Kampala International University
Uganda

BACHELOR OF GUIDANCE AND COUNSELING

MODULE 5

ENTREPRENEURSHIP

By

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Unit 1
Introduction to Entrepreneurship
1.1 Introduction

The word entrepreneur has been derived from a French word entrepredre which means to undertake

As a concept entrepreneurship has evolved for more than two centuries in the early classical economic theory days the concept was a shady one by the following diseases as perfect competition was the norm of the day the entrepreneur was though of either general manager it was in recent year that entrepreneurship has been openly recognized world one.

The concept of entrepreneurship from a personal perspective has been explored in this century. This exploration is reflected in the following three definitions of an entrepreneur:
In almost all definitions of entrepreneurship, there is agreement that we are talking about a kind of behavior that includes:

- Initiative taking.
- The organizing and reorganizing or social/economic mechanisms to turn resources and situations to practical account.
- The acceptance of risk or failure.

To an economist, an entrepreneur is one who brings resources, labor, materials, and other assets into combinations that make their value greater than before, and one who introduces changes, innovations, and a new order.
To a psychologist, such a person is typically driven by certain forces- the need to obtain something, to experiment, to accomplish or perhaps to escape the authority of others.

Entrepreneurship is the dynamic process of creating incremental wealth. Our definition of entrepreneurship involves four aspects:

- Entrepreneurship involves the creation process.
- It requires the devotion of the necessary time and effort.
- It involves assuming the necessary risks.
- The rewards of being an entrepreneur are independence, personal satisfaction, and monetary reward.

For the person who actually starts his or her own business there is a high failure rate due to poor sales, intense competition, lack of capital or lack of managerial ability.

AH Cole; defines entrepreneurship as a purposeful activity of an individual or group of association individuals, undertaken to initiate maintain organize profit by production or distribution of economic goods and services.

Diamond; defines entrepreneurship as an enterprise which involves the willingness to assure risks undertaking an economic a activity particularly a new one. It works risk taking and decision making

This definition uses entrepreneurships to refer to qualities required to innovate, stat a new venture, accept and bear risk.

Higgins; defines entrepreneurship as a function of seeking investment production opportunity organizing one enterprise to undertake new production process, introducing new techniques in order to support manager in the days operations of an enterprise

Entrepreneurship

Entrepreneurship refers to entrepreneurship within an existing organization or business structure.

Entrepreneurship can also bridge the gap between science and the marketplace.

Existing businesses have the financial resources, business skills, and marketing and distribution system to commercialize innovation successfully. Often the bureaucratic structure, emphasis on short-term profits, and structured organization inhibit creativity. Some corporations have tried to establish an Entrepreneurial spirit in their organization, some in the form of strategic business units (SBUs.)

Entrepreneurship

The third method for bridging the gap between the science and the marketplace is via entrepreneurship.

Many entrepreneurs have difficult time bridging this gap and creating new ventures. They may often lack managerial skills, marketing capabilities, or financial resources. They frequently do not know how to interface with banks, suppliers, customers, and distributors. Yet, entrepreneurship is the most effective method for bridging the gap and creating new enterprises, these activities affect an areas economy by building the economic base and providing jobs.

Entrepreneurial culture

This implies to a set values, norms and traits that are conducive to the growth or entrepreneurship.

Many people tend to confuse entrepreneurial culture with administrative culture

Where as administrative culture focuses on existing opportunities, organization structures and control procedures. What resources to control? Etc. entrepreneurial culture looks to where does the opportunity exist, what resources are needed etc.

Entrepreneurial structures

Good polices, practice and measurement make possible innovation and entrepreneurship they create proper attitudes and provide proper tools and this enable people with to the structure to innovate

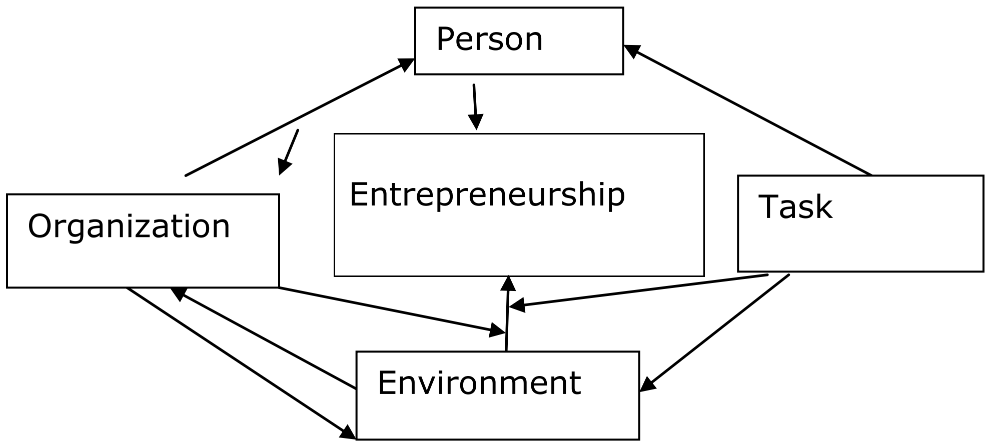
Entrepreneurial structure should all people to be entrepreneurial and these structures reflect/ required that,

- New venture should be separated from old and existing ones
- New special law for new ventures within the organization
- New innovations require different policies, rules and evaluation criteria
- A specific person/ group should be held accountable forth means or failure of the innovations.

1.2 Entrepreneurial Theories

There are several definition of entrepreneurship and such creates obstacles in understanding the whole concept because personal opinion or undertaking of entrepreneurial is at play entrepreneurs are seen as new cultural heroes ignoring a critical evaluation of their characteristics, the whole concept is an obstacle, though entrepreneur are tangible persons, few studies and research on entrepreneurship are untaken and lastly entrepreneurship is seen as something opposed from management hence making its depuration difficulty. However, Kao has developed a model of entrepreneurship as explained below;

A conceptual mode of entrepreneurship



Key players

Entrepreneurship
People
The task
The organization
The environment
Analyzing the above model reflects that;
The person; personality, skills, experience, motives, and psychological preference
The task; perceiving opportunity, marshalling resources, providing leadership
The environment; available of resources, infrastructures, competitive pressures state of technology etc.
The organization structures, rules, policies culture, human resources system communication systems. Etc.
Therefore, conceptualizing entrepreneurship will further be explained and enhanced by various theories as explained below;
Joseph Schumpeter did the pioneering work. On entrepreneurship according to him entrepreneurship is essentially a creative activity consisting things done in the ordinary course of business.

According to him an entrepreneur is one who innovates, carries out new combinations or enterprise and innovation involves problem solving so an entrepreneur is a problem solver.

Innovation may arise as a result of introducing of a new product, new method of production, new market, and new source of supply or new organization.

Schumpeter stressed the role of entrepreneurial function in economic development because development required basic changes and entrepreneurs carry out these changes.

Theoretical origin of entrepreneurship

As a concept and theory entrepreneurship ahs evolved over a period of two countries and there are different opinions on the emergence of entrepreneurship these opinions are in three categories as;
The economic view
The sociologists view
The psychologists view

The economists view

According the economists entrepreneurship and economic growth will take place in situations where economic conditions are most favorable the main proponents of this theory are GF Papanek and TR Hams, and they achieve that economic incentives are the main drive for the entrepreneurial activity, therefore the countries are regarded as the sufficient conditions for the emergence of industrial entrepreneurship

According to them individuals will realize that a market of a product is out of equilibrium he purchases or produces at the prevailing price and sell to those who are prepared to pay a higher price.

According to them various kinds of market imperfections and insufficient economic policies hinder entrepreneurial growth or entrepreneurship.

Sociologist view

These agree that entrepreneurship will emerge under a specific social culture to them social sanctions cultural values and role expectations are responsible for the emergence of entrepreneurships.

According to Cochran, an entrepreneur reflects the societies personality model, his attitudes and performance reflect variables in society like his occupation expectations and all these social values are the most determinants of attitudes and role expectations.

According to Hoselik, culturally marginal group promotes entrepreneurship and economic development; such groups create adjustments and thereby develop innovations.

According to stokes, social cultural values channel economic action, he suggests that personal and society opportunity and presence f the requisite psychological distributions may be seen as conditions for an individuals movement into industrial entrepreneurship.

Psychologists view

Proponents of this view believe that if a society ahs a sufficient supply of individuals possessing particular psychological characteristics then its entrepreneurial activities will be high. Schumpeter believes these are primary motivated by an atavistic will to power, will to found a private kingdom, and are characterized by, institutional capacity to see things in a correct way will and mind to overcome fixed habits of thought and capacity to withstand social opposition.

According to McClelland, it's the high need for achievement which drives people towards economic activities.

Therefore, each of the above theories is incomplete and as is right or wrong or cannot fully described the entrepreneurship, combinations of friction economic psychological and other general futures.

1.3 Characteristics of entrepreneurship

The major characteristics of entrepreneurship are;

- **Innovation;** Schumpeter contends that entrepreneurship s creative activities in which entrepreneurs introduce new things in the economy. Innovation may be a method of production or may involve problem solving and the entrepreneur focuses opportunity and undertakes it.
- **A function of high achievement;** McClelland looks at entrepreneurship on the basis of doing things in a better way and decision making ability and views the need for achievement as the most direct explanation of economic behavior whereby the need to achieve drives and motivates individuals to certain activities.
- **A function of group level pattern;** clusters or groups defines and decide certain course of action that are in them entrepreneurial and according to young societies change due to reactive sub groups these sub groups read because;
    - They experience low skills
    - Are derived accesses to important social networks
    - When a group has better institutional resources than other groups

- **Organizational building function**; According to Hobson organization from out of peoples initiative especially the organization builder who looks for new ideas and applies them in organization settings he focuses more on managerial skills and creativity.
- **A function of social political and economic structure**

Entrepreneur's characteristic/traits

According to McClelland is his book achieving society entrepreneurs are characterized by;

- An unusual creativeness
- A propensity of risk lacking
- A strong need for achievement

However, many other researchers reveal various characteristics viz

- Derive to achieve and growth
- Low need for structures and power
- Internal loan control
- Opportunity and goal, occupation
- Taking initiative of personal responsibility
- Integrity and reliability
- Realism and sense of humor
- Total commitment and determination

Personal characteristics

- Creativity and innovation
- Need for achievement
- Tolerance for ambiguity
- Risk for propensity
- Action orientation
- Need for independence and autonomy
- Self belief and internal locus of control
- Persistence, determination
- Flexibility, experimentation and improvisation
- Opportunity orientation
- Motivation and a positive attitude
- High level of energy and capacity for hard work

Characteristics of an entrepreneur as a business founder;

- Niche-craft/making segments
- Networking coalition building
- Teamwork
- Customer orientation
- Organization building
- Opportunity orientation

Review Questions

1. Define the term entrepreneurship?
2. Explain the characteristics of entrepreneurs
3. Discuss the theories of entrepreneurship
4. Describe the main stages in the entrepreneurial process

Unit 2
Classification of Entrepreneurs
2.1 Introduction
Like any processes, initially in the stages of economic development, entrepreneurs usually are surrounded by less initiative and drive, however as development proceeds, they become more interested, innovating and entosiatic, therefore, in relation to the active/inactive role, and the entrepreneur has been classified in the following categories.

- **Innovative entrepreneurs;** these are characterized by high level of agreement approach to undertaking issues and collection information. The ability to mobilize factors of production after seeing an opportunity is no long.
- **Adoptive and initiative entrepreneurs;** these are always ready to adopt successful innovation created by the innovation entrepreneur, they are good at initiating issues like technology and are particularly important in developing countries, these entrepreneurs help in transforming the systems with limited resources these will move of organizations of factors of production than p0lay creation they are so important because they set into motion the claim reaction.
- **Fabian entrepreneurs;** these are entrepreneurs who desire to innovate or adopt is low usually undertake all their dealings with reference to authority religion, tradition past practice.
- **Drone entrepreneurs;** these entrepreneurs have a very low attitude towards changes, they are commotional and strict to commotional means of production, if they suffer losses or their business become weak and they usually pushed out the market.

2.2 Entrepreneurs and Managers

An entrepreneur is different from a manager and the main points of difference between the two may be described as below;

- Innovation
- Risk taking
- Reward
- Skills
- Status
- Response to authority

The difference between the entrepreneurial and managerial styles involves five business dimensions.

