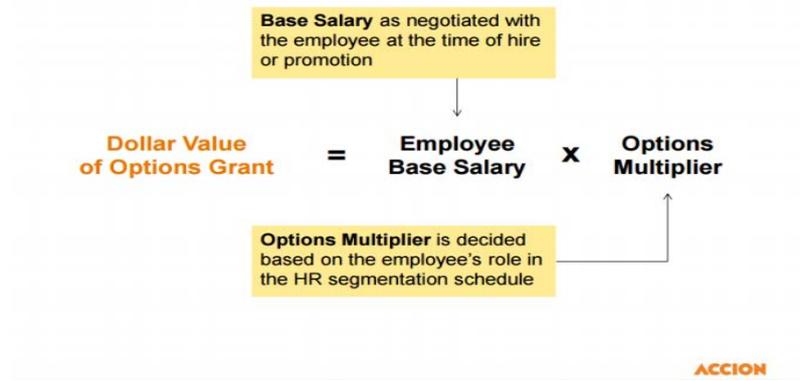
- After segmenting the early-stage team, establish a standardized multiple of base salary to be granted as an option package
 - These ranges provide a ballpark grant for each role
 - Get away from actively negotiating packages with employees
 - Be transparent about this methodology

Source: This range of multiples was provided by Fred Wilson of Union Square Ventures, which he created in collaboration with a leading HR consulting firm.

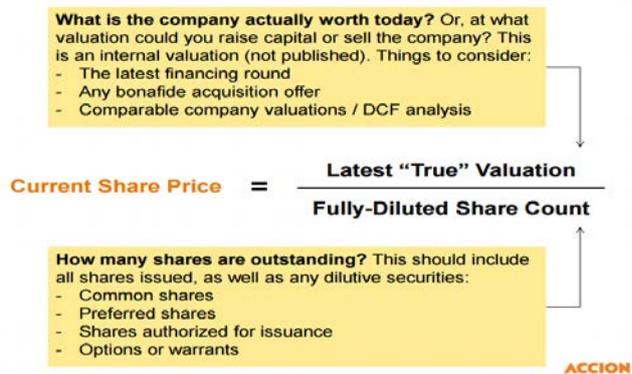
ACCION

Figure 18 [ACCION](#)

3. Determine the Dollar Value of the Options Grant

Figure 19 [ACCION](#)

4. Determine the Current Share Price

Figure 20 [ACCION](#)

5. Calculate the Options Grant

$$\text{Options Grant (Number of Shares)} = \frac{\text{Dollar Value of Options Grant}}{\text{Current Share Price}}$$

Figure 21 [ACCION](#)

Important Takeaways

- Top-down planning (“the allocation”)
 - Holistically consider what percentage of the company should belong to employees

- Allocate these shares to an ESOP
- Bottom-up planning (“the plan”)
 - Give specific consideration to the amount of equity awarded to each employee
 - Use this framework for individual equity grants
- Key Takeaway: Get away from ad hoc equity awards and personal negotiations by standardizing both the amount of equity available to employees and the process by which packages are awarded

Tax Obligations

The law stipulates that businesses must pay income tax on revenues, if any, after deducting the expense of operation such as the cost of inventory, rent, insurance premiums, salaries, and utilities. Additionally, businesses have to file tax returns and pay taxes to the government.

Some businesses may be required to collect taxes on behalf of government such as sales taxes (ABST) based on the value of goods or services sold. In these cases, it is clear that the money does not belong to the business owner as he or she is only a collection agent and must turn over the money to the government.

Other taxes that a business collect and pay over to the government are income taxes, Medical Benefits and social security taxes deducted from the salaries and wages of workers. These funds technically belong to the employee and are being transmitted to the government on the workers’ behalf.

Failure to pay income tax and other taxes may result in penalties and interest being added to the taxes due. In the case of businesses that underreport income or refuse to pay taxes, the principals may be the subject of criminal prosecution as well.



Activity

Guess speaker

Invite a representative from the Inland Revenue Department to discuss taxes in Antigua and Barbuda.



The type of business operated determines the formula used to calculate the tax contribution that should be paid. The three types of businesses are as follows:

- ✚ **Sole Traders business** - the owner and the business is treated as one entity, so the owner is required to pay the Unincorporated Business Tax
- ✚ **Partnership business** – the business itself is not taxed, but, under the Personal Income Tax system, the individual partners are required to pay taxes.
- ✚ **Corporation** – shareholders of corporations are taxed as is the business itself taxed as a separate entity. Shareholders are taxed according to the PIT rates, whereas the corporation is required to pay 20% of its gross profits yearly.

Social Security



Antigua and Barbuda Social Security

Every employed individual is required by law to make month contributions to the Social Security Scheme. For employed individuals contributions is shared between employee and employer. Contribution rates are as follows:

Private Sector employees pay **5%**; Private Sector employers pay **7%**
Public Sector employees pay **4%**; Public Sector employers pay **7%**

Self-employed individuals are required to make a ten percent (10%) contribution whenever they are employed. Contributions to the scheme should be paid in on or before the 14th of the following month or face a penalty of ten percent (10%).

Monthly remittance forms are submitted to the Social Security Office on a monthly basis. They show the employees' earnings, both employees' and employers' contributions and the number of weeks worked within the month. Monthly remittance forms can be obtained from the Social Security Office on Long Street or from its website <http://www.socialsecurity.gov.ag/downloads.php>

Medical Benefits



Antigua and Barbuda Medical Benefits Scheme

By law, every employed individual is required to make contributions to the Medical Benefits Scheme. Under the present Act, employees are required to make a three and a half percent (3.5%) and employers an additional three and a half percent (3.5 %) on behalf of the employee for a total contribution of seven percent (7%).

Self-employed individuals are required to make the seven percent (7%) contribution to the scheme.

