Business Formation

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I - Business Formation and Entrepreneurship

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Field of Activity: Business and Management Economics

Competence Center: Business Formation and Management

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Overview

For many years, there has been a growing interest in subjects related to **business formation and entrepreneurship**. This has resulted in a great number of publications and numerous internet offers. The present module intends to give a general overview of the practical aspects and problems related to the business formation process and entrepreneurial activity both of which form essential parts of entrepreneurship.

These aspects include recognizing, evaluating and selecting a business idea (chapter 3), a sound and consistent business plan (as described in learning unit 2) is another requirement to pursue the identified business potential and decide on its implementation. Further essential elements for the business implementation are the financing concept (learning unit 3), the market entry strategy (learning unit 4) and the choice of the optimal legal form reflecting the specific situation (leaning unit 5).

The above mentioned topics are not only relevant for start-ups and young businesses already on the market, since the entrepreneurial process, the business plan, the financing, the market entry strategy are permanent tasks and challenges an entrepreneur has to face both during internationalization and when choosing the appropriate legal form.

Considering the great number of business forms and entrepreneurial activities, the author does not claim to present a complete overview. It is therefore paramount to collect further information related to your project and to require the support of qualified experts.

Learning Objectives

- What is entrepreneurship?
- What are the different forms of entrepreneurship?
- What are the challenges an entrepreneur has to face?
- The role of entrepreneurship in the framework of structural changes
- Identifying business potentials and opportunities
- Practical basic knowledge in the field of creativity techniques
- Evaluation and selection of business ideas

Layout

1. Basic Principles
2. Types of Entrepreneurship
3. The Entrepreneurial Process
4. Tasks Including Solutions and Solution Propositions
5. Tasks to Send In

Time Management

The time needed to treat this learning unit is estimated at approx. 7 hours (including the exercises and the tasks to send in)

1. Basic Principles

Although the term “entrepreneurship” has many definitions and interpretations, there are a few points that are often mentioned when defining entrepreneurship, such as:

- Identification of business potentials
- Innovation orientation
- Acquisition of resources
- Business formation

In that sense, the entrepreneur, from French: “a person that undertakes something”, distinguishes himself clearly from the classical manager.

Whereas the manager guides and develops a company based on existing structures and resources, the entrepreneur concentrates himself on:

- **the identification of entrepreneurial opportunities** and
- **the creation of conditions allowing their implementation through the acquisition of the necessary resources** (financial and physical means, technology and human resources).

The same “entrepreneurial spirit” may also be found in existing, well-established companies. People animated by this spirit are generally called “**intrapreneurs**”.

One of the decisive elements for the success of an entrepreneur is his/her capability to realize that formation and operation processes need to be permanently adapted on all functional levels to respond to the requirements of the different development stages of the company.

As shown in the figure below illustrating the ideal enterprise and/or a product life cycle, every company and/or every product or service innovation goes through different stages from the business idea to its development, each of which confronting the entrepreneur with different challenges.

Business and/or Product Life Cycle Model

Formation Expenses and Project Costs	Turnover	Disposal Costs	Time
Idea finding process Alternative evaluation and selection Market potential analysis BP establishment Financing Production and/or service preparation	Market introduction Market penetration Market saturation Market degeneration	Market degeneration	
Set-up cycle	Market cycle	Disposal cycle	
Business formation and entrepreneurship, a complex task			

Fig. 1: Business and/or Product Life Cycle Model

Whereas during the **set-up cycle** visionary and planning capabilities, methods and instruments for the identification of the entrepreneurial potentials and the preparation of conditions allowing their implementation are at the forefront, during the **market cycle** the concrete implementation of the plans and the growth management are of particular importance.

Example: Marketing

During the marketing planning process different measures are planned (e.g. an advertising campaign) which will not only be implemented during the market entry phase (e.g. decision for a specific adverting layout) but which also have to be adapted to the real market conditions and demands (e.g. modification of the layout in case of failure or development of an international advertising campaign).

Therefore, entrepreneurs must acquire and develop **new skills, methods and instruments**.

The subject of entrepreneurship also has its importance for the national economy, not only as a means to generate growth and create new jobs or implement innovation but also as a means to provide structural changes. Whereas the primary sector (land, forestry, mining) and the secondary sector (industry and manufacturing trade) constantly loose importance (e.g. number of employees, gross value added), the tertiary sector (services) and the quaternary sector (information and communication) constantly gain in importance.

The two last sectors offer a great variety of potential business ideas, mainly because of the relatively low investment costs, for the identification and implementation of which entrepreneurs are best qualified.

Entrepreneurs play an important role for renewing the entrepreneurial landscape, creating employment opportunities and furthering economic growth.

2. Types of Entrepreneurship

Layout

2. Types of Entrepreneurship
2.1 Business Formation (Small Business Formation)
2.2 Acquisition or Participation in a Business
2.3 Business Succession

The future entrepreneur has several options:

- Business Formation
- Business Acquisition or Business Participation
- Business Succession

2.1 Business Formation (Small Business Formation)

The life cycle of a business starts with its birth that is its formation. The formation or creation of a business has to be well prepared which will be demonstrated in this module.