Strategic Orientation
The entrepreneur's strategic orientation depends on his or her perception of the opportunity. This orientation is most important when other opportunities have diminishing returns accompanied by rapid changes in technology, consumer economies, social values or political rules. When the use of planning systems is the strategic orientation, there is more pressure for the administrative domain to be operant.

Commitment to Opportunity
The **entrepreneurial domain** is pressured by the need for action and has a short time span in terms of opportunity commitment. The **administrative domain (***the ways mangers make decisions***)** is not only slow to act on an opportunity, but the commitment is usually for a longer time span.

Commitment of Resources
An entrepreneur is used to having resources committed at periodic intervals, often based on certain tasks or objectives being reached. In acquiring these resources the entrepreneur is forced to achieve significant milestones using very few resources. In the administrative domain, the commitment of resources is for the total amount needed. Administrative-oriented individuals receive personal rewards by effectively administering the resources under their control.

Control of Resources
The administrator is rewarded by effective resource administration and has a drive to own or accumulate as many resources as possible. The entrepreneur, under pressure of limited resources, strives to rent resources on an as-needed basis.

Managerial Structure
In the administrative domain, the organizational structure is formalized and hierarchical in nature.
The entrepreneur employs a flat organizational structure with informal networks

2.3 Functions of an Entrepreneur

Kilby indentified thirteen functions of an entrepreneur, which included some of the managerial functions also.

- These functions are as follows;

- Perceiving market opportunities
- Gaining command over scarce resources
- Purchasing inputs
- Marketing of the products and responding to competition
- Dealing with the public bureaucracy concessions, licenses and taxes
- Managing cu8stomer and supplier relations
- Managing human relations with in the firm
- Managing finance
- Managing production
- Acquiring and overseeing assembly of the factory
- Industrial engineering
- Upgrading process and product quality
- Introducing new production techniques and products.

Kirby suggested that these functions may vary according to the size, type and setting of an enterprise and could be augmented through training and education;

- Innovation
- Risk taking
- Organization building

2.4 Entrepreneurs Verses Intrapreneurs.

Intrapreneurs

An intra-preneur could be someone who leads a new project within the company, like the launch of a new product. This would have similaries to a launching a new company based around a single product because they'd still have to manage a team, look at a new market, and generally wear may hats.

An intra-preneur could also mean an engineer who thinks about the business in a broader sense. Most engineers are 100% focused on the technical work that consumes their time, but if an engineer was also involved in, say….bringing in new clients for the company, and making sales….he or she would be thinking like an entrepreneur.
Having an intra-prenurial mindset within a company is great, and I'm sure it would help you in your job. But there is one major problem with being an intra-preneur:

Entrepreneurs
Entrepreneurship is an attribute which makes a person a pioneer, a visionary who has a dream and strives to fulfill that dream despite all obstacles and hurdles. In all times, what an entrepreneur believes in has been ridiculed as impossible but he has proved his critics wrong as he takes mistakes and failures in his stride and learns from his failures as a stepping stone to success. It is his belief in his conviction that despite limited resources, he makes it possible and also makes others follow his design or product.

Entrepreneurship is a rare quality that has been behind all the development and inventions in human civilization. It must have been an entrepreneur who found the presence of wires in communication an obstacle that must be removed at all costs, and finally succeeded in inventing a mobile phone. Otherwise, we would have been relying on wired telephones today. The same can be said about all the modern gadgets that were inconceivable only a few decades ago.

Technically speaking, what an entrepreneur does should be entrepreneurship

But entrepreneur word has got diluted with passage of time and all business owners and those starting a venture on their own are simply called entrepreneurs.

Entrepreneurship is a rare attribute of having the ability to look at the future and grab opportunities when there exist none for common people and implement new ideas and innovations.

In today’s time, all entrepreneurs may not possess entrepreneurship.

2.5 Barriers to Entrepreneurship

- Lack of a viable concept
- Lack of market knowledge
- Lack of technical skills
- Lack of used capital
- Lack of business know how
- Complacency-lack of motivation
- Social stigma
- Time pressure and distractions
- Monopoly and protectionism
- Intubations due to patents

2.6 Environmental Factor Affecting Entrepreneurship

A complex combination of financial cultural personality and institutional factors determines the nature and degree of entrepreneur activity at any time.

Many environmental factors determine and affect the entrepreneurial spirit among people and in turn entrepreneurs create an impact on the environment this interaction between the entrepreneur and the environment is an on going one.

Due to the fragile and dynamic nature of the external environment sudden changes do take place and this affects organizations in very many ways and this may affect or hinder entrepreneurial activity, therefore some of the environmental factors which hinder entrepreneurial growth are;

- Sudden changes in government policy
- Non-cooperative attitude of banks and financial institutions
- Unfavorable market fluctuation
- Rise in the cost inputs
- Ideological and social conflicts
- Sudden political upsurge conflict
- Excessive retape

Review Questions

1. Explain in belief the factors that affect the growth of entrepreneurship
2. Describe the barriers entrepreneurship
3. Distinguish between entrepreneurs Verses Intrapreneurs
4. Explain the classification of entrepreneurs

Unit 3
Entrepreneurial Process and Business Start up

3.1 Introduction

Many individuals have difficulty bringing their ideas to the market and creating new venture. Yet entrepreneurship and the actual entrepreneurial decisions have resulted in several million new businesses being started throughout the world. Although no one knows the exact number in the United States.

Indeed, millions of ventures are formed despite recession, inflation, high interest rates, and lack of infrastructure, economic uncertainty and the high probability of failure

The entrepreneurial decision process entails a movement *from* something *to* something— a movement from a present life style to forming a new enterprise.

To leave a present live-style to create something new comes from a negative force--disruption. Many companies are formed by people who have retired, moved, or been fired. Another cause of disruption is completing an educational degree.

The decision to start a new company occurs when an individual perceives that forming a new enterprise is both desirable and possible.

Entrepreneurial Process

The **entrepreneurial process** involves finding, evaluating, and developing an opportunity by overcoming the strong forces that resist the creation of something new.

Phase 1: Identifying and Evaluating the Opportunity

Most good business opportunities result from an entrepreneur being alert to possibilities. Some sources are often fruitful, including consumers and business associates. Channel members of the distribution system-retailers, wholesalers or manufacturer's reps-are also helpful. Technically-oriented individuals often identify business opportunities when working on other projects. Each opportunity must be carefully screened and evaluated-this is the most critical element of the entrepreneurial process.

- The evaluation process involves looking at
- The creation and length of the opportunity
- Its real and perceived value

- Its risks and return.
- It's fit with the skills and goals of the entrepreneur
- Its differential advantage in its competitive environment

It is important to understand the cause of the opportunity, as the resulting opportunity may have a different market size and time dimension. The market size and the length of the **window of opportunity** are the primarily bases for determining risks and rewards. The risks reflect the market, competition, technology, and amount of capital involved. The amount of capital forms the basis for the return and rewards. The return and reward of the present opportunity needs to be viewed in light of any possible subsequent opportunities as well. The opportunity must fit the personal skills and goals of the entrepreneur. The entrepreneur must be able to put forth the necessary time and effort required for the venture to succeed. One must believe in the opportunity enough to make the necessary sacrifices.

Opportunity analysis, or an opportunity assessment plan, should focus on the opportunity and provide the basis to make the decision, including:

- A description of the product or service
- An assessment of the opportunity
- Assessment of the entrepreneur and the team
- Specifications of all the activities and resources needed
- The source of capital to finance the initial venture

The most difficult aspect of opportunity analysis is the assessment of the opportunity.

Phase 2: Develop a Business Plan

A good **business plan** must be developed in order to exploit the opportunity defined. A good business plan is important in developing the opportunity and in determining the resources required, obtaining those resources and successfully managing the venture.

Phase 3: Determine the Resources Required.

Assessing the resources needed starts with an appraisal of the entrepreneur's present resources. Any resources that are critical must be distinguished from those that are just helpful. Care must be taken not to underestimate the amount and variety of resources needed. Acquiring needed resources, while giving up as little control as possible, is difficult. The entrepreneur should try to maintain as large an ownership position as possible, particularly in the start-up stage. As the business develops, more funds will probably be needed, requiring more ownership be relinquished.

Alternative resource suppliers should be identified, along with their needs and desires, in order to structure a deal with the lowest cost and loss of control.

Phase 4: Manage the Enterprise.
The entrepreneur must employ these resources through implementation of the business plan. This involves implementing a management structure, as well as identifying a control system.

Key Terms

Breakthrough innovations
A new product with some technological change

Business ethics
The study of behavior and morals in a business situation

Desirability of new venture formation
Aspects of a situation that make it desirable to start a new company.

Entrepreneur
Individual who takes risks and starts something new

Entrepreneur as an innovator
An individual developing something unique

Entrepreneurial decision process
Deciding to become an entrepreneur by leaving present activity

Entrepreneurship
Process of creating something new and assuming the risks and rewards

Desirability of New Venture Formation
(Aspects of a situation that make it desirable to start a new company)
The perception that starting a new company is desirable results from an individual's culture, subculture, family, teachers and peers.
American culture places a high value on being your own boss, being a success and making money therefore, it is not surprising to find a high rate of company formation in the United States. On the other hand in some countries making money is not as valued and failure may be a disgrace. The rate of business formation in these countries is not as high. Many subcultures that shape value systems operate within a cultural framework.

Studies indicate that a high percentage of founders of companies had fathers and/or mothers who valued independence. Encouragement to form a company is also gained from teachers, who can significantly influence individuals. An area having a strong educational base is also a requirement for entrepreneurial activity. Peers are important, also, as is an area with an entrepreneurial pool and peer-meeting place.

Possibility of New Venture Formation
(Factors making it possible to create a new venture)

Although the desire of new venture formation derived from the individual's culture, subculture, family, teachers and peers needs to be present before any action is taken, the second feature necessary centers around this question "What makes it possible to form a new company?"

Formal education and previous business experience give a potential entrepreneur the skills needed to form and manage a new enterprise. Although educational systems are important in providing the needed business knowledge, individual will tend to be more successful in forming in fields in which they have worked. The government also contributes by providing the infrastructure to help a new venture.

The market must be large enough and the entrepreneur must have the marketing know-how to put
together the entire package.

Finally, financial resources must be readily available. Although most start-up money comes from personal savings, credit, and friends, but there is often a need for additional capital. Risk-capital availability plays an essential role in the development and growth of entrepreneurial activity.

3.2 Business Start Up

Entrepreneurs start up new business to counter or fulfill their dreams, this of course happens in a multi face environment.

Business start up takes a number of steps, these are;

Products selection

Entrepreneurs' selection of product in business start up depends on the capacity and motivation, usually innovative entrepreneurs design new products and or, institute existing products and improve them.

Economically the selection product should viable, and this is dependent up on

- Degree of substitution of an existing product
- Degree of import substitution
- Volume of potential demand
- Volume of aggregate existing demand in all products
- Demand in the foreign market
- Demand by big units of ancillary products
- Demand in domestic market

Forms for ownership decision
These are majority

- Sole proprietorship
- Family ownership

There are two help in having a unified control over the business

- Partnership
- Private limited company

These usually seek to facilitate the pooling of financial resources, technical skills, business and managerial experience.

Site selection

Selection of site of operation is an important quest for the whole business start up processes, because the site has a lot of implications to the consumer marketing and competition, usually in his effort the entrepreneur has the following options;

- Opt for space/land in an industrial area
- Opt to operate an established factor as a unit
- Develop privately

In site election the entrepreneur should guided by the following functions

- Economies of scale
- Accessibility
- Services available (water, electricity, security)
- Source of labor supply
- Source of raw materials
- Infrastructure (roads)

Capital structure development
The entrepreneur has to ascertain the capital structure up on what he is going tubas all the business operation, the sources of new venture capital is;

- Own funds
- Family and funds loans
- Financial assistance from banks and lending institutions

However, capital for business development has a lot of challenges and not easy to get it's usually affected by factors like

- Banks demanding collateral
- High interest rates
- Integrity issues

Partnership

This is an agreement between persons who agree to form a business together then share profit and losses as well as responsibilities, these people who form such business re referred to as "partner" hence the name partnership.

Partnership as a form of business organization is characterized by; having two or more people form of written or oral agreement, governed by law sharing of profits, mutual relationship among partners, and restructure on transfer of interest

Partnership has been following advantages.