Remittance forms should be submitted to the Medical Benefits Office on Nevis Street no later than the 14th day of the following month or face a ten percent (10 %) on the outstanding amount. Remittance forms can be obtained from the Medical Benefits Office or from the website http://www.mbs.gov.ag/information/forms_downloads.php

Education Levy

Every employee and the self-employed individual are required by law to make Education Levy contributions. Unlike Social Security and Medical Benefits, the contributions are paid fully by the employee the employer does not contribute to this deduction. Contributions should be paid to the Board of Education no later than the 14th of the following month. There is a penalty of six percent (6%) compounded for all late contributions.

Monthly deductions

Individuals earning five thousand dollars (\$5000) or less will have a \$541.67 exemption with two and a half percent (2.5%) on the balance.

Gross salary	5000.00
Exemption	<u>541.67</u>
Balance	<u>4458.33</u>
BOE deduction	$2.5\% * 4458.33 = \$111.46$

Individuals earning over \$5000 pays an additional five percent (5%) on the amount over \$5000.

Example for an individual earning \$7500 monthly

Gross salary	7500.00
Less	<u>5000.00</u>
	2500.00

BOE deductions	$2500 * 5\% = 125.00$
Plus	<u>111.46</u>
Total BOE Deduction	236.46

Weekly Deductions

Weekly contributors receive an exemption of \$125.00

For individuals earning \$1156 or less weekly

Gross wage	1156.00
Less exemption	<u>125.00</u>
	1031.00

BOE deduction $2.5\% * 1031 = 25.78$

Individuals earning \$1800 weekly

Gross wage	1800.00
Less	<u>1156.00</u>
	644.00

BOE deductions 644.00 * 5% = 32.20	
Plus	<u>25.78</u>
Total BOE Deductions	57.98

Valuation methods

In order to evaluate a company, one must have an initial understanding of it. Therefore, at Venture Valuation, we pursue a holistic evaluation approach. All valuations are based on a careful consideration of both hard facts and soft factors. We apply a thorough risk assessment of factors which include:

- Management
- Market
- Science and technology
- Financials / funding phase

To determine the value of a company as accurately and as objectively as possible, we use a mixture of different assessment methods. All methods are specifically suited for the evaluation of technology companies, with high growth potential and start-up companies of all types. Although not every kind of valuation method is appropriate, Venture Valuation assesses each company according to their industry and financing phase.

Discounted Cash Flow (DCF)

Method: The discounted cash flow method takes free cash flows generated in the future by a specific project / company and discounts them to derive a present value (i.e. today's value).

The discounting value usually used is the weighted average cost of capital (WACC) and is symbolized as the 'r' in the following formula:

$$DCF = \frac{CF_1}{(1+r)^1} + \frac{CF_{21}}{(1+r)^2} + \dots + \frac{CF_n}{(1+r)^n}$$

DCF = Calculated DCF value

CF = Cash Flow

r = Discount rate (WACC: Weighted average cost of capital)

Uses: DCF calculations are used to estimate the value of potential investments. When DCF calculations produce values that are higher than the initial investment, this usually indicates that the investment may be worthwhile and should be considered.

Risk-adjusted NPV

Method: The risk-adjusted net present value (NPV) method employs the same principle as the DCF method, except that each future cash flow is risk adjusted to the probability of it actually occurring.

The probability of the cash flow occurring is also known as the 'success rate.'

Uses: Risk-adjusted NPV is a common method of valuing compounds or products in the pharmaceutical and biotech industry, for example. The success rates of a particular compound/drug can be estimated, by comparing the probability that the compound/drug will pass the various development phases (i.e. phases I, II or III) often undertaken in the drug development process.

Also known as: rNPV, eNPV (e=estimated/expected)

Venture Capital method

Method: The venture capital method reflects the process of investors, where they are looking for an exit within 3 to 7 years. First, an expected exit price for the investment is estimated. From there, one calculates back to the post-money valuation today taking into account the time and the risk the investors takes.

The return on investment can be estimated by determining what return an investor could expect from that investment with the specific level of risk attached.

Uses: The Venture Capital Method is an often used in valuations of pre-revenue companies where it is easier to estimate a potential exit value once certain milestones are reached.

Market comparables method

Method: The market comparables method attempts to estimate a valuation based on the market capitalization of comparable listed companies.

Uses: The market comparables method is a simple calculation using different key ratios like earning, sales, R&D investments, to estimate the value of a company.

Also known as Multiples

Comparable Transaction method

Method: The comparable transaction method attempts to value an entire company by comparing a similar sized private company in a similar field, and using different key ratios. The price for a similar company can either come from an M&A transaction or a financing round.

Uses: The comparable transaction method is a simple calculation estimating the value of a target company based on comparable investments or M&A deals.

Decision Tree Analysis

Method: Decision trees are used to forecast future outcomes by assigning a certain probability to a particular decision.

The name decision tree analysis comes from the ‘tree’ like shape the analysis creates where each ‘branch’ is a particular decision that can be undertaken.

Uses: Decision trees are used to give a graphical representation of options, strategies or decisions that can be undertaken to reach a particular goal or “decision.”¹⁶⁹



Lesson Summary

¹⁶⁹ <http://www.venturevaluation.com/en/methodology/valuation-methods>

Summary

In order to have a successful venture it is important to ascertain the value of your business. Also an understanding of various options for raising growth capital is critical. An ethical business owners should also ensure that he/she meets all the relevant tax obligation as outline in the laws in the country of operation. In this lesson, you examined the various option for raising capital of expansion and the tax obligations for small business in Antigua and Barbuda. In the next lesson, you will look at the internet and its impact on venuture development.

Lesson 4 – E-commerce and growing the venture

Introduction

In this lesson you will review how the use of the internet can impact your business. You will also examine various approaches to e-commerce and the elements to consider before launching into e-commerce for your business.