Generally, the term **business formation** means the start-up of a company with a certain size and/or a certain development potential by a formation team based on a corporation.

For smaller companies, one generally uses the term **small business formation** (specifically appropriate to gain professional independence). On a legal level, small business formation starts with the registration of the trade or, in case of a liberal profession, with the registration at the Revenue Services. Further registrations and/or compulsory registrations (e.g. at the Chamber of Commerce) depend on the type of the activity planned.

The learning contents of this module are very general, allowing them to be applied to all types of entrepreneurship.

Any idea for a business formation or a small business formation must first be examined regarding its technical and economic feasibility. First, one will have to develop a not yet very detailed concept which allows answering the following questions:

- Who are the potential buyers?
- Are they willing to pay for the products and/or the services offered?
- Are the efforts for the formation worthwhile regarding the expected returns?
- …

The **spin-off** is a special form of business formation. A spin-off is the externalization of one part of an existing company. Business formations from universities are also called spin-offs.

2.2 Acquisition of or Participation in a Company

The business formation and the small business formation are certainly the most frequent forms of entrepreneurship. Still, one should also consider the acquisition of an existing company or the acquisition of participations of an existing company, since both are also interesting possibilities if one wants to become an entrepreneur. These options offer a number of advantages especially because of the existence of:

- a marketable product or service offer
- existing customer relations
- staff
- machines and means of production
- sub-contractors, etc.

The business acquisition or participation is based on an agreement with the former owner and the transfer of the corresponding participations of the company.
Generally, one can distinguish the following two forms:

Management Buy-Out (MBO)
A management buy-out is a form of acquisition where a company's existing management acquires a part or all parts of the company. This form of acquisition is useful when one plans restructuring measures or wants to solve succession problems within the company. The advantage of the MBO is that the future entrepreneurs already know the business and the framework conditions. Nevertheless, MBO often fail because of the managers' inability to provide sufficient financing and securities.

Management Buy-Out

Company
Management New Company

Fig. 2: Management Buy-out (MBO)

Management Buy-In (MBI)

The management buy-in defines the acquisition of a company by an outside management team. The advantage of the MBI is that the external managers add new expertise and new competence to the company and that they are not “blind” to the shortcomings of the company. This might have a positive effect on companies experiencing certain difficulties. On the other hand and since there is no common basis for confidence and experience; the employees may put up some resistance against the MBI.

Management Buy-In

External Management

Company

New Management

Fig. 3: Management Buy-in (MBI)

2.3 Business Succession

It one wants to become independent, it is not always necessary to form a new business. An interesting and reliable way to one’s professional independence is the takeover of an existing company through succession. For example, if there is no successor within the family, the agreement on an appropriate successor is a possibility to secure the continuation of the business. Therefore and within “the framework of the life cycle of a company, [the business succession] offers a new start after a generation of entrepreneurial activity”. (Fueglistaller et al. 2004, p. 171).

A good source of information on the offer and the demand in business successions is the nationwide German succession platform www.nexxt-change.org. The platform is a common initiative of the German Federal Ministry of Economy and Technology (BMWi), the KfW (SME bank), the DIHK (German Chambers of Commerce) and the ZDH (Central Association of German Trades) as well as the BVR and the DSGV.

See also the detailed analysis of the economic and emotional aspects of business succession in Felder und Klaus 2001.

The advantages of the business succession and the business acquisition are the existence of grown structures and processes with the corresponding customers, suppliers, collaborators and physical means. Still, the succession is a special challenge for the successor. The succession demands more "technical know-how, entrepreneurial experience, willingness to compromise and capability to deal with conflicts than a new business formation". (Fueglistaller et al. 2004, p. 174)

The choice of the type of entrepreneurship depends mostly on the identified business potential.

The possibilities thereof will be discussed in chapter 3. Once a business idea has been selected, one has to establish a business plan (learning unit 2), a financing concept (learning unit 3), a market entry strategy (learning unit 3) and choose the optimal legal form (learning unit 5).

3. The Entrepreneurial Process

Layout

3. The Entrepreneurial Process
3.1 Creativity and Innovation the Basis of Entrepreneurship
3.2 Creativity Techniques
3.2.1 Brainstorming
3.2.2 Morphological Box
3.3 Evaluation and Selection of Ideas

The entrepreneurial process generally starts with the business idea. The impulse for a business idea should ideally be prompted by the identification of an opportunity. The ideas will have to be generated, evaluated and finally the idea most likely to be successful will have to be identified. In developing the business plan these ideas form the basis for the implementation.

See some examples for the formation process in Dowling 2003, p. 15ff.

During this process, the demands on the entrepreneur increase continuously. Whereas in the beginning **creativity** and **planning capabilities** are the main issues, the market entry and the business growth require **strong leadership**, the **ability to negotiate** and **persuasiveness**, plus a **high tolerance to frustration** allowing the entrepreneur to overcome the problems that will inevitably occur.