- Easy to form
- Larger financial resources
- Advanced human and public relations
- High financial capacity

Selection of type of business organization

Business form especially as regards ownership is important therefore the entrepreneur must decide easy enough especially in regard to what type of ownership the new business will take. Ownership of business therefore determines the risk responsibility and control the entrepreneur has as well as profit, therefore the right some of ownership helps ensure sustainable business growth majority the ownership of business takes the following forms;

Sole proprietorship

This is a form of business organization that is owned and controlled by a single individual, he receives all the profits and bares all the risks, therefore he has unlimited liability and un-divided risk

This form of business organization has the following advantages

- Flexibility in business operations
- Less bureaucracy and free from government control

- High level of business secrecy
- Quick decision making
- Independent control
- High level of direct motivation
- Easy to form

Disadvantages
- Limited funds since there is a single source
- Lack of specialization
- Unlimited liability brings very high risks
- High level of business life uncertainty.

Partnership firm
This is business relationship between two or more persons who agree to share profit or losses of an organization or company, though joint lawful business and are commonly known individually called "partners" or generally as affirm

Characteristics
- Two or more persons
- Written agreement
- Sharing profits/losses and
- Unlimited liability

Formation and management of a partnership firm
Formed through an agreement. Called partnership deed, is signed by all partners the partnership deed contains
- Name of the firm
- Address and name of partners
- Nature of business
- Data of agreement
- Capital issues etc

Advantages
- Large financial base
- Specialization and balanced approach
- Easy to form
- Flexibility of operations
- Protection of minority interest
- Personal locative and suspension
- Capacity for survival

- Better human and public
- Business secrecy.

Disadvantages of partnership

- Unlimited liability
- Limited resources
- Risk of applied agency
- Lack of harmony
- Lack continuity
- Nontransferable of interest
- Public distrust

Joint Stock Company

This is incorporated and voluntary associated of individuals into a business entity with a destructive name, limited liability and common sea and with joint capital divided into transferable shares of fixed value.
Unlike other business forms, joint stock company helps in the collection of vast financial and managerial resources with provision fo limited limited liability and continuity of operation.

Characteristics

- Separate legal entity
- Artificial legal person
- Perpetual succession
- Limited liability
- Common seal
- Transferability of shares
- Incorporated association of persons
- Separate of ownership and managerial

Foundation Companies

A type of company formed from research and development that usually does not go public. This firm can grow in five to ten years from 40 to 400 employees.

High-Potential Venture

A venture has high growth potential and therefore receives great investor interest. The company may start out like a foundation company, but its growth is far more rapid. After five to ten years the company could employ around 500 employees. These firms are also called **gazelles** and are most important for the economic development of an area.

3.3 Role of Entrepreneurship in Economic Development

The role of entrepreneurship in economic development involves initiating change in the structure of business and society. One theory of economic growth depicts innovation as the key, not only in developing new products, but also in stimulating investment interest. The new capital created expands the capacity for growth (supply side), and new spending utilizes the new capacity and output (demand side.)

In spite of the importance of investment and innovation in the economic development of an area, there is still a lack of understanding of few factors which are as follows:

The **product-evolution process** is the process through which innovation develops and commercializes through entrepreneurial activity, which in turn stimulates economic growth. It begins with knowledge in the base technology and ends with products or services available in the marketplace.

The critical point in the process is the intersection of knowledge and a recognized social need, called the **iterative synthesis.** This point often fails to evolve into a marketable innovation.

Most innovations introduced in the market are **ordinary innovations**, with little uniqueness.

Technological innovations refer to new products with significant technological advancements.

Breakthrough innovations mean the development of new products with some technological change.

Regardless of the level of uniqueness or technology, each innovation evolves into and develops towards commercialization through one of three mechanisms: the government, entrepreneurship, or entrepreneurship. Entrepreneurship has assisted in revitalizing areas of the inner city. Individuals in innercity areas can relate to the concept and see it as a possibility for changing their present situation.

Review Questions

1. Identify the basic types of start-up ventures
2. Explain the role of entrepreneurship in economic development
3. Explain the entrepreneurial process

Unit 4
Project Identification and Classification
4.1 Introduction

Meaning of project

In the precise sense, a project presupposes commitment to tasks to be performed with well defined objectives, schedulers and budget. It can be defined as a scientifically evolved work plan devised to achieve a specific objective with in a specified period of time. Taken in this perspective, while projects can differ in size, nature, objectives and complexity, they must all partake of three basic attributes of being a course of action, of having specific objectives and of involving a definite time perspective;

Project objectives

- Specific, not general
- Not overly complex
- Measureable, tangible and verifiable
- Realistic and attainable
- Established with in resources bunds
- Consistent with resources available or anticipated
- Consistent with organizational plans, policies and procedures.

4.2 Project Classification

Quantifiable and non-quantifiable projects

Quantifiable projects are those where assessment can be made while in non-quantifiable projects such an assessment is not possible.

Sect oral projects

- Agriculture and allied sector
- Irrigation and power sector
- Industry and mining sector
- Transport and communication sector
- Social services sector
- Miscellaneous sector
- TECHNOLOGICAL Analysis
- Behavioral operational feasibility

Why we carry out feasibility study

- It allows the entrepreneurship to assess whether specific product/service has the returns needed compared to the resources required
- It enables the project analyst to determine the possibilities or probabilities of either improving the existing project or developing a new project.
- To establish the details of anticipated or proposed project
- To ensure that any project developed is acceptable to the users.
- It helps to obtain an over view of the problem and get rough assessment of whether there feasible solution that can meet the problem
- To define and analyze alternative approaches to production process and out come
- To avoid costly repair at a later stage when the project is implemented
- In order to define the problems and objectives of the project

4.3 Steps of Establishing an Entrepreneurial System

Step 1 Search for business ideas

a) Sources of ideas

- Observing markets
- Prospective customers
- Developments in other nation
- Study of project profiles
- Government organization
- Trade fairs and exhibitions

Step 2 Process of the idea

a) Preliminary evaluation and testing of ideas
   - Technical feasibility
   - Commercial viability
b) Detailed analysis

Step 3 Idea Selection

Step 4 Assemble the necessary inputs resources

- Man in put required include

- Information and intelligence
- Finance
- Personnel

Step 5 Establish the Enterprise

4.4 Business Environment Analysis

These are the conditions and circumstances surrounding the business that influence its performance

Business challenges

- High competition
- Availability of diverse and cost effective technology
- To navigate from the present situation to the next in un-increasing way (business has to be dynamic).
- To combat environment threats for example competition, declining markets and to exploit business opportunities.

Project formulation

- Need for project evaluation
- Selection of appropriate technology
- Influence of external economies
- Death of technically trained personnel
- Resource mobilization
- Knowledge about government regulations

Significance of project formulation

Elements of project formulation

Project formulation is by itself an analytical management aid. It enables the entrepreneur to arrive at the most effective project decision. Project formulation exercise normally includes such aspects as follows;

Feasibility analysis

Feasibility study (evaluating the opportunity)

A feasibility study includes a description of the product or services, an assessment of the opportunity, an assessment of entrepreneur and the team specification of all the activities and resource needed to translate the opportunity into a viable business venture, and the source of capital to finance the initial venture as well as its growth.

It's a formal investigation into an opportunity leading to a rational decision making it's carried out whenever there is a complex problem or opportunity to be utilized. In fact it's a preliminary investigation which emphases the point of look before you leap

It focuses on

- Financial analysis cost benefits analysis, market analysis demand analysis, and competitor analysis
- Economic feasibility
- Social profitability analysis

Environmental analysis

In order to work out the challenges on how to go about, tere is need to carry out environmental analysis and diagnosis

Internal environmental analysis

Focused should be on;

- The level of education
- Location of the organization
- Value system
- Mission and objectives
- Management structure and nature
- Internal power relationship
- Human resources
- Company image and brand equity
- Physical assets and facilities for example production capacity
- Marketing resources
- Financial factor.

External environmental analysis

Focuses on

- Suppliers
- Marketing intermediaries
- Customers
- Completion
- Public
- Economic environment
- Government policy
- Cultural environment
- Government policy
- Industrial analysis
- Demographic environment
- Natural environment for example geographical etc

Project Selection

- Economic size
- Status of industry or scope
- Raw materials availability
- Cost of production
- Capital cost
- Utility requirements
- Infrastructure facilities needed
- Profitability
- Government policy

4.5 Financial Analysis

- Project cost estimates
- Relevant costs for project analysis
- Future cost
- Opportunity cost
- Imputed cost
- Incremental differential cost
- Interest cost
- Depreciation and income tax
- Secondary costs and benefits

Principal method of estimating costs

- Reference to similar projects
- Method of extrapolation a shift to the service sector
- Liberalization and globalization

- Easter access to information through vast communication networks like the world wide web
- Down sizing
- Profitable riches for entrepreneurs have been opened as most customers are demanding higher quality goods and services

Why people under take entrepreneurship challenges

- An opportunity to gain control over one's destiny
- An opportunity to reach ones full potential
- An opportunity to make a difference
- An opportunity to make costs of money
- An opportunity to contribute to society and be recognized for it
- An opportunity to enjoy one's work
- To raise prospects for more productive and satisfying lives

Small business and entrepreneurship

A small business is defined as one owned by one individual or a small group of people

Its sale, assets and liabilities are small/low

Characteristics

- Unlimited liability
- Little capital
- Few customers
- Managed b the owner
- Mostly engaged in retail/whole sale business
- Not market research
- High degree of flexibility

Weaknesses

- Lack of economies of scale
- Poor management system
- Enquires from suppliers
- The use of published tariff, survey and official regulations

Principles sources of error in estimating costs

- Estimates of investment expenditure too low

- Failure to allow for working capital
- Overoptimistic estimates of cost and out puts in the early years of operation
- Failure to consider future trend of costs

Review Questions

1. Describe the institutional set up for entrepreneurial development in a developing country
2. Describe various steps taken by an entrepreneur to start a small business
3. What are the major sources of project finance
4. Define financial analysis and its scope

Unit 5
Entrepreneurship and economic development
5.1 Introduction

Entrepreneurship development is deliberate endeavor in human resource development, which is usually undertaken by the state or a community with the major aims of;

Development competence among participants to stat, manage and develop enterprises

Economic development (economic growth)

In a developing economy, entrepreneurship development has been gaining increasing significance. An entrepreneur is looked up on as a special talented person capable of assuming risks, marshalling the necessary resources and above all having eh insight to in for innovations and adapting to fast changing circumstances.

5.2 Need for Entrepreneurship Development

Over the past few decades, entrepreneurs have gained popularity not only in Uganda but also in the wider world. And its due to changes in the network place and the social and political environments that are funning the growth of entrepreneurship world wide. These factors include;

- Technological advancements that have compressed technological processes and enabled many things to be done.
- Hard to acquire loans
- Unable to influence prices
- Have no intensive marketing net work
- Lack distribution network
- Low wag payment compared to high enterprises
- Poor decision making

5.3 Entrepreneurship of the enterprise

An **entrepreneur** is a person who has possession of a new enterprise, venture or idea and is accountable for the inherent risks and the outcome of a product.

The term was originally a loanword from French and was first defined by the Irish-French economist Richard Cantillon. Entrepreneur in English is a term applied to a person who is willing to help launch a new venture or enterprise and accept full responsibility for the outcome. Jean-Baptiste Say, a French economist, is believed to have coined the word "entrepreneur" in the 19th century - he defined an entrepreneur as "one who undertakes an enterprise, especially a contractor, acting as intermediatory between capital and labour".

A broader definition by Say: "The entrepreneur shifts economic resources out of lower and into higher productivity and greater yield." The question arises why an entrepreneur (entrepreneur) has a different way of thinking of human beings in general. They have the motivation, calling, perceptions and emotions are strongly associated with values, attitudes and behavior as a superior human being.

Influences, personality traits, and characteristics

The most significant influence on an individual's decision to become an entrepreneur is workplace peers and the social composition of the workplace. Entrepreneurs also often possess innate traits such as extroversion and a propensity for— risk-taking.—Nanda, R and Sorensen, J (2008) Workplace Peers and Entrepreneurship . According to Schumpeter, an entrepreneur characteristically innovates, introduces new technologies, increases efficiency, productivity, or generates new products or services. An entrepreneur acts as a catalyst for economic change and research indicates that entrepreneurs are highly creative individuals who imagine new solutions by generating opportunities for profit or reward.

There is a complexity and lack of cohesion between research studies that explore the characteristics and personality traits of, and influences on, the entrepreneur. Most studies, however, agree that there are certain entrepreneurial traits and environmental influences that tend to be consistent. Although certain entrepreneurial traits are required, entrepreneurial behaviours are dynamic and influenced by environmental factors. Shane and VenKataraman (2000) argue the entrepreneur is solely concerned with opportunity recognition and exploitation; however, the opportunity that is recognised depends on the type of entrepreneur which Ucbasaran et al. (2001) argue there are many different types dependent on their business and personal circumstances.