At the end of this lesson, students should be able to:

1. Explain how the internet impacts venture development
2. Identify approaches to E-commerce
3. Identify the elements to consider before launching into E-commerce
4. Assess the online potential of a venture
5. Discuss the benefits of selling via the internet
6. Outline some of the myths about e-commerce
7. Identify strategies for e-commerce success.

E-commerce is a transaction of buying or selling online. Electronic commerce draws on technologies such as mobile commerce, electronic funds transfer, supply chain management, Internet marketing, online transaction processing, electronic data interchange (EDI), inventory management systems, and automated data collection systems. Modern electronic commerce typically uses the World Wide Web for at least one part of the transaction's life cycle although it may also use other technologies such as e-mail.

E-commerce businesses may employ some or all of the following:

- Online shopping websites for retail sales direct to consumers
- Providing or participating in online marketplaces, which process third-party business-to-consumer or consumer-to-consumer sales
- Business-to-business buying and selling
- Gathering and using demographic data through web contacts and social media
- Business-to-business (B2B) electronic data interchange
- Marketing to prospective and established customers by e-mail or fax (for example, with newsletters)
- Engaging in pretrial for launching new products and services

- Online financial exchanges for currency exchanges or trading purposes

Business application

Some common applications related to electronic commerce are:

- Document automation in supply chain and logistics
- Domestic and international payment systems
- Enterprise content management
- Group buying
- Print on demand
- Automated online assistant
- Newsgroups
- Online shopping and order tracking
- Online banking
- Online office suites
- Shopping cart software
- Teleconferencing
- Electronic tickets
- Social networking
- Instant messaging
- Pretail
- Digital Wallet¹⁷⁰



Assessments

Assessment

1. Identify two business in your community that use e-commerce.
2. Identify the ways in which each of the business mentioned in part a are using e-commerce.
3. Identify one business in your community that is not engaged in e-commerce suggest two ways in which they can begin to use e-commerce in their business.

¹⁷⁰ https://en.wikipedia.org/wiki/Types_of_e-commerce

How Can A Website Benefit Your Business

1. Why should you have a website?

In order to succeed in today's world, you must have an Internet presence. More and more people log on to the internet every day; there are billions of users worldwide, and there are several reasons why one needs a website. A website is a powerful first impression.

Placing your business on the World Wide Web gives your business the potential for global exposure, no matter the size of your business – be it large or small; singular or multi-national. To have your own website gives your invaluable business advantages, which is illustrated in answer to the next question, viz-a-viz:

2. How can a website be useful?

The website helps you leverage web services for streamlining data transfer to and from your organisation.

There are myriad reasons for - How a website can be useful and why you should bring your business online? Some of them are, briefly, mentioned below:

a. Enhanced customer convenience

Your business concern can be more easily and quickly reached, every time a potential or an existing client searches for relevant businesses, products, and services over the Internet. Your customers can always keep in touch with you and your business, just by knowing your website address.

b. Greater reachability of your business profile:

Your business profile can be accessible from anywhere in the world. No other ad medium provides such global coverage. You need not depend on phone book entry or restricted yellow pages and newspaper ad presentations, any longer.

c. Greater possibilities for promoting your business portfolio:

People will not buy your products or services unless they know that they actually exist. You can tell your potential audience much more through a WEBSITE than you could possibly do via any print advertisements, Yellow Pages listings, or TV/radio commercials. There are no limitations as far as space, time, nationality and residency are concerned. You can say as many things as you want, to as many people as you wish. And your business representation can be as resourceful as is the Internet itself.

d. Efficient, low-cost advertising:

Your customers will always be able to obtain thorough, up-to-date information about your services or products. Instead of having to rely on randomly aired TV or radio commercials, they can simply browse through your website whenever they like.

e. 24/7 availability:

The website is available to you 24 hours a day, 7 days a week, 365 days a year. It will be your hardest working employee, never getting sick, or taking a holiday. And you can rest assured that your website is always there for you – to answer your customers' questions or to collect their feedback on your behalf.

f. Time-saving:

Prospective clients can learn about you and your business at any time of the day simply by visiting your website, so you won't have to be present or involved in the process in any way. Your precious time can be saved and invested in other activities that can increase your profits and further enhance the scope of your business.

g. Cost -cutting:

You can save a lot of money cutting your costs on print ads, brochures, coupons, flyers, specials, newsletters or mailings. What is more! It's always quick easy and extremely efficient to update real time information on your website; whereas regular renewals of printed materials turn out to be very expensive and time-consuming. The fact optimized productivity at minimal cost is more valued in any business, and it is possible only through world wide web.

Web services provide a standard way to implement a business function that can also be managed remotely. It employs an effective exchange of information and data feeds between B2B and B2C portals, information warehouses, news providers, shopping portals like e-bay and search engines like Google, MSN, Yahoo, etc.

Your website must work hard in today's competitive online environment — attracting visitors, providing a rich user experience and converting them into loyal customers.

3. What makes a site work successfully?

It is a hotly debated question – “What makes a website work well that will genuinely help your business and attract more customers?”

A well-designed website can certainly lead to increased business. By following simple guidelines, it is possible to create a good-looking website that will really give your business the best chance of being noticed.

For your online presence to really count, your brand needs to exude credibility, confidence, and efficiency through your website. A well-designed website can certainly leverage your business processes. One can achieve this by blending strong design and content, with seamless functionality, and expert support throughout - with time-tested processes.

Web Designing is “a process of conceptualization, planning, modeling, and execution of electronic media delivery via the Internet in the form of Markup language suitable for interpretation by Web browser and display as Graphical user interface” (ref- Wikipedia)

Web Design can have a powerful effect. Web Design is important, and it must be right! The right design kindles in a website visitor the right perception of your business. It engenders confidence and trust in your business. Success online is vital to the overall strength of your business.

It is essential that –

- In an arena saturated with billions of web pages, it requires innovation and expertise, to represent your brand effectively.