The Entrepreneurial Process

From the idea to the first	Establishing a business plan	Market entry and business

concept		growth
- Find ideas - Evaluate and select ideas - Market potential analysis - Write a concept - Etc.	- Written explanation section - Quantitative section - Appendix	- Market entry date - Managing business growth - Internationalization - Etc.
The entrepreneurial process		

Fig. 4: The Entrepreneurial Process

Any entrepreneurial process starts first with a *creative idea* and/or a *problem-induced* or *potential-induced impulse*. (For problem-induced and potential-induced impulses in the field of materials, see Klein 2001, p. 39)

3.1 Creativity and innovation the Basis of Entrepreneurship

In order to find and/or generate business ideas or business potentials there are different possibilities.
Business ideas can be generated through master theses, seminar papers, practical workshops, company visits, and observations during work or during trips abroad or through hobbies, skills and daily problems.

Ideas for small business formations or ideas for becoming independent may also be generated specifically through different **creativity techniques** (see chapter 3.2).

Creativity not only helps to specifically generate new ideas, it also allows to open new perspectives on existing problems and chances (= creative force). In order to change the creative and potential problem solving ideas and create innovation, these ideas must be transformed into marketable products and/or services.

In the framework of our discussion, it is important to distinguish between **invention** and **innovation**. Invention means the discovery or the making up of a new technical potential to solve a problem (= invented objectively for the first time), whereas innovation means the implementation of a new technical, economic, organizational or social potential to solve a problem within the company or on the market (= found subjectively for the first time).

“The transformation of an invention to a (marketable) product is therefore called an innovation” (Volkmann und Tokarski 2006, p. 85f)

Innovations – yes but how?

In principle, innovations may stem from the development of new technologies/services that have not existed on the market before (for example: browser-based use of software). Another possibility is to transfer existing products and services to new groups of customers or new target markets (for example: development of game consoles for former non-players based on a new game concept).

A new combination of products and services that forms an attractive “global product” is also considered an innovative problem-solving offer (for example: triple play, the offers made in telecommunication combining telephone, broadband connection and entertainment offers such as television and video on demand).

Furthermore, one can develop new variations or variants of existing products and services or incorporate new technologies/findings in an existing business model.

The **function of an entrepreneur** is therefore to develop and implement new business models based on creative and innovative problem solving potentials by using a systematic procedure.

3.2 Creativity Techniques

Layout

3.2 Creativity Techniques
3.2.1 Brainstorming
3.2.2 Morphological Box

Creativity techniques and techniques to find new ideas serve to specifically generate new, innovative ideas.

To specifically generate new ideas, one can chose between a wide variety of methods, which help to define problems, to accelerate the flow of new ideas of an individual or a group, to enlarge the perspective and to dissolve mental blocks.

Creativity techniques first supply **basic ideas**, which will have to be further developed and put into concrete terms when drawing up the concept. Following this first stage, the ideas will have to be implemented and put into practice. At every stage of the process, appropriate evaluation procedures and selection strategies are used to make sure that only promising ideas are transferred to the next stage.

Creativity techniques may be divided in intuitive and discursive methods.

Intuitive method	Discursive method
• Brainstorming • 6-3-5 method • Brainwriting • Negative conference • Mind Map	• Morphological box • Osborn checklist • Cause-effect diagram • Relevance tree analysis • Progressive abstraction

Table 1: Selection of Intuitive and Discursive Creativity Techniques

Intuitive methods aim to produce as many ideas as possible within a very short time. It is decisive to think "out of the box" and to abandon existing thought patterns. The bolder and the more imagination the better!

Discursive methods, on the other hand, follow a systematic solution seeking process divided into individual logically arranged steps. Due to its systematic nature, this procedure can also be used for individual work.

Below we will briefly explain a practical intuitive and a discursive method – the brainstorming and the morphological box. For a more detailed description of the other creativity techniques, we refer the reader to the pertinent literature.

3.2.1 Brainstorming

The brainstorming is one of the best-known intuitive procedures to find new ideas. The method invented in the 1930 by Alex Osborn and further developed by Charles Hutchison Clark serves to rapidly generate new ideas in a group of people.

One reason why this method is so widely used lies in the fact that it is easy to use and allows to generate a great number of ideas within a brief period. First, the participants are selected according to the problem or the task to be accomplished. The more complex the task, the more the group should be interdisciplinary. The number of participants generally varies between three and twelve persons.

During the brainstorming session, which lasts between 10 and 30 minutes, it is important to make sure that the contributions of any of the participants are neither criticized nor evaluated (not even positively!). This helps to encourage every participant to freely express his or her ideas or propose solutions.

After this session, the ideas are sorted (thematic classification), evaluated and selected.