Psychological studies show that the psychological propensities for male and female entrepreneurs are more similar than different. Perceived gender differences may be due more to gender stereotyping. There is a growing body of work that shows that entrepreneurial behavior is dependent on social and economic factors. For example, countries which have healthy and diversified labor markets or stronger safety nets show a more favorable ratio of opportunity-driven rather than necessity-driven women entrepreneurs. Empirical studies suggest that women entrepreneurs possess strong negotiating skills and consensus-forming abilities.

New research regarding the qualities required for successful entrepreneurship is ongoing, with work from the Kauffman Foundation forming the statistical basis for much of it.

Situated within Lancaster University Management School – one of the UK's leading business schools – the **Institute for Entrepreneurship and Enterprise Development (IEED)** undertakes outstanding work in the fields of entrepreneurial **research**, **education** and **business support**. Its strengths derive from the close alignment of these three key elements and from the continuous 'real world' feedback that it receives through interaction with the business community. Founding all operations upon the real and current demands of business is fundamental to IEED.

Every process, product and stage of activity within the Institute is informed by dialogue and engagement with businesses and external organisations. This generates a constantly expanding knowledge base which shapes the development and delivery of both new and existing services.

This ensures that they are always up to date, focused and precisely matched to the needs of students, businesses and the wider community.

5.4 Entrepreneurial accounting

Bookkeeping & Accounting – What's the Difference?

Bookkeeping is commonly defined as the recording of financial transactions. Financial transactions include sales, purchases, income, and payments by an individual or organization. Bookkeeping should not be confused with accounting.

Accounting is defined by the American Institute of Certified Public Accountants (AICPA) as "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof." In other words, the accountant focuses on reviewing the work of a bookkeeper, making appropriate adjustments, and reporting the recorded financial transactions. The accountant is also responsible for filing reports and forms with government agencies.

Differences between a bookkeeper and an accountant

- Bookkeepers accurately and efficiently enter daily transactions in the appropriate ledgers and sub-ledgers, process accounts payable and accounts receivable, process payroll, reconcile accounts, and perform periodic closes.
- Accountants are not only skilled bookkeepers but also investigators who review books for completeness, locate errors or omissions, and make appropriate adjustments. A professional accountant is skilled in communicating with the client and providing customized reporting that not only addresses the needs of the client but also the needs of the tax accountant and other team members.
- An Accounting Manager (or Controller) is often found in the accounting department of a small to medium sized company. They review accounting and operations processes and build or recommend improvement. An Accounting Manager will create customized reports and is able to analyze financial statements, interpret them (or review and interpret them with the owner or business manager), and make recommendations for future improvements for budgeting and planning purposes.

A Tiered Approach

When you consider hiring a professional bookkeeper or accountant, it makes sense to consider a tiered approach. With a tiered approach to your accounting, you pay for the level of service you receive based on hourly rates. You only pay for services when you need them, performed by the appropriate hourly rate, making the service a cost effective, all-inclusive alternative to a full-service accounting department.

Basic Accounting Equation

ASSETS = LIABILITIES + OWNERS EQUITY

5.5 Small Business Vs Entrepreneurship

The entrepreneur aims more on expansion than the small business owner does. Thus entrepreneurship requires/involves a lot of innovation than a small business. Both business are profit oriented but the fact is just the entrepreneur is just entering the business, using limited resources; he needs a lot of profit which require a lot of innovation to compete favorable.

However, the similarities are very many in fact a small business owner is an entrepreneur when he is starting the business

Entrepreneurship is concerned with innovation that lead to new corporation division or subsidiary ventures in established larger firms.

Entrepreneurships are being cited as away for established business to find new markets and new products.

Intrapreneurship; means a person within a large corporation who takes direct responsibility for turning an idea into a profitable finished product through assertive risk taking innovation

- It involves entrepreneurs who are in large firms combining resources and coming up with new products and services
- They have no personal step in their creations/innovations nor are they personally recognized for their contributions.
- The desire for intra-preneurship is taking course in that in some points of time companies become stagnant and need rejuvenation hence the need to recruit such managers with zeal and ability in take the initiative
- The intra-preneurial employees need to b;
    - Courageous
    - Moderate risk takers
    - Flexible and creative about their part way

Intra-preneurship requires employees to;

- Do any job needed to make your project work regardless of your job description
- Share credit wisely
- Remember, its easier to ask for forgiveness than permission
- Come to work each day willing to be fired
- Ask for advice before asking for resources
- Build a quiet coalition for your idea

- Be true to your goals, but realistic abut ways to achieve them
- Honour your sponsors.

Types of intra preneurship

- Administrative intra preneurship
- Opportunistic intra preneurhips
- Initiative intra preneurship
- Incubative intra preneurship

Barriers to intra preneurship

- Ignorance of lack of skills
- Employees find them selves at odd with the ownership

5.6 Business Strategy

Innovation my be defined as a complex series of activities, beginning with an idea and followed by a succession of inter woven steps, research and development, financing, marketing and production.
Innovation is the process of interacting with the environment to add the goods and services or to create a new goods and services of value. Innovation therefore provides the fuel/resources for entrepreneurial activities.

Innovation is only completed when the market accepts a product, process or service entrepreneurship is identified with innovation
Innovation dos not always mean inventing something physical but could involve redefining the way something is done.

Innovation is the specific instrument of entrepreneurship, it is the act that vies resources the capacity to create wealth innovation creates resources the are no resources until entrepreneurs find a use for it through innovation.

Innovation is organized, systematic, rational work and not just intuition it is based on the analysis of the perception of change, of opportunity of new realities and of the incongruities between what most people are sure is the reality and what has actually become the reality.

Although some innovations occur instantaneously in a flash of genius or lack being innovative can be learned and developed in a systematic manner

Sources of innovation

Drucker (1986) looks at seven major sources of innovation that include

- Process needs-HR, Research and development

- Incongruities-having difficulty to change in particular direction, having barriers in the environment
- The un expected success, failure or un expected event
- Demographics
- Industry and market structure
- Change in perceptions
- New knowledge knowing what is happening the economic and responsibility to it.

Review Questions

1. Describe the barriers of intra-preneurship
2. Distinguish between small business and entrepreneurship
3. Discuss the different types of intra-preneurship

Unit 6
Business plan
6.1 Introduction

Planning is a process that never ends. In the early stages, the entrepreneur should prepare a preliminary plan. The plan will be finalized as the enterprise develops. Many different types of plans may be part of any business operation-financial, marketing, production, and sales plans. Plans may be short term or long term, or they may be strategic or operational. All of these plans have one purpose: to provide guidance and structure to management in a rapidly changing market environment.

What Is the Business Plan?

A **business plan** is a written document prepared by the entrepreneur that describes all the relevant external and internal elements involved in starting a new venture. It addresses both short- and long-term decision making. The business plan is like a road map for the business' development. The Internet also provides outlines for business planning. Entrepreneurs can also hire or offer equity to another person to provide expertise in preparing the business plan. In developing the business plan the entrepreneur can determine how much money will be needed from new and existing sources.

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

Who Should Write the Plan?

The business plan should be prepared by the entrepreneur; however, he or she may consult many sources.
Lawyers, accountants, marketing consultants, and engineers are useful supplemental sources. Other resources are the Small Business Administration, Service Core of Retired Executives, Small Business Development Centers, universities, friends, and relatives. To help determine whether to hire a consultant, the entrepreneur needs to make an objective assessment of his or her own skills.

Scope and Value of the Business Plan who reads The Plan

The business plan must be comprehensive enough to address the concerns of employees, investors, bankers, venture capitalists, suppliers, and customers.

Three perspectives need to be considered:
The *entrepreneur* understands the new venture better than anyone. The *marketing perspective* considers the venture through the eyes of the customer. The *investor* looks for sound financial projections. The depth of the business plan depends on the size and scope of the proposed venture.
The business plan is valuable to the entrepreneur and investors because:

- It helps determine the viability of the venture in a designated market.
- It gives guidance in organizing planning activities.
- It serves as an important tool in obtaining financing.

Potential investors are very particular about what should be included in the plan. The process of developing a business plan also provides a self-assessment of the entrepreneur. This self-evaluation requires the entrepreneur to think through obstacles that might prevent the venture's success. It also allows the entrepreneur to plan ways to avoid such obstacles.

How Do Potential Lenders and Investors Evaluate the Plan
Because the business plan should address the needs of all the potential evaluators, software packages and Internet samples should be used only to assist in preparation. As the entrepreneur becomes aware of who will read the plan, changes will be necessary. Suppliers may want to see a business plan before signing a contract to supply products or services. Customers may also want to review the plan before buying the product. The business plan should consider the needs of these constituencies. Potential suppliers of capital will vary in their needs and requirements in the business plan. Lenders are primarily interested in the ability of the new venture to pay back the debt and focus on the four C's of credit:

- The entrepreneur's credit history or *character.*
- Their ability to meet debt and interest payments (*cash flow*.)
- The *collateral* or tangible assets being secured.
- *Equity contribution* or the amount of personal equity that has been invested by the entrepreneur.

Investors provide large sums of capital for ownership (equity) and expect to cash out within 5 to 7 years.

They will often place more emphasis on the entrepreneur's character than lenders. The venture capitalist will play an important role in management of the business and wants the entrepreneurs to be pliable and willing to accept this involvement. These investors will also demand high rates of return and will thus focus on the market and financial projections. If the entrepreneur does not consider the needs of these sources, the plan may be an

internalized document without consideration of the feasibility of meeting market goals.
Most external advisors and potential investors are bound by a professional code of ethics regarding disclosure.

Presenting the Plan
It is often necessary for an entrepreneur to orally present the business plan to investors. Typically the entrepreneur provides a short (20-30 minutes) presentation of the business plan. The entrepreneur must sell their business concept in a short time period. A venture capitalist or angel group may also ask the entrepreneur to present the plan to their partners before making a final decision.

6.2 Information Needs
Before preparing a business plan, the entrepreneur should do a quick feasibility study to see if there are possible barriers to success. The entrepreneur should clearly define the venture's goals, which provide a framework for the business plan. The business plan must reflect reasonable goals.

Market Information
It is important to know the market potential for the product or service. The first step is to define the market. A well-defined target market makes it easier to project market size and market goals. To assess the total market potential, the entrepreneur can use trade associations, government reports, and published studies.

Operations Information Needs
The entrepreneur may need information on:

- Location
- Manufacturing operations
- Raw materials
- Equipment
- Labor skills
- Space
- Overhead

Each item may require some research but is needed by those who will assess the business plan.

Financial Information Needs
Before preparing the plan, the entrepreneur must evaluate the profitability of the venture through the following:

- Expected sales and expense figures for the first three years
- Cash flow figures for the first three years
- Current balance sheets and pro forma balance sheets for the next three years
- Determination of expected sales and expenses is based on the market information gathered earlier.
- Estimates of cash flow will consider the ability of the new venture to meet expenses at designated times.

Current balance sheet figures show the assets, liabilities, and investments made by the owner.

Using the Internet as A Resource Tool

Thanks to technology, entrepreneurs are able to access information efficiently, expediently, and at very little cost. The **Internet** can serve as an important source of information in preparing the business plan.

Information on industry analysis, competitor analysis, and measurement of market potential can be located.

In addition, the Internet also provides opportunities for actually marketing the new venture's products. A web site, or home page, typically describes a firm's history, existing products, background of the founders, and other information to create a favorable image. The web site can be a vehicle for advertising or for direct marketing. Many new ventures use web pages to increase sales contacts and reach potential customers. An entrepreneur can also access competitors' web sites to gain knowledge of their strategy in the marketplace. To gather information anonymously the entrepreneur can also investigate newsgroups. All that is needed to use these sources is a small investment in hardware and software.

6.3 **Writing the Business Plan**

The business plan should be comprehensive enough to give a potential investor a complete understanding of the venture.

Introductory Page

- The title page provides a brief summary of the business plan's contents, and should include:
- The name and address of the company
- The name of the entrepreneur and a telephone number
- A paragraph describing the company and the nature of the business
- The amount of financing needed
- A statement of the confidentiality of the report
- It also sets out the basic concept that the entrepreneur is attempting to develop.