- Your site must be easy to navigate and simple to use. If your users and potential customers cannot find what they want, this will undermine your site's performance, in relation to your business goals.
- Your website should clearly and concisely, reflect your business, values, and products since your website is now the first point of contact for a new user or potential customer.
- A good and innovative design ensures that the site is memorable and encourages the viewer to explore beyond the home page.
- The web functionality and programming should use only standard, compliant, valid coding as well as provide an alternative programming, to ensure that your site is viewable in any Browser and at any Screen Resolution.

Most Web design and development companies possess skills in one or the other – rarely both. This is where ImagiNET Ventures web solutions differ, as we understand how to design a website that will most effectively present you, your business or organisation, with your products and services.

4. What are the common mistakes of a website?

Let us face it! If visitors get lost or become confused while attempting to surf your website, they might hit the back button, and look for a more user-friendly website. People do not like to think when it comes to finding their way around websites. Do not make them tick. You need to plan your website from stage to stage and make a difference between a very poor website and a very good website.

Let us now see – what are the pitfalls inherent in designing and setting up a website? You may know some of them already, but by avoiding and correcting them, you can be sure to keep a constant flow of visitors entering and re-entering into your portal! The list of most common errors is unending but invaluable for new designers, web developers and content writers – who need a list for their website spot check.

1. Site best viewed:

New designers usually use this “site best viewed” with a disclaimer statement regarding which web browser or screen resolution they designed their site, for best viewing. It does not impress the visitor. Instead, invest in a skilfully designed website that renders well in multiple browsers, and in any screen resolution.

2. Shabby layout and glaring design:

Some sites are totally unbalanced in their layout and overloaded design. The designs do not match the page content and appear misplaced and misfit in the entire scene. Give your pages a pleasing appearance, with just the necessary facts and place your design outlay with a professional touch. Always take screenshots of designs in different resolutions, before uploading the appropriate one.

3. Horizontal scrolling:

The horizontal scroll makes it extremely difficult to read the content on your site, and often your visitors will lose patience and leave. Check your website in a site resolution viewer. A professional website can be viewed without horizontal scrolling in, both, a smaller and larger screen resolution. User's find scrolling from the top to the bottom of your pages, more clear to view and easy to read.

4. Free Web Hosting:

This is a common web page mistake you definitely need to avoid. Often business owners claim that the business is “just starting,” and that is why they have not yet moved their site to a domain host. Do not use free web hosting if you want your business to be taken seriously. It reflects on your image and credibility.

To resolve this issue, you must choose and purchase a domain name if you, already, do not have one. You also need to choose a professional domain host. There is no getting around this one. If you want to run a successful online business, you absolutely must have a reliable domain host.

5. Appalling Images

Do not allow your visitor view badly shaped or terribly cropped images and missing graphics files. Optimize your images, using the best height

and width. Keep your files in the best formats - jpeg for Photographs and gif for artwork.

6. Blaring and ghastry color schemes:

Avoid using ghastry and loud colours that do not match your website concept and mission. Although your text may be easy to read, overly-bright colours distract and repels the reader away from your site's purpose. Your designs must reflect class and designer quality, with state-of-the-art designs and pleasantly eye-catching color schemes for your web pages.

7. Slow loading:

If your page does not download rapidly, visitors will quickly move on to find another site. Take action now to reduce the "weight" of your pages . Each image on your site must be correctly sized and optimized for web use. Keep your pages clean and fast for the visitor to move on quickly, with interest.

8. Spell check:

Always spell check the text, keeping it free of grammatical error, punctuations, and spelling mistakes. Without spell check, the site looks amateurish and shabby.

9. Ineffective Text Content:

A major mistake is to fill the pages with long text, without any headings and sub-headings. Do not cram your web pages with loaded decorative words and hi-funda text. Readers do not have time to fill their heads with all details.

Make your text more effective. Keep your text simple, crisp and to-the-point. Use decorative words in the right context. Your language should spell clarity, consistency, and coherence in content, style, structure and font. The pages should be easy to read and simple to understand, with a smooth flow. The fonts should be rightly used, with appropriate side-headings and the text need to be phrased in short paragraphs, giving a pleasing feel to the reader.

Your website must provide a clear message with a goal-oriented direction, setting you apart from your competitors. Your content should easily answer his question - “what is in it for me?” The reader must be able to identify with your write-up and find you as his 'partner' for addressing his solutions.

10. Absence of an Email Subscription Form:

This critical aspect is often neglected by most website owners. It is very important to have a lead generation to your website via Email subscription form, for optimal business returns. Having a mailing list gives you several advantages like maintaining a visitors list who allows you to contact them, build a relationship, and establish yourself as an expert for solving their problems.

11. Using a weak message 'join my newsletter':

Your content, design layout and solutions should be so user-friendly such that it compels the reader to subscribe your mailing list. Do not use a weak message like – “join my free newsletter.” The reader would wonder “Why?” and “If I subscribe, will you give me a bonus, or a free gift instantly, as soon as I join?” If your design and text work impresses the reader for availing your services, you would automatically get email subscriptions for membership, from your visitors. It speaks to your credibility.

12. No Contact Information - Just giving your email id and the web address is not sufficient for your readers – who may be prospective clients. Keep your detailed contact information easy to find and easy to read. The inclusion of a sitemap works wonders for your business.

13. *Advertising* – Advertisements provide huge revenue if executed skillfully and with reference to the current times. Appropriate advertisements should be placed - reflecting the different verticals of your business. Do not overload your page with ads, especially the big flashy banners. Well placed, well-designed ads are okay if you do not overload the page.

14. *Prices* – Do not waste your time, hoping you will get email inquiries on your prices. The moment a visitor sees your product or services, his prime question will be “what is the price of this item?” Do not keep the visitor guessing the price; it will give him an opportunity to jump into

another website where the price is mentioned, and you may end up losing a prospective customer. You need to include a price with the item description if you sell something.