Advantages and Disadvantages of Brainstorming

Advantages +	Disadvantages -
▪ Big number of innovative business ideas ▪ Easy to perform ▪ Easy to learn the rules ▪ Little effort ▪ Synergy effects through the presence of several groups	▪ Success depends strongly on the participants ▪ Many of the ideas found are useless ▪ In many cases a selection process is necessary to identify the appropriate ideas ▪ Group dynamics conflicts may occur

Table 2: Advantages and Disadvantages of Brainstorming

3.2.2 Morphological Box

The morphological box is an analytical creativity technique used as a systematic search tool for a great number of different problem solving potentials. The method was first devised by the Swiss physician Fritz Zwicky (1898-1974).

The method is divided into four steps:

1. Analysis of the Problem

Exact description and definition of the problem.

2. Determination of the Parameters of the Problem

Determination of distinctive characteristics (also called parameters, attributes, dimensions) of the problem, which are written down one below the other. It is important to make sure that the characteristics are independent from each other and that they may be put into practice.

3. Determination of the Characteristics

Determination of all the possible characteristics of the parameter. They are written down on the right of the corresponding parameter.

4. Combination of the Solution Alternatives and Verification of Appropriateness

The matrix developed offers a big number of combination possibilities, where each combination of characteristics represents, in principal, a possible solution to the problem. This solution has to be verified for appropriateness.

Many of the possibilities found will be senseless because of the technical, economic or social conditions. Nevertheless, this method allows recognizing a combination possibility nobody has thought of so far. This possibility will have to be examined more thoroughly with the appropriate criteria (estimated selling price, production costs, sales opportunity, etc.) to verify its possible implementation.

The following example of an MP3 Player describes the procedure in more details.

Example: MP3 Player

Parameter		Expression		
Form	square	rectangular	round	…
Material	aluminum	plastic	steel	…
Color	black	white	red	…
Capacity	1 GB	4 GB	8 GB	…
Display size	1,3 inch	1,8 inch	2,5 inch	…
Playtime	25 hours	35 hours	45 hours	
….				

Fig. 5: Morphological Box

The grey fields represent one of the many possible combinations that have to be verified and their concept further developed.

3.3 Evaluation and Selection of Ideas

Not all the identified business ideas can be pursued, since resources are limited and the efforts for their implementation too big. Therefore, the ideas have to be evaluated and selected.

To do so, one can use a great variety of evaluation methods and procedures. In most cases, one will start with a purely qualitative evaluation, which allows developing and evaluating relevant criteria. Helpful tools may be interviews with experts or potential customers or friends as "sparring partners".

Further possibilities are the point-value methodology, the cost utility analysis or the scoring model. "in which the evaluation of the ideas is expressed through points which express the degree of fulfillment of the evaluation criteria. Weighting allows taking into account the influence of the different evaluation criteria". (Klandt 2006, p. 129).

For general information on the evaluation of ideas in small and medium sized enterprises, see also: Weiss, 2006; and in the field of business formation: Leidig, 2004.

4. Tasks Including Solutions or Solution Propositions

Task 1

What are the advantages of the acquisition of a company compared to a business formation?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 2

What is the main difference between a manager and an entrepreneur?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 3

What are the decisive skills of an entrepreneur to guarantee long-term success?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 4

What are the basic creativity techniques?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 5

What is the objective of a brainstorming session?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 6

What are the four steps to develop a morphological box?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

5. Tasks to Send In

Please answer the following questions and send your answers to your mentor.

1. What are the main types of entrepreneurship?

2. What is a Management Buy-out (MBO)?
3. Explain the difference between invention and innovation.
4. Name the main advantages and disadvantages of a brainstorming session.

Please note the indications in the learning room concerning the latest send-in date!

Summary

The present learning unit illustrated the interesting and permanently changing tasks and challenges an entrepreneur has to face during the start-up phase and the life cycle of a business. For the practical implementation of a business formation or a small business formation, there are numerous possibilities, e.g.:

- Business formation
- Acquisition or participation
- Business succession.

The business idea stands at the beginning of this process. The idea may stem from recognizing an opportunity or may be generated through intuitive or discursive methods.

An essential point for the business success is the adequate evaluation and the appropriate selection of the business ideas with the highest success potential. This learning unit showed the different approaches to achieve this goal.

II - The Business Plan

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Academic Institution: University of Applied Sciences Luebeck
Field of Activity: Business and Management Economics
Competence Center: Business Formation and Management

Start!

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Overview

The business plan is a document outlining the results of the planning activities.

A business plan is not only an important planning tool when launching a new business, it is also a valuable instrument for established companies wanting to open up new business segments or create new product or service ideas in existing or new markets.

Learning Objectives

- Why establish a business plan?
- What to pay attention to when establishing a business plan?
- What are the key elements that should typically be included in a business plan?
- Basic knowledge on the establishment of a business plan.
- What are the typical pitfalls that should be avoided when establishing a business plan?

Layout

1. Motives, Target Groups and Structural Elements
2. The Importance of the Business Plan for Start-ups and Growing Businesses
3. Formal and Content-Related Requirements
4. Structure and Key Elements of the Business Plan
5. Pitfalls to Avoid when Establishing a Business Plan
6. Tasks Including Solutions and Solution Propositions
7. Tasks to Send In

Time Management

The time needed to treat this learning unit is approx. 18 hours (including the exercises and the tasks to be sent in.