Executive Summary
This is prepared after the total plan is written. It should be three to four pages in length and should highlight the key points in the business plan. The summary should highlight in a concise manner the key points in the business plan.
Issues that should be addressed include:

- Brief description of the business concept
- Any data that support the opportunity for the venture.
- Statement of you this opportunity will be pursued.
- Highlight some key financial results that can be achieved
- Because of the limited scope of the summary, the entrepreneur should ascertain what is important to the audience to whom the plan is directed.

Environmental and Industry Analysis
The entrepreneur should first conduct an **environmental analysis** to identify trends and changes occurring on a national and international level that may impact the new venture.
Examples of environmental factors are:

- Economy
- Culture
- Technology
- Legal concerns
- All of the above external factors are generally uncontrollable
- Next the entrepreneur should conduct an **industry analysis** that focuses on specific industry trends
- Some examples of industry factors include:
  - Industry demand
  - Competition

The last part of this section should focus on the specific market. This would include such information as who the customer is and what the business environment is like. The market should be segmented and the target market identified.

Description of the Venture
The description of the venture should be detailed in this section. This should begin with the mission statement or company mission, which describes the nature of the business and what the entrepreneur hopes to accomplish. The new venture should be described in detail, including the product, location, personnel, background of entrepreneur, and history of the venture. The

emphasis placed on location is a function of the type of business. Maps that locate customers, competitors, and alternative locations can be helpful. If the building or site decision involves legal issues, the entrepreneur should hire a lawyer.

Production Plan or Operations Plan

If a new venture is a manufacturing operation, a production plan is necessary. This plan should describe the complete manufacturing process, including whether or not the process is to be subcontracted. If the manufacturing is carried out by the entrepreneur, the plan should describe the physical plant layout and machinery and equipment needed.

If the venture is not manufacturing, this section would be titled *operational plan***.** The entrepreneur would need to describe the chronological steps in completing a business transaction.

Marketing Plan

The marketing plan describes how the products will be distributed, priced, and promoted. Potential investors regard the marketing plan as critical to the venture's success.

Organizational Plan

The organizational plan section should describe the venture's form of ownership. If the venture is a corporation, this should include the number of shares authorized, share options, and names and addresses of the directors and officers. It is helpful to provide an organization chart indicating the line of authority.

This chart shows the investor who controls the organization and how members interact.

Assessment of Risk

It is important that the entrepreneur make an assessment of risk in the following manner: The entrepreneur should indicate the potential risks to the new venture. Next should be a discussion of what might happen if these risks become reality. Finally the entrepreneur should discuss the strategy to prevent, minimize, or respond to these risks. The entrepreneur should also provide alternative strategies should these risk factors occur.

Financial Plan

The financial plan determines the investment needed for the new venture and indicates whether the business plan is economically feasible. The entrepreneur should summarize the forecasted sales and expenses for the first three years. Cash flow figure for three years are needed, with the first year's projections provided monthly. The projected balance sheet shows the financial condition of the business at a specific time.

Appendix
The appendix contains any backup material not included in the text of the document.

Other possible documents
Letters from customers, distributors, or subcontractors
Secondary or primary research data
Leases and contracts
Price lists from suppliers and competitors

6.4 Using and Implementing the Business Plan

The business plan is designed to guide the entrepreneur through the first year of operations. It should contain control points to ascertain progress. Planning should be a part of any business operation. Without good planning the employees will not understand the company's goals and how they are expected to perform their jobs. Bankers say that most businesses fail because of the entrepreneur's inability to plan effectively.
The entrepreneur can enhance efficient implementation of the plan by developing a schedule to measure programs and to institute contingency plans.

Measuring Plan Progress
Plan projections will typically be made on a 12-month schedule, but the entrepreneur should check key areas more frequently.

- Inventory control By controlling inventory, the firm can ensure maximum service to the customer.
- Production control Compare the cost figures against day-to-day operating costs.
- Quality control Quality control depends on the type of production system used.
- Sales control Information on units, dollars, and specific products sold should be collected.
- Disbursements

The new venture should control the amount of money paid out
Updating the Plan
Environmental factors and internal factors can change the direction of the plan. It is important to be sensitive to changes in the company, industry, and market.

6.5 Why Some Business Plans Fail

A poorly prepared business plan can be blamed on:

- Goals set by the entrepreneurs that are unreasonable.

- Goals those are not measurable.
- To be successful
- Goals should be specific.
- They should also be measurable and should be monitored over time.
- The entrepreneur who has not made a total commitment to the business will not be able to meet the venture's demands of the venture. Investors will not be positive about a venture that does not have fulltime commitment. Investors will typically expect the entrepreneur to make significant financial commitment to the business. Lack of experience will result in failure unless the entrepreneur can gain knowledge or team up with someone. The entrepreneur should also document customer needs before preparing the plan

6.6 Format of the Business Plan

- Business Plan

Mission Statement

- A clear statement of your company's long-term mission. Try to use words that will help direct the growth of your company, but be as concise as possible.

The Team

- List CEO and key management by name
- Include previous accomplishments to show these are people with a record of success
- Summarize number of years of experience in this field

Market Summary

- Market: past, present, & future
  - Review those changes in market share, leadership, players, market shifts, costs, pricing, or competition that provide the opportunity for your company's success.

Opportunities

- Problems and opportunities

- State consumer problems, and define nature of product/service opportunities created by those problems.

Business Concept

- Summarize key technology, concept or strategy on which your business is based

Competition

- Summarize competition
- Outline your company's competitive advantage

Goals & Objectives

- Five-year goals
    - State specific measurable objectives
    - State market share objectives
    - State revenue/profitability objectives

Financial Plan

- High-level financial plan that defines financial model, pricing assumptions, and reviews yearly expected sales and profits for the next three years.
- Use several slides to cover this material appropriately.
- Resource Requirements
- Technology requirements
- Personnel requirements

Resource requirements

- Financial, distribution, promotion, etc.
- External requirements
- Products/services/technology required to be purchased outside company

Risks & Rewards

- Risks
    - Summarize risks of proposed project
    - Addressing risk

- Summarize how risks will be addressed
- Rewards
- Estimate expected pay-off, particularly if seeking funding

Key Issues

- Near term
  - Isolate key decisions and issues that need immediate or near-term resolution
- Long term
  - Isolate issues needing long-term resolution
  - State consequences of decision postponement
- If you are seeking funding, state specifics

6.7 Marketing Plan

Purpose and Timing of the Marketing Plan

The marketing plan establishes how the entrepreneur will effectively compete and operate in the marketplace. Marketing planning should be an annual activity focusing on decisions related to the marketing mix variables. The marketing plan section should focus on strategies for the first three years of the venture. For the first year, goals and strategies should be projected monthly. For years two and three, market results should be projected based on longer-term goals. Preparing an annual marketing plan becomes the basis for planning other aspects of the business.

Understanding the marketing plan

The marketing plan should answer three basic questions:

Where have we been? -The history of the marketplace, marketing strengths and weaknesses, and market opportunities.

Where do we want to go (short term)? - Marketing objectives and goals in the next twelve months.

How do we get there? -Specific marketing strategy that will be implemented.

The marketing plan should be a guide for implementing marketing decision-making and not a superficial document. The mere organization of the thinking process involved in preparing a marketing plan can be helpful in understanding and recognizing critical issues.

Purpose and Timing of the Marketing Plan

The marketing plan establishes how the entrepreneur will effectively compete and operate in the marketplace. Marketing planning should be an annual activity focusing on decisions related to the marketing mix variables. The marketing plan section should focus on strategies for the first three years of the venture. For the first year, goals and strategies should be projected monthly. For years two and three, market results should be projected based on longer-term goals. Preparing an annual marketing plan becomes the basis for planning other aspects of the business.

Market Research for the New Venture

Information for developing the marketing plan may require some marketing research. Marketing research involves the gathering of data in order to determine such information as who will buy the product, what price should be charged, and what is the most effective promotion strategy. Marketing research may be conducted by the entrepreneur or by an external supplier or consultant. Market research begins with definition of objectives. Many entrepreneurs don’t know what they want to accomplish from a research study.

Defining the Purpose or Objectives

One effective way to begin the marketing plan is to make a list of the information that will be needed to prepare the marketing plan.

Possible objectives:

- Determine what people think of the product or service and if they would buy it.
- Determine how much customers would be willing to pay for the product.
- Determine where the customer would prefer to purchase the product.
- Determine where the customer would expect to hear about such a product or service.

Gathering Data from Secondary Sources

An obvious source is data that already exists, or secondary data, found in trade magazines, libraries,
government agencies, and the Internet. The Internet can provide information on competitors and the industry, plus can be used for primary research. Commercial data may also be available, but the cost may be prohibitive. Free secondary information is available through:

The U.S. Bureau of Census and the Department of Commerce.

State departments of commerce, chambers of commerce, and local banks.
Private sources of data, such as *Predicasts*, the *Business Index*, and the SBA's *Directory of Business Development Publications*, can be found in a good business library.

A local business library can also provide access to reference sources and articles about competitors and the industry.
The entrepreneur should exhaust all possible secondary data sources, observation, and networking before beginning costly primary data research.

Gathering Information from Primary Sources
Information that is new is primary data. Observation is the simplest approach. Networking is an informal method to gather primary data from experts in the field, can be a valuable low-cost research method.
A recent study found that the most successful ventures were focused on information about competitors, the customer, and the industry. Less successful ventures were more focused on gathering information on general economic and demographic trends. Interviewing or surveying is the most common approach, but is more expensive. The questionnaire used by the entrepreneur should include questions designed to fulfill one or more of the objectives. Questions should be designed so they are clear and concise, without bias, and easy to answer. If the entrepreneur lacks experience, he or she should seek help in developing the questionnaire through Small Business Development Centers or a local education institution.

Focus groups
A focus group is a sample of 10 or 12 potential customers who participate in a discussion.
Groups discuss issues in an informal, open format.
These groups should be led by an experienced monitor.
Experimentation involves control over specific variables in the research process.

Analyzing and Interpreting the Results
The entrepreneur can enter the results on a computer or hand-tabulate the results. Summarizing the answers to questions will give preliminary insights. Data can then be cross-tabulated to provide more focused results.

Understanding the Marketing Plan
The marketing plan should answer three basic questions:

Where have we been? -The history of the marketplace, marketing strengths and weaknesses, and market opportunities.

Where do we want to go (short term)? - Marketing objectives and goals in the next twelve months.

How do we get there? -Specific marketing strategy that will be implemented.
The marketing plan should be a guide for implementing marketing decision-making and not a superficial document. The mere organization of the thinking process involved in preparing a marketing plan can be helpful in understanding and recognizing critical issues.

Characteristics of a Marketing Plan
An effective marketing plan should:

- Provide a strategy to accomplish the company mission.
- Be based on facts and valid assumptions.
- Provide for the use of existing resources.
- Describe an organization to implement the plan.
- Provide for continuity.
- Be simple and short.
- Be flexible.
- Specify performance criteria that can be monitored and controlled.

The marketing system identifies the major interacting components, both internal and external, that enable the firm to provide products to the marketplace. Environment factors, although largely uncontrollable, should be studied.

Internal environmental factors are more controllable by the entrepreneur:
Financial resources: The financial plan should outline the financial needs for the venture.
Management team: An effective management team responsibilities assigned is needed for implementing the marketing plan.

Suppliers: Suppliers used are generally based on a number of factors, such as price, delivery time, and quality.
Company mission: Every new venture should define the nature of its business and what it hopes to
accomplish.

The Marketing Mix
The actual short-term marketing decisions in the marketing plan will consist of four important marketing variables, called the **marketing mix:**

- Product or service.

- Pricing.
- Distribution.
- Promotion.

Each variable should be described in detail in the strategy section of the marketing plan.

Steps in Preparing the Marketing Plan

Step 1: Defining the Business Situation

The **situation analysis** is a review of where the company has been and considers many of the environmental factors. The entrepreneur should provide a review of past performance of the product and the company. Industry analysis should include information on market size, growth rate, suppliers, new entries, and economic conditions.

Step 2: Defining Target Market/Opportunities and Threats

The entrepreneur should have a good idea of who the customer or **target market** will be. The defined target market will usually represent one or more segments of the entire market. **Market segmentation** is the process of dividing the market into smaller homogeneous groups.. The process of segmenting is:

- Decide what general market or industry you wish to pursue.
- Divide the market into smaller groups based on characteristics of the customer.
- Select segment or segments to target.
- Develop marketing plan integrating the parts of the marketing mix.

Step 3: Considering Strengths and Weaknesses

It is important for the entrepreneur to consider its strengths and weaknesses.