15. *Under Construction* - Avoid having a “closed – under construction” or “yet to open” website. Give your visitors at least a single page of content, with a notice - when the whole site will be open.

16. *Music*: Include a soft and soothing music or that which is relevant to the content. Do not include music, if it is not needed. Music should not be out-of-control and keep the control buttons easy-to-use. Music can turn one's mind on but at the same time put your mood off, if it is not rightly timed, controlled and soft.

The list of common mistakes is innumerable. The above general tips give you an idea of what to avoid and how to resolve. By keeping your website design in good shape and ensuring your web content writing is in good taste, you will find more people visiting and enjoying your website!¹⁷¹



Assessments

Assessment

Case Study

You are a small business consultant, Mr. and Mrs. Breads run a small bakery called Tasty Treats. Mr. and Mrs. Breads cannot agree upon whether or not their Outline three reasons why a website would be beneficial to their business.

- A. Outline two benefits that their customers would receive from them having a website.
- B. Discuss two common ways in which a website can be unsuccessful and provide a remedy for each.

The benefits of a website in selling through the internet

Capacity to enhance customer service

¹⁷¹ <http://radarearth.com/content/how-can-website-benefit-your-business-0>

Online stores must describe products for sale with text, photos, and multimedia files, whereas in a physical retail store, the actual product and the manufacturer's packaging will be available for direct inspection (which might involve a test drive, fitting, or other experimentation). Some online stores provide or link to supplemental product information, such as instructions, safety procedures, demonstrations, or manufacturer specifications. Some provide background information, advice, or how-to guides designed to help consumers decide which product to buy. Some stores even allow customers to comment or rate their items. There are also dedicated review sites that host user reviews for different products. Reviews and even some blogs give customers the option of shopping for cheaper purchases from all over the world without having to depend on local retailers. In a conventional retail store, clerks are generally available to answer questions. Some online stores have real-time chat features, but most rely on e-mails or phone calls to handle customer questions. Even if an online store is open 24 hours a day, seven days a week, the customer service team may only be available during regular business hours.¹⁷²

Interactive communication

When somebody buys something online, he or she want to know when it is going to arrive at his or her door. People are impatient, after all. Giving them an estimated delivery date during the checkout process is a good start. Emailing them when their product is dispatched is great. Giving them a tracking number if using a delivery service that supports online tracking is even better. Keep the user informed at every step of the process, before and after the sale, about as much as you can.

How will this improve your conversion rate? Leaving the customer happy once they have made a sale means they are more likely to speak favourably about you later. They may even recommend you to their friends and within online communities. They are also far more likely to buy from you again.

Think about it like this - if a salesman is doing their absolute best to help you, and to make your life easy, and answering your questions, you might buy what they were selling. If they completely ignored you after you'd bought from them, how would you feel about them? They might well have undone all the good work they put in because once you'd completed your purchase, they see no immediate value in you. A company that shows it cares about their customers, even after they've finished shopping, will make a user far happier and far more likely to return.¹⁷³

¹⁷² https://en.wikipedia.org/wiki/Online_shopping CC BY SA

¹⁷³ <https://www.addedbytes.com/articles/online-marketing/ten-ways-to-improve-your-website-conversion-rate/>

Lower cost of doing business; ability to grow faster

One of the best Advantages E-Commerce has to *Overcome Geographical Limitations*. If you have a physical store, you are limited by the geographical area that you can service. With an e-commerce website, the whole world is your playground. Additionally, the advent of m-commerce, i.e., e-commerce on mobile devices, has dissolved every remaining limitation of geography¹⁷⁴.

Track sales results

Many people make the mistake of only tracking small pieces of information. Or tracking everything but only looking at a small part of the data. Data is your friend, and you need to understand what the different metrics available to you are actually measures of if you want to have any clue what effect your work is actually having.

Most important, of course, when looking at the conversion rate, is the volume of sales. Some people only look at that number. But other numbers can tell you about how useful your site is throughout the shopping process.

The percentage of repeat visitors tells you something, about whether you are engaging visitors early in the purchasing process and bringing them back for the sale. A high bounce rate indicates pages that are failing to deliver on their promises. Add to cart rates, cart abandonment rates, login vs. registration vs. abandonment rates, product removal (from cart) rates - all of these will identify areas of your checkout and purchase process that are underperforming, or improving.¹⁷⁵

Ability to spot new business opportunities

It is extremely difficult to predict accurately what changes will have a significant positive effect. So many factors work together, and there are so many differences between users of one site compared to another, that experience can often work against you when you are trying to improve a conversion rate.

Let me take you on a journey through Site A (an online shop I had the pleasure of advising). The owner of Site A had changed his product listing.

¹⁷⁴ <http://cs205sp14.wikidot.com/e-commerce>

¹⁷⁵ <https://www.addedbytes.com/articles/online-marketing/nine-more-ways-to-improve-your-website-conversion-rate/>

He used to have ten items per page, and he increased it to 20. The extra products listed on each page gave the users more choice, but his conversion rate didn't change. Next, he added larger product imagery to the listing - unfortunately this slowed the site down considerably, and his conversion rate went down 10%. Finally, he split his categories up, as they were getting a bit crowded and unwieldy. After this last change, his conversion rate increased back to its original level.

After three rounds of changes, the owner of Site A had the same conversion rate for his site, and viewed the only positive change as the last one, change 3. He attributed it to better organisation of products. And here we have the problem - he was wrong. The positive change was actually change 2.

I am going to run through this slowly, as this is counter-intuitive - after all, how can the change with the measured negative effect actually be positive? The reason the change was actually positive is that these things work together - **they are not independent**.