1. Motives, Target Groups and Structural Elements

There are numerous reasons or motives why one would like to establish a business plan:

- Forming a new business
- Forming a small business
- Acquisition of an existing business
- Business succession
- Mergers
- Structural modifications
- Planning new business segments
- etc.

The **goal** of the business plan depends mainly on the motives. Whereas in the formation phase of a business, obtaining the necessary resources is often essential, established companies primarily want to **plan their business activities**.

The motives underlying the business plan also determine the target group, e.g. the people you write the business plan for. Possible target groups are:

- Venture capital firms
- Corporate venture capital firms
- Business angels
- Banks
- Public authorities and other institutions
- Guarantors
- Cooperation partners
- Staff
- etc.

Whereas small and medium sized businesses as well as big corporations have access to a variety of already existing data to establish their business plan, new businesses can only rely on a limited set of appropriate data. Especially when it comes to establishing profit and loss statements, liquidity statements and the balance sheet the lack of historical data is a big challenge for the planer.

For all these reasons, new business projects have a considerable demand for organization and planning. Since those who want to open a small business often lack planning skills and experience, they need to invest a considerable amount of time in the process of information acquisition, an aspect that has to be taken into account in your time management.

2. The Importance of the Business Plan for Start-ups and Growing Businesses

Founders of small businesses and young entrepreneurs as well as potential investors can use the business plan to decide whether the business idea is feasible and may be implemented successfully.

When launching a new business or a start-up, the business plan is a key document for the evaluation of the business idea and for the development of the business.

For the evaluation and the monitoring of the business activity, the business plan is a critical tool since it:

- compels its author to systematically think the business idea through
- reveals lack of knowledge and "pitfalls"
- enforces decisions
- promotes structural thinking and focused procedure
- allows for the permanent development of the business plan to guarantee long-term business success
- helps to assess the economic efficiency of the business idea.

The business plan is an important decision making tool for the investor and an essential step for the implementation of the business idea. A well-written business plan shows that the founder seems to be able to transform his business idea into a business. Only those who are capable of describing their project concisely and in simple words, have the prerequisites to successfully implement their ideas.

3. Formal and Content-Related Requirements

When establishing a business plan, one of the questions regularly asked relates to the size of the business plan. Since the size strongly depends on the business model, the capital requirements, the motives and the target groups, we can only offer some general recommendations. A business plan should not exceed 10 to 30 pages (not including appendices).

When writing a business plan, one should pay special attention to a reader-friendly layout and include informative charts and images that complete the written explanations.

Concerning the **content-related requirements,** one should particularly pay attention to a clear and understandable language and consistency. The reader should be able to follow the "red thread" from the beginning to the end.

A business plan is not an advertising copy. You have to convince with facts!

4. Structure and Main Elements of the Business Plan

Layout

4. Structure and Key Elements of the Business Plan

4.1 Executive Summary

4.2 Product and/or Service

4.3 Business Team

4.4 Market and Competition

4.5 Marketing and Distribution

4.5.1 Product Policy

4.5.2 Pricing Policy

4.5.3 Distribution Policy

4.5.4 Communication Policy

4.5.5 Business Checklist – Marketing and Distribution

4.6 Business System and Organization

4.7 Business Project Schedule

4.8 Opportunities and Threats

4.9 Financial Planning

4.9.1 Profit and Loss Statement Planning (P&L)

4.9.2 Liquidity Planning

4.9.3 Balance Sheet Planning

4.9.4 Interrelationship between the Financial Statements

4.9.5 Business Checklist – Financial Planning

4.10 Appendix

A business plan can be divided into three sections:

- Written explanation section
- Quantitative section
- Appendix

The **written explanation section** is the part where the project is explained with regard to the points 1 to 9 of the overview of the key elements of a business plan below. The **quantitative section** shows the consequences of the "written planning". The **appendix** includes all the documents that sustain and support section 1 and 2. The appendix may also include additional information.

Key Elements of the Business Plan

1. Executive Summary
2. Product and/or Service
3. Business Team
4. Market and Competition
5. Marketing and Distribution
6. Business System and Organization

7. Business Project Schedule
8. Opportunities and Threats
9. Financial Planning
10. Appendix

Table 1: Key Elements of the Business Plan

The key elements for the establishment of a business plan are described in detail below; they also include some practical advice. With the help of the business checklist at the end of each key element, you can check whether your business plan takes into account all the relevant aspects.

There is a whole variety of publications that provide further and more in-depth information on the establishment of a business concept. The internet also provides numerous pages that may help you to establish your business plan. The so-called business plan competitions offer free manuals and tools for the establishment of the financial statements (see for example the information on the business plan competition of Northern Bavaria: www.bpwn.de)

Generally, business plans are highly personal documents tailor made for the topic-related planning. Still, both in theory and in practice, there are certain key elements – as shown in the table above – that are common to many of them. Therefore, we advise you to refer to these key elements and adapt them as necessary.