Step 4: Establishing Goals and Objectives

Before strategy decisions can be outlined, the entrepreneur must establish realistic **marketing goals and objectives.** These answer the question "Where do we want to go?" These goals should specify such things as market share, profit, sales, market penetration, pricing policy, and advertising support. Not all goals and objectives must be quantified. It is a good idea to limit the number of goals to between six and eight.

Step 5: Defining Marketing Strategy and Action Programs

Strategy and action decisions respond to the question "How do we get there?" It incorporates:

1. Product or Service
This includes a description of the product and may include more than the physical characteristics.
It involves packaging, brand name, price, warranty, image, service, features, and style.

2. Customer Service
Meeting customer needs and creating loyalty involves a number of low-cost steps:

- In writing develop a statement of customer service principles.
- Train those employees who have direct contact with customers.
- Establish a process for evaluating customer service.
- Reward employees who are most effective in providing quality customer service.
- Make regular contact with customers.
- Invest in quality telephone equipment.
- Meet customer expectations.
- Customer service is especially important for e-businesses.

3. Pricing.
One of the difficult decisions is determining the appropriate price for the product. Factors such as costs, discounts, freight, and markups must be considered. Marketing research can help determine a reasonable price that consumers are willing to pay.

4. Distribution.
This factor provides utility or makes the product convenient to purchase when it is needed. This variable must be consistent with other marketing mix variables. Type of channel, number of intermediaries and location of members should be described. Regardless of the type of business, it is usually necessary for the new venture to have a website. The Internet will become an increasingly important medium for information and distribution. Direct mail or telemarketing may be considered. Direct mail marketing is one of the simplest and lowest in entry costs. But the direct marketing or Internet strategies are not a guarantee for success.
The entrepreneur should evaluate all possible options for distribution.

5. Promotion.
The entrepreneur needs to inform customers as to the product's availability using advertising media such as print, radio, or television. Usually television is too expensive unless cable television is a viable option. Larger markets can be reached using direct mail, trade magazines, or newspapers. A

website may also create awareness and promote the product and services of the venture. It is possible to make use of publicity as a means of introduction. It is important that the marketing strategy and action programs be specific and detailed enough to guide the entrepreneur through the first year.

Step 6: Coordination of the Planning Process

The management team must coordinate the planning process. The entrepreneur may be the only person involved but may lack experience in preparing the plan. Assistance is available from many sources, such as the SBA.

Step 7: Designing Responsibility for Implementation

The plan must be implemented effectively to meet all of the desired goals and objectives. Someone must take the responsibility for implementing each decision made in the marketing plan.

Step 8: Budgeting the Marketing Strategy

Planning decisions must also consider the costs involved in the implementation of these decisions. This budgeting will be useful in preparing the financial plan.

Step 9: Implementation of the Marketing Plan

The marketing plan is meant to be a commitment to a specific strategy. A commitment to make adjustments as needed by market conditions is also valuable.

Step 10: Monitoring Progress of Marketing Actions

Monitoring of the plan involves tracking specific results of the marketing effort. What is monitored is dependent on the specific goals and objectives outlined.

Review Questions

1. Define what the business plan is, who prepares it, who reads it, and how it is evaluated.
2. Describe the scope and value of the business plan to investors, lenders, employees, suppliers, and customers.
3. Identify information needs and sources for business planning.
4. Explain how to monitor the business plan
5. Explain with examples and a step-by-step explanation of the business plan.
6. Explain how to write a business plan
7. What are the differences between business planning, strategy plans, and market planning
8. Illustrate an effective and feasible procedure for the entrepreneur to follow in engaging in a market research study.
9. Explain the marketing system and its key components.
10. Discuss different creative strategies that may be used to differentiate or position the new venture's products or services.

Unit 7
Entrepreneurship in a Changing World
7.1 Introduction

Women Entrepreneurs

The traditional perception of women as a helper in the occupation of the husband and a home- market is gradually vanishing. Women have started providing themselves in many fields including entrepreneurship and their participation in entrepreneurial activities has increased by leaps and bound.

Quite a large number of women entrepreneurs have set up their enterprises nd are managing very well.

- The realization that the women are a valuable human resource has been gaining ground.
- Women's services as a necessary subsystem of the centric socio-economic system are gradually becoming part of modern attitudes
- As a new phenomenon, female entrepreneurship has gained a central stage in the global economy in the last decade and has since attracted attention in the global economy in the last decade and has since attracted attention in the socio-economic and development fields of most countries
- The enhancement of female entrepreneurship leads to considerable development in an economy because female entrepreneurs create employment opportunities as well as linkages for both rural and urban business, and the spillorers have a positive impact on women empowerment, education training levels and acquisition of business.
- Women entrepreneurs do engage in the operations and managements of SMEs in various sectors of any economy and this creates a new dimension in a male dominated economy.

7.2 Problems Faced by Women Entrepreneurs

Women face certain problems as entrepreneurs but as women. These problems are classified as below;

Personal problems

- Lack of family and community support
- Male dominated society
- Lack of education and information

- Economic backwardness
- Low risk bearing capacity

Managerial problems

- Lack of knowledge of general management and experience
- Lack of skilled labour
- Labour absenteeism and labour turnover
- Lack of clear objectives
- Transportation problem as women

Marking problems

- Lack of knowledge of how to market the product and whom to contact
- Heavy competition with big enterprises
- Exploitation by middlemen and difficulties in collection of dues
- Inadequate sales promotion avenues
- Lack of marketing support

7.3 Measures in Assisting and Promoting Women Entrepreneurship

To widen and strengthen the bore of women entrepreneurship, the following remedial measures may prove meaningful.

To solve financial problems the government and financial institutions should draw and implement special lending policies like moving of collateral and marginal money requirements, quick processing of loans and liberal repayment schedules for women entrepreneurs.

The government voluntary organizations should conduct elaborate marketing training to women entrepreneurs

Attention of government and voluntary organization need to draw rectify socio-personal problems

The government should give subsidies of materials supply, assistance for up gradation of technology, research and development and giving production training to women entrepreneur.

Review Questions

1. What are the differences between women and men entrepreneurs
2. Discuss the problems women face in entrepreneurship
3. Explain the solution to the women entrepreneurship.

Unit 8
Entrepreneurial Motivation
8.1 What motivates people to become entrepreneurs

The common man thinks that people go into business and become entrepreneurs solely to make money. The desire to earn money is no doubt an important motivating force. But entrepreneurs are motivated not by profits alone; several research studies have been carried to identify the factors that inspire entrepreneurs. A brief review of these studies is given below;

Many factors do motivate entrepreneurs, other than making money profits entrepreneurs are also motivated by;

- Occupation experience
- Educational background
- Assistant from government
- Desire for independence
- Availability of technology

All the above parties and many more do motivate individuals. Entrepreneurs to undertake certain innovations, whether they achieve the desired motivation or not is debatable however the achievement of motivation has been explained well by David McClelland through the achievement motivation theory

According to McClelland the individuals need for achievement refers to the need for personal accomplished is the desire to do things well and his enhance the time feelings and more factors contribute to entrepreneurial motivation these are;

- Keen interest in situation involving moderate risk
- Organizational skills
- Energetic
- Adaptation of future associates.
- Need for achievement through self study
- Desires for taking personal risk

P.N.Misra identified nine motivating factors which are as follows;

- Educational background
- Occupational experience
- Desire to work independently in manufacturing line

- Desire to branch out to manufacturing
- Family background
- Assistance from government
- Assistance from financial
- Availability of technology/raw material
- Other factors, demand of the particular product, utilization of excess money earned from contractual estate business, started manufacturing to facilitate trading/distribution business since the product was in short supply, unstable policy of the foreign government for non-residents, and no chance for further promotion.

The above nine factors were grouped into two major categories internal and external, first five motivating factors were termed as internal and the last four factors as external. The internal motivating factors like education, occupational, experience, fail background, the desire to do something independently together make the personality of the entrepreneur. These factors generate an inclination of adopt entrepreneurial activity.

Factors internal to the entrepreneur

- Strong desire to do something independent in life
- Technical knowledge and or manufacturing experience
- Business experience in the same or related line

Factors external to the entrepreneur

- Financial assistance from institutional sources
- Accommodation in industrial estates
- Machinery on hire purchase
- Attitude of the government t help new units
- Financial assistance from non-governmental sources
- Encouragement from big business
- Heavy demand
- Profit margin
- Unsound units

After analyzing the importance of the above factors, Prof. Sharma concluded; from the foregoing analysis, it is evident that a vast majority of the new entrepreneurial class was prompted to enter industry mainly because of three factors;

- They have a strong desires to do something independent in life
- They possessed technical knowledge or trading or manufacturing experience in the same or related line
- Governmental and institutional assistance became available to those who would have, perhaps, otherwise not taken to entrepreneurial activity.

8.2 Entrepreneurial Motivations Classified the Factors behind Entrepreneurial Growth into Three Categories as Follow;

- Entrepreneurial ambitions
- Compelling reasons
- Facilitating factors

Entrepreneurial ambitions

- To make money
- To continue family business
- To secure self employment
- To fulfill desire
- To gain social prestige
- Making decent living
- To be independent

Compelling reasons

- Unemployment
- Dissatisfaction with the job
- Make use of idle resources
- Professional skills

Facilitating factors

- Success stories of entrepreneurs
- Previous employment
- Property inherited
- Advice or inheritance
- Previous associations

Review Questions

1. Explain the factors which motivate people to become entrepreneurs
2. How far success stories of new entrepreneurs motivate prospective entrepreneurs.

Unit 9
Investment appraisal
9.1 Introduction to Investment

Investment means postponing present consumption to increase future returns. In a business sense this will involve the purchase of capital equipment such as plant and machinery with the objective of increasing future output, sales revenue and profit.

In the next section we will be looking at investment appraisal. In essence, we will be looking at the question 'is it worth investing in that project?'

Just like individuals, the finance available to firms is limited and so they must choose how to spend this finance in a way that offers the best return on their investment. This is not always an easy assessment because it is dependent upon the time period involved and the level of risk the firm is prepared to take.

A business may have a variety of investment decisions. They may have to choose between:

- Launching one product or another
- Between different locations for parts or whole of their business
- Buying one piece of equipment or another

Investment appraisal is a quantitative technique used to avoid relying on 'hunch' decision making. However, like all such business tools it must be remembered that the reliability of the outcome is only as good as the data used in the appraisal. As is often said, 'Garbage In, Garbage Out' (GIGO).

Investment appraisal requires two main pieces of information

- The **capital cost** of the project
- The **value of the project** (what cash will it bring in for the cost?)

Investment appraisal is a forward-looking process. It considers what might happen, and makes forecasts of financial returns. However, these forecasts will always contain elements of inaccuracy, uncertainty and risk and we will examine how different investment appraisal methods account for these elements.

Investment appraisal will not only be used to choose between one project and another, but also to rank the investments in terms of financial returns. Just like other tools in the business and management toolbox, it is likely that investment appraisal will be used in combination with other tools to provide a broader analysis. Non-financial information may be just as important in the decision making as financial outcomes. It may be the best financial decision to locate in a remote area of the world, but how will employees and customers react?

9.2 Investment Appraisal Techniques

Investment appraisal methods divide into two groups:

1. Simple, easy to calculate methods. They are not very accurate or sensitive, but are good for screening out poor projects from a long list. All projects should be subjected to these tests. These screening tests are

- **Payback period**
- **Average rate of return (ARR)**

2. Detailed and more accurate tests. If a project passes through the initial screening, then in larger businesses, which can afford the cost, the project may be it is subjected to more complex tests are based on discounted cash flow methods. They are:

- **Discounted cash flow (DCF)**
- **Net present value (NPV)**

We will look at all these tests in turn using a single example.

Investment appraisal example

Student Computers plc is trying to decide between two expansion projects. It has the following data available from the projects department. All units are $000's.

Project A has a capital cost (in year 0) of $400k
Project B has a capital cost (in year 0) of $700k

	Net cash inflow ($000)	
Project A		**Project B**
50	**Year 1**	100
100	**Year 2**	300
150	**Year 3**	500
200	**Year 4**	300
100	**Year 5**	200

Which project is best, or should Student Computers decide to do neither?

9.3 Payback period

Payback period is a method of investment appraisal that estimates the time period taken to recover the initial cash outlay on an investment. Although simplistic it is the most popular method of investment decision making.

This technique is not a measure of profitability, but more a measure of short-term risk. Long payback periods indicate a high risk, short ones a low risk.