The first change to Site A was neutral. When the second change was made, 20 extra images per page were being loaded. These images slowed the site to a crawl. When the third change was made, several categories contained fewer products than before - around half of his categories had 10 products or less - and these new, smaller category pages loaded faster. Much faster. These smaller category pages were much faster to load, and the extra imagery did a good job of helping to sell to the users. The increase in sales came from these pages, after the third change, came from these smaller categories.

After change 3, Site A still has the same conversion rate as it did before starting. But once the changes were correctly identified as positive (change 2), negative (change 1) and neutral (change 3), it is a simple matter of reversing the negative. So, the new categories were kept, the images were kept, and the number of items per page was reduced back down to 10. The final result of all of this was a positive change to the conversion rate.

And the moral of the story - it is very easy, in hindsight, to attribute positive and negative effects to changes, but it is extremely difficult to do so accurately and correctly. Examine the effects of changes and, if you can, isolate and test individual effects.¹⁷⁶

¹⁷⁶ <https://www.addedbytes.com/articles/online-marketing/nine-more-ways-to-improve-your-website-conversion-rate/>



Assignments

E-Commerce HuMoR!!¹⁷⁷



Looks Familiar?

ASSIGNMENT QUESTION:

Study the scenario in the picture above, identify three benefits to the customer and three benefits to the seller of what is shown there. (6 marks)

MYTHS ABOUT ECOMMERCE

Ten (10) Widespread Myths about Starting an Online Business

We live in a **digital world**, where the internet, smart devices, and digital tools are widely used. The market, like always, is evolving and rapidly adapting to the newest trends. A lot of entrepreneurs prefer starting an online business rather than an offline one.

There's even a new big niche floating around: "how to **make money online**." It is one of the most popular niches nowadays, along with the weight loss niches. Because there are so many "gurus" that are teaching how one can have online business success, there are lots of myths that new entrepreneurs take as facts and truths.

¹⁷⁷ <http://cs205sp14.wikidot.com/e-commerce>

Online business success is harder than you could probably imagine. Besides the huge effort, one has to make in order to succeed; there are also a thousand variables and setbacks around the way. Good choices and a lot of commitment until the end of the project are essential!

As new online entrepreneurs do not know what to expect, we have gathered a list of ten myth-breakers explanations. You will learn what to do, and what not to do in order to **start your online business** on the right foot. Let's begin.

Myth 1: If You Have a Lot of Passion, You Will Have Success

Being passionate about what you do is always a good thing. It will boost your motivation when you are feeling down, and you'll have an easier time while putting the hard work that's required.

But, there is a huge but: **passion doesn't equal success**. Everyone is passionate, but surely not everyone is driving expensive cars and holds successful online business. The big "gurus" are doing everything they can to make more profits out of you, so they are telling you whatever you want to hear.

When you hear that the road to endless profits is paved by your passion only, understand that you are misguided. Business systems – that is, what makes a business successful. The way you organise it, the tools you use, the strategies you approach, and so on!

Myth 2: You Can Work Full Time and Be an Online Business Entrepreneur in the Meanwhile

Of course, some people can have different side hustles while still working an 8-hour shift every day. But that leaves them what? Maximum of three to four hours to develop their online business. It is possible, yes, but an online business can mean a thousand things. It could be a huge e-commerce store or just a very small affiliate marketing blog.

Especially if you are new, I can assure you that entering the online business world and **doing it successfully** requires a lot of time and hard work. Some successful entrepreneurs work from ten to twelve hours per day, and they complain that they do not have enough time.

If you are just starting out, the best suggestion would be to keep your full-time job and start doing the extra work during your evening hours. When you see the potential, and you are confident that things are going to work out, only then quit your job and go pro.

Myth 3: You Can Start Your Business with a Few Bucks

Have you ever read about the “free methods” of starting a business? If you check out Google results, you’ll find dozens of articles pretending to teach you the right ways of starting a business for free.

Let me tell you from the start: there’s no such thing as a **free online business startup**. There are indeed a lot of online websites building services, free domains, or maybe even free hosting.

The last thing you want to do is to set the foundation of your future business with **low-quality resources**. Usually, free resources are just a small part of what it is required in order to succeed. The best advice would be to save up some dollars and establish a budget for **your business**. Depending on what you want to start, you can find good solutions and go for cheaper (but paid) options.

Myth 4: You Need Investors in Order to Pursue Your Idea

Myths are quite funny, as many times they tend to contradict other myths. As mentioned earlier, you can’t start a serious online business without having an at least decent budget. Well, some people believe that they stand no chance if they do not have proper investors and funds.

While getting investors for your project can prove to be truly beneficial for your future success, you have to be aware that you can do it without having thousands of dollars to invest. There are ways, and so many people start from scratch.

Myth 5: You Can Automate Every Aspect of Your Business

Again, here’s another myth that is widely spread among newbie entrepreneurs. Automation means allowing tools, software, and employees to run your online business on autopilot. It is everyone’s dream to be a “boss” and has passive income while just sitting and doing nothing.

Well, in reality, it is nothing like that. Entrepreneurs that start their business from nothing will always still have work to do. They must make decisions, take care of important aspects that no employee or software can, and be present for the important events.

Myth 6: You Must Take Care of Every Aspect of Your Business

You **do not** have to do everything alone. Most of the successful entrepreneurs realize that their time is extremely important. In order to learn all of the required skills, they choose to outsource what they do not know what to do.

For example, every online business needs content. Also, most of the businesses rely on websites to perform their activity. In **case** you do not know the technicalities of building good-looking websites, you can choose to go for a **website building service**.

If you are bad with words, definitely go for a **writing service** that provides well-written content with good research. Outsourcing is awesome because it allows you to **focus your time** on aspects that only you can deal with.

Myth 7: Being an Online Entrepreneur Equals Non-Stop Travelling

Even though this dream life possibility is widely spread among online entrepreneur communities; however, things are not so simple. Indeed, there are a lot of successful entrepreneurs that are living that life, but out of 100, maybe 5 are actually doing it.