The key elements will be explained in the next section.

4.1 Executive Summary

The main target of an executive summary is to grab the interest of the reader, to make him/her want to keep reading the other sections. As with the blurb on the cover of a book, there is only limited room for an executive summary. It should not have more than two pages DIN-A4 so that the reader can read and understand it within a maximum of five minutes.

The executive summary describes the character of the company in short and precise terms. It is not an introduction but a **short résumé of the most important aspects of the business plan**. These aspects include:

- objectives
- products and/or services offered
- customer benefits (if possible, in quantitative terms)
- most important members of the team
- essential aspects of the market and analysis of the main competitors (competitive advantages)

- capital requirements and the expected financial returns.

The presentation of the business project has to be easily understandable, even to nonprofessionals.

Practical Advice:

- Write the executive summary at the end!
- Allow enough time for the executive summary and carefully verify all expressions – if possible, get help from a third person who is not involved in the business plan.
- Ask yourself one question: does the text stimulate the curiosity and the interest of the target group (for example, potential investors)?

Business Plan Checklist – Executive Summary

- ☐ What is your **business idea**?
  Is it already protected or can it be protected (patent, utility model patent, etc.)?
- ☐ What is your **unique selling proposition** (USP)?
- ☐ Who are your **target customers**?
- ☐ Who are your **reference or pilot customers**?
- ☐ What is the benefit for your target customers (if possible, quantify)?
- ☐ What kind of **market volume** and which **growth rate** do you expect?
- ☐ How does the **competition** look like?
- ☐ What are the most important **milestones**? Which milestones have already been attained in the past?
- ☐ What are the further (technical) **development steps** necessary?
- ☐ What are your estimates on the **financial requirements**?
- ☐ What are the **distribution channels** that you will use for your products/services?
- ☐ What are the (strategic) **partnerships** you want to engage in?
- ☐ What are the essential **opportunities and threats** of your project?
- ☐ What are your estimates concerning the **turnover**, the **costs** and the **benefits**?
- ☐ What **legal form** will you use for your business?
- ☐ Short description of the **business team** explaining the function and the qualification of its members.

4.2 Product and/or Service

This section describes the planned product and/or service offers. It is particularly important to underline the difference to already existing problem solving solutions and the customer benefit that can be achieved with the new product/service.

In other words:
What is the innovative part of your offer and what are the benefits customers can gain from it?

Look at your offer from the customer's perspective. Is your problem solving solution good enough to make him pay the price you want?

The customer will pay the price, if the product or service offered has – from his point of view – a certain value, as compared to a product or service "nice to have".

"Innovative" does not necessarily mean new technologies or services that do not yet exist on the market, as it is often thought; the term also implies the transfer of an existing product or service offer to a new group of customers. Even the combination of already existing offers to form a "global product" attractive for the customer, can be considered an innovative problem-solving solution, just as the variation of products and services and the integration of new technologies and know-how in an existing business model.

The description of the **customer benefit** is based on economic optimization criteria: costs, quality and time.

Economic Optimization Criteria – a Basic Tool to Describe the Customer Benefit

Costs
Quality — Customer benefit
Time

Fig. 1: Economic Optimization Criteria – a Basic Tool to Describe the Customer Benefit.

To evaluate the advantages of a product and/or a service from the perspective of the customer, one can also describe the customer benefit in comparison to:

- **the competitors on the market**
- **the conventional technologies/services**

If possible, the customer benefit should be quantified. The quantification does not only allow for a better evaluation of the customer benefit, it also helps to determine the price.

State of Development and Future Development Plans

Describe the present state of development – if possible with figures and charts – as clearly as possible, without giving too many technical details. Investors particularly like prototypes since they always want to minimize their risks. Another positive aspect would be an already existing cooperation with a pilot customer who already uses the innovative product or the service.

The existing situation of the property rights should also be presented, what are one's own property rights and what are the patents, licenses, etc. of the competitors.

Business Plan Checklist – Product and/or Service

- ☐ In which way your product and/or service is innovative or new?
- ☐ What are the target customer groups you want to reach?
- ☐ What is the customer benefit of your product and/or service offer?
  Can you quantify the customer benefit?
- ☐ What is your level of problem solving potential starting at the present state of the art?
- ☐ What are the development steps you are planning? What are the milestones you have to reach and when?
- ☐ Do you perceive any essential technical development risks? If so, how will you deal with these risks?
- ☐ What is the level of development of your product/your service idea?
- ☐ What are the competitive products that already exist on the market or that are being developed by your competitors?
  In which way your offer differs from the competitors' offers?
- ☐ How is the present situation concerning patents and licenses?
  What kind of patents/licenses do you hold?
  What kind of patents/licenses do the competitors hold?
  What are the property rights you will have to obtain?
- ☐ Compare the strengths and the weaknesses of comparable products/services with your own offer and show the comparison in a table or figure.
- ☐ What are the service and maintenance offers that are part of your performance spectrum?