Cumulative cash flow method of payback
Cumulative cash flow

Cumulative data is generated by adding up consecutive numbers within a series. So with project A the annual returns are:

Project A ($000)
50
100
150
200
100

So the ***cumulative returns*** at the end of each year are:

Year	Cumulative ($000)
1	50
2	150 (50 + 100)
3	300 (50 + 100 + 150)
4	500 (50 + 100 + 150 + 200)
5	600 (50 + 100 + 150 + 200 + 100)

Payback period method - convert the net cash flow data to cumulative net cash flow and to find the time when cumulative net cash flow is the same as the capital cost. In other words when the project repays the capital cost.

Project A			Project B	
Cost: 400	**Payback reached?**	**Capital cost ($000)**	**Cost: 700**	**Payback reached?**
		Cumulative net cash inflow ($000)		
50	No	**Year 1**	100	No
150	No	**Year 2**	400	No
300	No	**Year 3**	900	Yes
500	Yes	**Year 4**	1200	
600		**Year 5**	1400	

The cost of project A has been covered by the end of year 4, and the Project B covered by the end of year 3. But this is not as accurate as we require. We need to know when the payback occurs within the year.

Project A pays back between 3 and 4 years. At the end of the third year Student Computers need an additional $100 000 to payback their investment. A total of $200 000 in cash inflows are expected in the fourth year, so:

Payback period = 3 + 100/200 = 3.5 years (i.e. 3 years and 6 months)

Project B pays back between years 2 and 3. At the end of the second year, Student computers need an additional $300 000 to payback their investment. A total of $500 000 in cash inflows are expected in the third year, so:

Payback period = 2 + 300/500 = 2.6 years (i.e. 2 years and 7.2 months)

Firms will often set a ***criterion level or screening test*** in advance for undertaking a project. For instance Student Computers may state that only projects paying back within 3 years will be undertaken. In this case only Project B would be acceptable. However, they may set a payback period as 5 years, in which case both projects fulfil the investment criterion. Then it is a choice between the two.

Clearly on a financial basis, Project B is preferable as it pays back the quickest. However, other factors may now be considered, such as non-financial issues or liquidity issues. It may be that the firm's cash flow is poor, so it is important to select the project that pays back the quickest even if other factors suggest it is not the best in the long-run.

Benefits of payback method

- Easy to calculate and understand
- Includes the cost of the investment
- Focuses on short-term cash flow and is appropriate for equipment with a relatively short life

Limitations of payback period

- Not a measure of profit.

- Ignores all cash flows after the payback point.
- Ignores the pattern of cash flow.
- Ignores the 'time value' of money.
- Encourages a short-term view of investment

Payback period - problems

The payback period can also be calculated without using the cumulative method by the following formula:

$$\frac{\textit{Initial investment}}{\textit{Contribution per month (revenue less variable cost)}}$$

Initial investment = 3000
monthly contribution = 300

Payback 9000/300 = 30 months or 2 years 6 months

This method is not normally used in IB examinations and would only work if the net cash inflow was constant.

9.4 Average rate of return (ARR)

The **average rate of return (ARR)**, or accounting rate of return, method of investment appraisal ***measures the annual income of a project as a percentage of the total investment cost***, which is something that simple payback does not do. This is a measure of average profit, and is expressed in a familiar percentage form. It is also a relatively straightforward method and the result can be compared with returns from alternative uses of funds and with the base bank interest rate.

As with payback, it is likely that the firm will establish an investment criterion. For example, the firm may decide that any project with an ARR of less than 5% will not be considered.

ARR - The three main steps

The ARR measures the net return each year as a percentage of the initial cost of the investment.

$$\textit{Average rate of return} = \frac{\textit{Net return (profit) per annum}}{\textit{Capital outlay}} \times 100$$

EXAMPLE: Three projects have the following costs and expected income:

		Project A ($)	Project B ($)	Project C ($)
Cost		50,000	40,000	90,000
Return				
	Yr 1	10,000	10,000	20,000
	Yr 2	10,000	10,000	20,000
	Yr 3	15,000	10,000	30,000
	Yr 4	15,000	15,000	30,000
	Yr 5	20,000	15,000	30,000
Total		70,000	60,000	130,000

STEP 1. Calculate the total net profit from each project by subtracting the total return of the project from its cost.

$i.e. \$70,000 - \$50,000 = \$20,000 \; for \; project \; A$

STEP 2. Calculate the net profit per annum by dividing the total net profit by the number of years the project runs for.

$i.e. \frac{\$20,000}{\$5,000} = \$4,000 \; for \; project \; A$

STEP 3. Calculate the ARR using the following formula:

$$ARR \; (project \; A) = \frac{\$4,000}{\$50,000} \times 100 = 8\%$$

Calculate the ARR for the projects B and C.

Follow the link below if you need to look again at the example figures.

Student Computers - investment appraisal example

Project	A	B
Total gain (sum of each years	600	1400

cash inflow)		
Less: capital cost	(400)	(700)
Total net gain	200	700
Years	5	5
Average net gain	200/5 = 40	700/5 = 140
ARR (as % of initial investment)	40/400 = 10%	140/700 = 20%

This is a measure of profit, and project B seems to be preferable here as well.

Benefits of ARR

- Measures profitability
- Uses all the cash flows
- Easy to understand
- Easy to compare percentage returns with other investment opportunities

Limitations of ARR

- Ignores the pattern of cash flow - when they occur
- Later cash flows are unlikely to be accurate as they are longer term forecasts
- The length of the project or the life span of a machine maybe an estimate
- Ignores the timing of cash flows
- Ignores the 'time value' of money
- Ignores the risk factors associated with a long payback period on liquidity

ARR - problems

So, with all of the problems associated with these methods of analysis, what are they used for? They are simple and quick to prepare, and are used as screens or sieves to weed out poor, or useless, projects. Firms have to set themselves '**action standards**' for payback and ARR, say 3 years maximum and 15% minimum, and only if these are met and/or exceeded will a project 'pass' to be examined by the more complex discounted cash flow method. Action standards are selected by the firm concerned to reflect their view of the future and individual requirements. You will be given them in an exam if they are appropriate.

So in our example (Student Computers) project A has failed; project B has passed. Project B now has to be evaluated allowing for the 'time value' of money.

Discounted cash flow (DCF) & Net present value (NPV)

Discounted cash flow (DCF) analysis is a method of valuing a project, company, or asset using the concepts of the *time value of money*. DCF is used to calculate the value of future cash flows in terms of an equivalent value today. All future cash flows are estimated and discounted to give their present values (PVs).

What is the time value of money?

When you were younger, you probably looked at compound interest in mathematics and were asked some simple questions such as,

If you had $100 and put it in the bank at 10% interest how much would you have at the end of:

Year 1?
Year 2?
Year 3? and so on...

The answers are:

Year 1 $110 ($100 + $100 x 10 per cent) or ($100 x 1.1).
Year 2 $121 ($110 + $110 x 10 per cent) or ($110 x 1.1).
Year 3 $133.1 ($121 + $121 x 10 per cent) or ($121 x 1.1).

N.B. Multiplying by 1.1 is the same as working out 110%.

Why is it called *compound interest*? The reason is that you will get 10% interest on your original $100 deposit (*the principal*) ***plus*** you also get 10% interest on any *previous interest*. So in the case of year 2 to year 3, you will receive 10% on your original $100 (which is $10) plus an additional 10% on your $21 interest (which is $2.1). So in total you receive $12.1 interest. Add that to your $121 and you get $133.1.

Compound interest

Compound interest is interest which is calculated not only on the initial principal, but also the accumulated interest of prior periods. Compound interest differs from simple interest in that simple interest is calculated solely as a percentage of the principal sum.

Therefore, it can be asked what $110 earned in one year's time is worth *today* (the **Present Value or PV**) if the interest rate is 10%. One way of thinking of this is *reverse compound interest*. The answer is obviously $100 as this could have been invested a year ago at 10 per cent to earn $10 in interest giving $110. Therefore $100 is worth the same as $110 received in a year's time or $121 received in two years' time. This indicates the *time value of money*

Discounted Cash Flow (**DCF**) deals with the two problems of **interest rates** and **time**. The return on an investment project is always in the future, usually over a period of several years. Money earned or paid in the future is worth less today, because of the concept of *reversecompound interest:*

We have already seen that, $100 is worth the same as $110 received in a year's time or $121 received in two years' time. This indicates the *time value of money.* So the **Present Value or PV** of $110 received in a year's time is $100 as this could have been invested today at 10 per cent to earn $10 in interest giving $110 at the end of the year. $100 today is therefore exactly the same in financial terms as $110 received at the end of the year. By now you should be getting the point!

Therefore, if a business wishes to compare two possible investments, which deliver different returns in the future, it is impossible to compare the relative merits unless the business can compare 'like with like'. To achieve this, all future returns must be converted into ***present values (PV)***. This can be achieved by ***discounting*** future returns.

To evaluate the worth of an investment we will then need to calculate the Net Present Value:

9.5 Net Present Value

The Net Present Value (NPV) of a project is the return on the investment (the sum of the discounted cash flows) less the cost of the investment.

If the NPV is larger than the initial cost (positive NPV), then the firm will see a return on its money. If it is less than the initial cost (negative NPV) then the project is not worth pursuing.

An investment project costing $100,000 yields an expected stream of income over a three year period of:

Year 1 - $30,000
Year 2 - $40,000
Year 3 - $50,000

If the interest rate is 10%, the discount values (present values) can be calculated using the technique below:

$$\text{Present value} = \frac{\$30{,}000}{(1+0.1)^1} + \frac{\$40{,}000}{(1+0.1)^2} + \frac{\$50{,}000}{(1+0.1)^3}$$

$$\text{Present value} = \frac{\$30{,}000}{(1\ .1)^1} + \frac{\$40{,}000}{(1.1)^2} + \frac{\$50{,}000}{(1.1)^3}$$

$$\text{Present value} = \frac{\$30{,}000}{1.1} + \frac{\$40{,}000}{1.21} + \frac{\$50{,}000}{1.331} \text{ (you may recognize these numbers!)}$$

Present value = $27,272 + $33,057 + $37,565 = $97,894

The above project is not viable since the present value of the return of $97,894 is less than the cost of the project of $100,000.

Present value of return	-	Cost of the investment	=	NPV
$97,894	-	$100,000	=	- $2,106

The firm will be losing money on the investment (a negative NPV), so should not undertake it.

Fortunately, it is not necessary to carry out these discount factor calculations as tables of discounted values at different interest rates can be used and should be included with the examination paper (unless the examination board forgets to do so, which can happen!). The example above shows you how the discount factors are worked out.

The extract of a table below shows the present value of $1 receivable for a 6 year period at an interest rate of 5% per cent (rounded to two decimal places).

Present value of $1 receivable at the end of 6 years at 5 per cent

After	**1 yr**	**2 yrs**	**3yrs**	**4 yrs**	**5 yrs**	**6 yrs**
Present value of $1	$0.95	$0.90	$0.86	$0.82	$0.78	$0.75
Discount factor	0.95*	0.90	0.86	0.82	0.78	0.75

Therefore, it is possible to calculate the present values of the yields from previously used example using the correct discount factor from the table:

Present value of income in year 1	= $30,000	x	0.95*	=	$28,500
Present value of income in year 2	= $40,000	x	0.90	=	$36,000
Present value of income in year 3	= $50,000	x	0.86	=	$43,000
Total present value of all income	=				**$107,500**

This investment is now viable as the Total Present Value ($107,500) is greater than the cost ($100,000). **The NPV, therefore, is $7,500.**

Worked Example: Net present value (NPV)

Our company - Student Computers - wants a minimum return on its investment of 15%, after allowing for the time value of money. We can work out what Project B is worth in terms of today's money using the discount factors below.

Discount rate 15%

Year in future	**1**	**2**	**3**	**4**	**5**
Discount factor (f)	0.870	0.756	0.658	0.572	0.497

The project has a capital cost of $700k and the **net cash inflow** for each year will be:

Cash inflow for year x discount factor (for year)

Year	**Cash inflow**	**Discount factor**	**Net cash inflow**
1	100,000	0.870	87,000
2	300,000	0.756	226,800
3	500,000	0.658	329,000
4	300,000	0.572	171,600
5	200,000	0.497	99,400
		Total cash inflow	$ 913,800

The project is worth $913.8k in today's money, but costs only $700k. This means that it has a net present value (NPV) of +$213.8k.

i.e. $913.8 - $700k = + $ 213.8k

This means that the project should bring in more money than simply investing the $700k in the bank at a rate of 15%.