You have to understand that in order to leave everything behind and start travelling, your online business needs to be extremely stable, and you have to outsource human resources and professional software. You need a great business stability and responsible employees that can deal with everything.

If you create **your business** from scratch, you'll be the only person who will understand and be aware of the ins and outs of the entire operation. More than often, it is hard to leave and make someone else responsible for everything.

Myth 8: Social Media Promotion is Cheap and Easy

You may have heard people saying that social media is a great way to promote **your business**. That, in fact, is a true statement. What crosses the boundaries of truth is the fact that getting targeted traffic through social media is **extremely cheap** and easy.

Nope, it is not easy. In fact, in order to organise a successful social media campaign, you have to go through a lot of testing and **optimizing**. You **will** lose money, and it **won't** be easy. When you start your online business journey, you got to have the right expectations.

Myth 9: You Can Work Whenever You Want

Most of the times, you can work on your online business from your own place, from office, or from a beautiful beach. The only things you need are an internet connection, a device, and **time**. Many new entrepreneurs are fooled and live with the illusion that they can work **whenever they want**.

Even though it is possible to work whenever you feel like, you must understand that developing a successful business takes away 99% of your effort and time. Maybe you think this is bull, but just take a look at what other established entrepreneurs are saying.

Taking advice from people who can show results is one thing, and taking the word of "online gurus" that **only** teach people how

to **make money online** is another thing. Be careful whom you listen to; they might prove to be frauds.

Myth 10: Online Business Success is Easier than the Offline One

You can often start an online business with less financial resources than it would otherwise be required for starting an offline one. Everything happens on the web, and you will only have to deal with online tools and communication.

When I first got into internet marketing (or the online business activity), everyone promised me an overnight success. E-books, webinars, articles, and so many other resources claim that they hold the formula to quick success. I soon found out that that's a big lie meant to make me spend more money on **training material**.

STRATEGIES FOR E-COMMERCE SUCCESS

Six (6) essential qualities for a successful eCommerce website

For any business or activity success results from a complex interplay of factors. Similarly, **eCommerce websites' success** depends on many aspects. Setting apart the financial, logistic, and industrial ones, the **eCommerce digital marketing strategy** is crucial since it is the main instrument to promote services and market products online.

E-commerce marketing lies on 6 main elements:

- Real and perceived value in relation to sale price;
- Website usability;
- Pleasant navigation and entertainment;
- Security and trust;
- Social media influence;
- Online marketing strategies.

1. Real and perceived value in relation to sale price

Otherwise than in the physical world, in internet comparing products features and prices is easy, immediate and zero cost: just a few click of a mouse. In order to be competitive, it is needed to shrink profit margins and, at the same time, communicate efficaciously the own added value and the advantages compared to other competitors. Meanwhile, it is necessary to work on the identification of the right target consumers through online analysis and marketing after setting a clear goal: bringing to the website leads and prospects.

2. Website usability

Online shops remove human mediation from the purchasing process; for this reason, it is paramount that it works perfectly and be easy to do. Purchase funnel, from products adding to cart to final payment, have to be short and require the minimum work. A good eCommerce website conforms to web usability guidelines and is accessible to everybody. It should be accessible to any type of device included smartphones and tablets (mobile website version).

3. Pleasant navigation and entertainment

A perfectly functional website may be highly inadequate in aesthetic, ergonomic and communicational terms. If the user experience is not pleasant and engaging - finally sales are limited. The buying experience always has an emotional side that an eCommerce shop needs to include during the website planning and in the marketing strategies. Graphic and design should be likable, information clear, contents interesting and, why not, entertaining.

4. Security and trust

In all E-Commerce surveys and investigations, the customer's perception of the buying process arises as a critical factor to increase online sales. A digital shop must reassure users by means of all possible signals. Security and trust are key concepts. Users have to be able to contact the merchant by phone, email and possibly live chat. It is very important to offer transparency of shipping and delivery times, customer's refund and return rights. Guarantee security of payments is clearly showing methods and possibly credit card logos. All details contribute to foster the conversion of visitors into clients/customers.

5. Social media influence

In our real life our purchases are influenced by opinions and suggestions coming from people we know, likewise, on the internet, many sales occur only after reading recommendations and comments made by friends or unknown customers. An E-Commerce website that integrates social networks and their sharing functions have certainly more chances to be successful. Similarly, conversion rate improves when a system to publish users opinions and reviews is added to the products pages.

6. Digital marketing strategies

The previous five points somehow are all different aspects of an articulated E-Commerce marketing strategy and should always be included in the digital marketing services provided to companies. Considerately, they are the backbone of the E-Commerce marketing from which to develop

specific tactics to promote the online shop. The amount of these tactics is endless; nonetheless, a good plan should strive to coordinate them all to make E-Commerce online marketing more effective.



Figure 23 Some of the most popular sites that USE E-Commerce are shown above.¹⁷⁸



Assignments

ASSIGNMENT QUESTION:

Select any **three sites** from EACH category (International sites, Online Marketplace and B2C/Specialty stores). For each site, indicate two types of products that are offered for sale. (9 marks)

E-commerce online marketing

Without pretending to be exhaustive, a compendium of relevant eCommerce marketing strategies should include:

Competitors analysis and prices benchmark;
Website design and user experience improvement;

- SEM – Search Engine Marketing;
- SEO (Search Engine Optimization) and SMO (Social Media Optimization);
- SEA (Search Engine Advertising) and Social Network Advertising;
- Remarketing and Retargeting;

¹⁷⁸ <http://cs205sp14.wikidot.com/e-commerce>

- Email marketing;
- Social Media Marketing;
- Conversational and Viral Marketing;
- Social media integration into the E-Commerce website;
- Social login implementation;
- Content Marketing;
- Affiliate marketing;
- Marketplaces sales;
- Digital marketing across price comparison websites;
- Data mining and analysis.