4.3 Business Team

If the business is founded by several persons, the business team is a crucial element in the successful implementation of the business potential.

Only good teams will be able to manage the difficulties that will surely occur during the implementation of the business idea. Accordingly, many investors are convinced that bad teams are unable to even implement good ideas. On the contrary, good teams may even transform a bad business potential into a successful business by adapting it accordingly.

Good teams are characterized by the complementarities of the individual team members, their technical and commercial qualifications, and their soft skills and by the fact that the chemistry in the group is right.

In this section, you should describe the business team and/or key collaborators on the basis of their:

- qualifications
- experience
- knowledge of the business sector and
- their technical know-how.

Define who will be responsible for the individual **tasks**. Positions/tasks that have not been attributed yet should be clearly marked.

If available, also add a short description of the relevant consultants (tax advisors, lawyers) and the members of the advisory or supervisory board. The right names add to the credibility of the project and show that you have access to certain networks.

Business Plan Checklist – Business Team

- ☐ Who are the members of your business team and what are their characteristics regarding their future function within the formation or the project team: education, professional experience, technical knowledge, success, professional qualifications, soft skills …
- ☐ What are the experiences and skills of the team that are particularly crucial for the implementation of the business or project idea and how do these skills complete each other?
- ☐ What are the experiences and skills the team is lacking? How and when will you

complete the team and by whom?

- ☐ What are the objectives of the team members in relation to the business formation?
- ☐ Have the team members already been working together (successfully) in the past?

4.4 Market and Competition

Market

Section "Product and/or service" showed the possible problem solving offers. This section will describe the relevant markets, the size and the growth of these markets. If you want to limit your target markets, market segmentation is a useful tool. There are different criteria that help to segment the market. Table 2 shows some examples for segmentation criteria for consumer goods and capital goods markets.

Customer segmentation: consumer goods	Customer segmentation: capital goods
▪ **Demographic** age, sex, profession ▪ **Psychographic** personality characteristics, life style (eco-oriented, techno freaks, active seniors, …) ▪ **Behavior oriented** spec. attitudes, behavioral patterns, brand loyalty, … ▪ **Geographic** provinces, cities, climate, purchasing power districts…	▪ **Demographic** company size, sector of activity… ▪ **Purchasing behavior** centralized/decentralized, cooperative purchasing group, purchasing criteria ▪ **Company-related** uses technologies (analog/digital), … ▪ **Situation-related factors** urgency, order volume…

Table 2: Segmentation Criteria for Consumer Goods and Capital Goods

An important aspect when choosing the segmentation criteria is a homogenous customer group which helps to reach the customers evenly with the planned distribution measures.

Once the market segments have been established, you can start to look for the necessary information. The quickest, easiest and least expensive way to collect data is the so-called **secondary data analysis**. This analysis uses already existing data sources which will be collected, analyzed and interpreted for your own purpose. When using the cost-intensive **primary data collection**, the information is collected through surveys and investigations, for example with interviews or by observation. Table 3 shows an overview of the possible data sources.

Secondary data	Primary data
▪ Internet ▪ Data base (e.g. Federal Agency for Foreign Economic Affairs, Genios, etc.) ▪ Chambers of Commerce (IHK, HWK, AHK), professional associations ▪ Official statistics (e.g. Federal Statistical Office) ▪ Analyses from consultancy firms (e.g. KPMG, McKinsey, etc.)	▪ Interviews (experts, suppliers, customers, competitors) ▪ Observation ▪ Commissioning of market analyses, feasibility tests, etc. ▪ Document analyses

Table 3: Secondary and Primary Data as a Source of Information for Market and Competitor Analysis

Considering the scarcity of resources, new small businesses are not advised to treat and analyze all the possible market segments right from the beginning. One should rather focus on certain economically promising market segments. Nevertheless, this section should still indicate the whole medium-term and long-term market potential.

Competition

The **competitor analysis** identifies the competitors that are present on the beforehand identified market. The strengths and weaknesses of theses competitors are compared with your company's. To do so, you should use relevant comparative criteria like the price/performance ratio, the use of technology, sales, turnover, target groups, price, quality, market share, distribution, etc. as illustrated in the following Strength-Weakness-Profile.

Example for a Strength-Weakness-Profile

Comparative criteria	Degree				
	very strong ++	strong °	medium +/-	weak -	very weak --
Price/performance					
Use of technology					
Technological creativity					
Market share					
Quality					
Customer service					
Qualified staff					
Flexibility					
Service performance					

Capacities					
Customer image					
…					

Company (example)

Fig. 2: Example for a Strength-Weakness-Profile

It is much more difficult to identify the future competitors or the substantial potential. In this context, you have to ask yourself what are the potential competitors and the possible substitution products, for example, in case of an increased attractiveness of the market that may influence your competitive position.

You also have to explain the positioning of your business in respect to other competitors, for example, what is the unique selling proposition that allows the company to generate a competitive advantage. The uniqueness may be the price, the design or the benefit of the product. The unique selling proposition may also be used as the basis for an advertising campaign.