Note how NPV is written as + or - , $, number. You must give the sign (+/-) and the money unit as well as the number itself. Do not forget the thousands if they are there.

Interpretation of NPV

- **NPV is positive**: The project earns more than the discount rate. The project has 'passed' this test, and may be considered further.
- **NPV is zero**: The project earns exactly the discount rate. It may or may not be rejected.

- **NPV is negative**: The project earns less than the discount rate. The project will be rejected.

Benefits of Discounting/NPV

- Considers all cash flows
- Accounts for the time value of money and therefore considers the opportunity cost
- It is more scientific than the other methods

Limitations of NPV

- Complex to calculate
- Only as good as the original data. If the estimates of cost or net cash inflows are wrong, so will be the NPV
- The selection of the discount factor is crucial, but it is mostly guesswork as this rate is constantly changing
- NPV's look deceptively accurate
- Ignores all and any non-financial factors.

Average rate of return

The average rate of return for a project gives you:

- an indication of the worth of a project based on the time value of money

- an exact measure of the profitability of a project, but ignores the time value of money

- an estimate of the profitability of a project, but ignores any earnings after break even

An estimate of the profitability of a project, but ignores the time value of money
Discounted cash flow
Discounted cash flow methods of investment appraisal

- give an indication of the worth of a project based on the time value of money

- give an indication of the worth of a project

- allow for the time value of money

- give an exact picture of the worth of a project based on the time value of money

The time value of money

The dollar and time

Look at the following data:

Year	**1963**	**2009**
New honours graduate salary	$800 per year	$50,000 per year
3 bedroom house	$2,825	$400,000
Small car	$400	$10,000

All monies are in dollars, but they clearly do not have the same value. The $ in 1963 was worth more than the one today. So a $ today is worth more than a $ tomorrow; a demonstration of the time value of money.

This approach is general, not specific or numerate. That is where discount tables come in.

Discount tables

Imagine that you invest $100 at 10% per annum, compounded annually. Your deposit would grow.

Year	**0**	**1**	**2**	**3**	**4**	**5**	**6**
Value	100	110	121	133	146	160	176

This is the future value of a $ today at 10%. We can turn this round and look at the present value of a $ earned in the future. It is the reciprocal of the numbers above.

Present value of $1 earned in the future.

Year	**0**	**1**	**2**	**3**	**4**	**5**	**6**
Present value	1.000	0.909	0.826	0.75	0.684	0.625	0.568

This tells us that a $ received in 3 years time is worth the same as 75 cents today at 10% rate of interest.

Do the same thing for an interest rate of 20% and we get:

Year	**0**	**1**	**2**	**3**	**4**	**5**	**6**
Future value	100	120	144	173	207	249	299
Present value	1.000	0.833	0.694	0.578	0.483	0.401	0.334

The higher the interest rate, the less money is worth received in the future.

For interest rate, read discount rate and you have the discount tables.

Residual values

The residual value of any investment is the scrap value of any plant etc. at the end of its life. This does not reduce the cost of a project; it simply gives another cash inflow in the year when the item is sold.

What effect does a residual value have on our tests?

- **Payback period** - none at all, since the money comes after the payback point.
- **Average rate of return** - will increase the 'gain' and hence the 'net gain'. The return will increase if the number of years is not adjusted.
- **NPV** - little change, unless the residual value is very high. Discount factor will be low since the money only comes in after the project is over.

Review Questions

1. Calculate the payback period and ARR for an investment
2. Analyse the results of the calculations
3. Calculate the NPV for an investment
4. Analyse the results of the calculations

Unit 10

Entrepreneurial accounting.

This is your business. You are the entrepreneur, the leader, the manager, the investor. You are responsible for growing your business. Understanding your business' finances reduces the risk involved in being an entrepreneur. No amount of planning, estimating, or calculating can prevent failure, but having a firm grasp of accounting basics will show you where to make changes to avoid problems and find growth.

If your understanding of entrepreneurial accounting is limited to checking account and credit card balances, you are in a dangerous place. Simply having the immediate cash on hand, while important, is not necessarily enough to keep your business afloat. While you may have heard the old adage stated as fact, "Cash is King", it is only partially true. In addition to have properly timed cash inflows, a business positioned for growth will also be showing a profit in the same or recent accounting period. It is possible to show a profit, but have no cashflow. It is also possible to have substantial cashflow, but show a negative profit. In either case, the business may be able to survive for some amount of time, either through existing cashflow, loans, or equity investments. However, over time (usually, much sooner when cashflow is the issue) the business will no longer be able to meet its expenses.

The solution to this problem is simple: understand your numbers. Depending on your situation, you may need to do the bulk of your own book-keeping (data entry, statement reconciliation, etc), but you should have an accountant verify your work and point out any areas hiding potential problems. As these areas are explained, be sure to note how they were identified so that you may identify future areas.

Of course, when is the easiest time to get a firm grip on accounting? During the startup stage! The startup stage is perfect for learning accounting due to the minimal number of transactions occurring. Starting a new venture requires an entrepreneur to perform every imaginable function, from cleaning to strategic decision making. Whether you enjoy it or not, accounting is an absolute necessity.

Accounting Terminology

12th MAY 2008

Entrepreneurs who understand accounting terminology benefit in both increased knowledge of their business as well as a decrease in expense for professional accounting services. When communication between an entrepreneur and an accountant is smooth and flows in a common language, the time will be more productive, resulting in less time being needed. To make it easier, we've listed 14 words that are essential for the entrepreneur accountant. Read More >

General Ledger

12th MAY 2008

The central listing of all activities posted on the sub-ledgers is the General Ledger. This covers all financial transactions and may be used to audit activities that may have been incorrectly posted. A trial balance will show whether the ledgers are in balance or not.

Chart of Accounts

12th MAY 2008

The Chart of Accounts is the numerical list of all assets, liabilities, sources of revenue, and expenses in the company's operating business that is used to organize and track all financial transactions. In the company's accounting system, most common transactions (sales or purchases) will automatically default to an account in the chart. The expenditure of any cash will default to an expense account.

Accounting Terminology

12th MAY 2008

Any entrepreneur will be able to make better financial decisions for their business by knowing and understanding basic accounting terminology. We've listed the most essential terms here!

Assets

This is the total value of any tangible property and property rights, less any reserves set aside for depreciation. Hard assets will not reflect any appreciation in value that are not strictly quantifiable under current accounting principles.

Book Value

This is the value of an asset shown on the Balance Sheet, listed at cost and then reduced by total accumulated depreciation. Accelerated depreciation schedules may reduce value to less than current market value. Tangible assets may be fully depreciated while still having usable life.

Capital

The worth of a company as determined by the total amount of all assets minus all outstanding liabilities.

Cash Basis Accounting

This method recognizes revenue when the money is received and expense at the time that payment for them is made. There is no match of revenue against expense in a fixed period, so comparison on a period-to-period basis is not possible. This system provides less financial control because unpaid expenses are not recognized.

Cash Flow

The difference between the cash at the beginning of a period with the cash at the end of a period is cash flow. Cash flow may be increased by the sale of assets or the acquisition of new debt. It may be decreased by large purchases, but not for current use or principal debt payments.

Credits

Credits always appear on the right-hand side of the General Ledger. A credit will increase items on the revenue side as well as on the liability side.

Debit

Debits always appear on the left side of the General Ledger. A debit will increase the asset account and the expense account.

Depreciation

The conversion of the cost of an asset into an expense, expressing the useable life of the item covered. Set up over a fixed period in a depreciation schedule according to current tax regulations. Once an item has been fully depreciated, it no longer is carried on the books of the company as having any asset value.

The depreciation can be made in equal amounts over the useful life, known as straight line depreciation, or taken more in the early years, known as accelerated depreciation.

The Balance Sheet will show the asset at its original cost, and then the reserve for depreciation, resulting in the net asset value. This number reflects book value, not necessarily actual value.

Equity

Also referred to as net worth, this is the difference between the total assets of an entity and the total liabilities. Shown on the liability side of the ledger, it may be thought of as the amount owed to owners, since theoretically, this would be disbursed to them if assets were sold and liabilities paid.

Gross Profit

This number is derived from the gross (total) sales revenue less any direct costs, such as labor, material, and subcontracting that is directly attributable to that sale.

Also referred to as operating profits, the gross profit represents the money available to pay overhead expense and taxes, and to generate a net profit for the company to retain as working capital.

Journal Entry

These include transactions entered on a sub-ledger and into the General Ledger. Entries include the date of transaction, account number, and which accounts were debited and credited as a result of the transaction.

Retained Earnings

Profits that are not distributed through dividends, but are left in the business are carried on the books as retained earnings. This can be reduced over time by losses or increased over time by net profits.

Sub-ledger

A sub-ledger is used to record accounting transactions of revenue and expense items to accounts payable and accounts receivable journals. Sub-ledgers are also posted to the General Ledger to track all financial transactions.

Working Capital

This is the difference between current assets and current liabilities, and is an indication of liquidity and the ability of the company to meet current obligations. The assumption is that current assets will turn into cash concurrently with obligations such as payables and loans.

The variable here is the ability to collect current receivables and sell inventory. This may mean that a company is less liquid in reality than it appears to be on paper.

Understanding Your Balance Sheet

12th MAY 2008

This includes the summary of assets, liabilities, and net worth of a business at the end of a monthly or yearly accounting period. A Balance Sheet includes current assets such as a cash, accounts receivables, and inventory, as well as long-term assets such as property and equipment. Liabilities that are listed as current include accounts payable and current loan amounts, as well as long-term portions of loans, mortgages, and notes. Read More >

Profit & Loss (Income) Statement

12th MAY 2008

Prepared annually and often monthly and quarterly as well, this is the report of the income and expense, and the results as expressed in profit or loss. This report identifies all income from product sales or other activities and reports all direct and indirect costs by category. Operating (gross) profits are listed, as are the net (before tax) profits.

Balance Sheet

12th MAY 2008

This includes the summary of assets, liabilities, and net worth of a business at the end of a monthly or yearly accounting period. A Balance Sheet includes current assets such as a cash, accounts receivables, and inventory, as well as long-term assets such as property and equipment. Liabilities that are listed as current include accounts payable and current loan amounts, as well as long-term portions of loans, mortgages, and notes.

Statement of Cash Flows

12th MAY 2008

There are several different types of Cash Flow Statements, the basic one being simply the measure of cash flowing in and out of the business. Most important from a management perspective is the operating cash flow statement that measures inflow of revenue versus outflow of expense, and does not reflect cash reserves or borrowings.

Bookkeeping & Accounting – What's the Difference?

Bookkeeping is commonly defined as the recording of financial transactions. Financial transactions include sales, purchases, income, and payments by an individual or organization. Bookkeeping should not be confused with accounting.

Accounting is defined by the American Institute of Certified Public Accountants (AICPA) as "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof." In other words, the accountant focuses on reviewing the work of a bookkeeper, making appropriate adjustments, and reporting the recorded financial transactions. The accountant is also responsible for filing reports and forms with government agencies.

Differences between a bookkeeper and an accountant

1. Bookkeepers accurately and efficiently enter daily transactions in the appropriate ledgers and sub-ledgers, process accounts payable and accounts receivable, process payroll, reconcile accounts, and perform periodic closes.

2. Accountants are not only skilled bookkeepers but also investigators who review books for completeness, locate errors or omissions, and make appropriate adjustments. A professional accountant is skilled in communicating with the client and providing customized reporting that not only addresses the needs of the client but also the needs of the tax accountant and other team members.
3. An Accounting Manager (or Controller) is often found in the accounting department of a small to medium sized company. They review accounting and operations processes and build or recommend improvement. An Accounting Manager will create customized reports and is able to analyze financial statements, interpret them (or review and interpret them with the owner or business manager), and make recommendations for future improvements for budgeting and planning purposes.

A Tiered Approach

When you consider hiring a professional bookkeeper or accountant, it makes sense to consider a tiered approach. With a tiered approach to your accounting, you pay for the level of service you receive based on hourly rates. You only pay for services when you need them, performed by the appropriate hourly rate, making the service a cost effective, all-inclusive alternative to a full-service accounting department.

Basic Accounting Equation

ASSETS = LIABILITIES + OWNERS EQUITY

Stuff that has future economic benefit: cash, receivables, inventory, patents, equipment, etc.

Things I owe to to other people: payables, tax liabilities, loans, mortgages, etc.

READING MATERIALS / LIST

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