In other website's sections it is possible to examine more in depth different types of online marketing; here we confine ourselves to list **27 advises very useful to increase e-Commerce sales**.

1. Create the E-Commerce website planning from the beginning at least part of the digital marketing strategy. Reflecting on marketing at this stage allows to better define features and functions that online shop is going to need.
2. Start search engine optimisation at the beginning of the E-Commerce platform development.
3. Strive to specialise: big online shops are run by huge commercial entities.
4. Develop some unique product/service capable of giving popularity to you on the market. Promote it across all web channels.
5. Reduce profit margins of products in highly competitive markets: prices are a critical factor according to all E-Commerce studies.
 1. Comply with delivery times especially in the case of international E-Commerce: making mistakes on this issue decrease significantly customers retention.
6. .
7. Allocate an adequate budget on SEO. All leads coming from organic search means money saved from different advertising investments.
8. Aim at the "long tail." Most of the website's visits coming from organic searches are made of a variety of keywords and key phrases of low occurrence.
9. There is not only Google. Leverage all search engines.

10. Use social networks to promote your brand and take advantage of word of mouth.
11. Be aware of your target, find out what it is told about you, monitor market sentiment and analyse your online reputation.
12. Launch a blog and produce valuable contents. All traffic generated by blog marketing reinforce brand reputation and impact positively on the E-Commerce shop.
13. Take care of product sheets and use high-quality photos.
14. Take on the challenge of product reviews: they boost sales and improve ranking on search engines.
15. Incentivise first purchase with a gift or enticing discount.
16. Leverage discounts coupons and promotions to increase transactions.
17. Prepare bundles and gift packages, exploit cross and up selling to raise the average order value (AOV).
18. Push on email marketing which usually results in high conversion rates.
19. Incentivise in all ways newsletter sign-ups.
20. Chase users and customers with remarketing and retargeting campaigns.
21. Do not forget incentives for the purchase like scarcity and sense of urgency.
22. Facilitate impulse buying.
23. Exploit dynamic pricing technique. Products price is a critical aspect of online shopping. There are soft-wares that monitor prices on different E-Commerce websites allowing an excellent benchmarking service in real time. The year Amazon has implemented this system profits raised a 27,2%. At Amazon, online shop prices change every 10 minutes.
24. Invest in Internet advertising and PPC campaigns knowing that each advertisement exposes your brand to a large audience; it is not just a strategy to generate leads.
25. Diminish as much as possible web pages loading time: it can make the difference.

26. Rely on website's traffic statistics, analyse users' behavior and draw information to optimise digital marketing strategies.

27. Be opened to innovations, year by year internet gives birth to new marketing tools. E-commerce websites must be the quickest to integrate them into their online strategy¹⁷⁹.

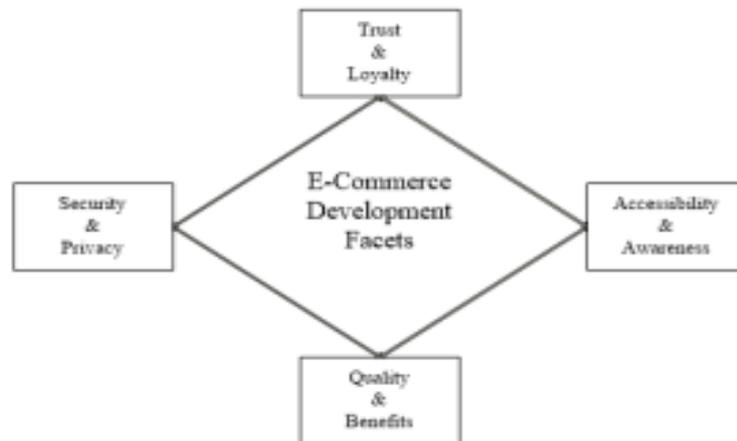


Figure 24 ¹⁸⁰



Assignments

ASSIGNMENT QUESTION:

Your local business has been doing well. However, you wish to expand your market. A business consultant suggests that you create a website to assist in boosting sales for your goods. Using the subheadings from the diagram above to create a blueprint for your website, discuss (in no less than 1200 words) the impact of those issues and describe how you will ensure that those e-commerce development facets are addressed in the creation of your website. (40 marks)



Assessments

¹⁷⁹ <http://www.outofseo.com/ecommerce-marketing-strategies-online-shop-services/>

¹⁸⁰ <http://researchleap.com/factors-influencing-e-commerce-development-implications-for-the-developing-countries/>

E-commerce websites must be the quickest to integrate them into their online strategy.¹⁸¹

Assessment

One the line provided write true if the answer is true or false if the answer is false.

1. One of the main elements of e-commerce marketing is website usability. _____
2. The poor user experience on an e-commerce website can reduce e-commerce sales. _____
3. Two e-commerce marketing strategies are search engine marketing and social media marketing. _____
4. One way to increase sale is to use Google as the only search engine because of its popularity. _____
5. The use of high-quality photos on an e-commerce website can be used to boost sales. _____

Answers all are true except number four.



Summary

Lesson Summary

In order to be successful online, you have to be **very knowledgeable** in your topic, **constantly informed**, and ultimately, you must **work** hard and smart. If you are not fine with putting up the necessary hours, you are doomed to fail. Treat your future business seriously and expect to walk a long journey until you actually taste the success you want.

Always analyze the information that you are receiving. There are a lot of myths circulating around the web, and you must be very careful with what you choose to believe. Starting an online business is not as easy as it seems, and most of the myth-breakers ideas presented today can clarify the issues and expectations you might be having.¹⁸²

¹⁸¹ <http://www.outofseo.com/ecommerce-marketing-strategies-online-shop-services/>

¹⁸² <http://technofaq.org/posts/2016/10/10-widespread-myths-about-starting-an-online-business/> CC BY SA