Business Plan Checklist – Market and Competition

- ☐ What is the size of the present and the future market volume for your product and/or service offer?
- ☐ What are the niches that you want to occupy?
- ☐ What are the benefits and the problem solving solutions that your customer target groups expect from you?
- ☐ What are your market segmentation criteria?
  What are the areas you want to cover?
- ☐ What is the market share you want to achieve in each market segment?
- ☐ Who are your potential customers?
- ☐ Do you already have reference or pilot customers that you are allowed to name and/or how do you want to gain them?
- ☐ What are the main competitors who offer comparable products/services?
- ☐ What is the price offered by your competitors? What is their pricing strategy?
- ☐ What kind of new developments can you expect from your competitors?
- ☐ How are the competitors organized?
- ☐ Who are the potential competitors who may enter your target market on a short and medium term basis?
- ☐ What are the market entry barriers that exist in your sector?
  What are your measures to overcome these barriers?

- ☐ How long will you be able to benefit from your competitive advantage? Explain your answer.
- ☐ Compare the strengths and weaknesses of your main competitors with your own and illustrate them in a profile.
- ☐ What is your comparative advantage?
- ☐ What are the specificities of your competitors, e.g. regarding quality, service, etc.?
- ☐ What kind of reactions do you expect from your competitors? What kind of counter-measures have you planned?

4.5 Marketing and Distribution

Layout

4.5 Marketing and Distribution
4.5.1 Product Policy
4.5.2 Pricing Policy
4.5.3 Distribution Policy
4.5.4 Communication Policy
4.5.5 Business Checklist – Marketing and Distribution

The market and competitor analysis forms the basis for the marketing and distribution strategies and measures as developed in a **marketing concept**.

Developing a Marketing Conception

What are the goals we want to achieve?	Marketing objectives	The planning of the marketing objectives is based on the business objectives: - Target content -→ realistic planning of economic goals - Target size → quantification of the target - Target time → determination of the timeline to reach the

		targets
How can we achieve them	Marketing strategy	Business segment strategy: →Market selection →Selection of market participants Competition strategy →cost leadership →differentiation strategy →niche strategy
What do we have to do to achieve them?	Marketing mix	- Product policy - Pricing policy - Distribution policy - Communication policy

Fig. 3: Developing a Marketing Conception

A **marketing concept** is a "concise, global action plan oriented towards the determined objectives for the implementation of which appropriate strategies will be chosen and on the basis of which adequate marketing instruments will be determined" (Becker 2001, p. 5).

Marketing objectives can generally be deduced from the business objectives, they refer to economic objectives like a certain turnover. Especially newly formed businesses should remain realistic when determining these objectives, they should be attainable within a set period of time and, if possible, quantifiable. In this context, it is important to formulate clear and verifiable objectives. This means that the objectives will have to be formulated clearly and verifiably (has the increase in turnover been reached yes or no) by determining their content (e.g. increase the turnover), their extend (250.000 EUR) and their time reference (compared to last year).

For new businesses, the first main target is to acquire a sufficient number of first customers. Example: Within the first half marketing year, we plan to gain 50 new customers in Germany.

"Once the objectives have been determined, the marketing strategy will describe the way to reach these objectives." (Klandt 2006, p. 211)

The marketing strategies include the definition of the:

- business segment strategy and the
- competitive strategy

The **business segment strategy** derives from the basic decisions taken in the section Market and Competition regarding the target markets and the target customer groups.

The **competitive strategy** also builds on the results of the last section. Once the competitors have been analyzed, a decision on the following basic competitive strategies is taken:

- **Cost leadership**
  Objective: gain competitive advantages through low costs. This strategy allows offering a relatively low price on the market.
  Example: Low cost airline Ryanair.

- **Differentiation strategy**
  Objective: From the customers' perspective, the offer should present a unique selling proposition compared to the competitors' offers. For example in the following areas: price, quality, design, etc.

- **Niche strategy**
  Objective: concentration on certain priorities. For example, through certain customer target groups, geographical markets, etc.
  Example: Brembo (Italian brake manufacturer) has specialized in tailor made solutions for the racing industry (Formula 1 / motorbikes).

After having defined the marketing objectives and the marketing strategy, one has to determine the individual **marketing instruments** through a marketing-mix description. The **marketing-mix** also known by the term 4 P (= product, price, place and promotion), comprises the product, the price, the distribution and the communication policy, as illustrated in the figure below.

- In the online version an interactive multimedia element will be included here.

The list below shows the essential contents of these elements. For a detailed description of these elements, please refer to the online version.

Marketing-Mix

Product policy	Pricing policy
- Market segment related adaptation of product/service offer - Product line - Development potential	- Price - Discount/rebate - Financing options (e.g. leasing)

- Quality management - Service performance	
Marketing-Mix	
Distribution policy - Physical distribution - Direct approach - Indirect approach - Choice of location	Communication policy - Advertisement - Sales promotion - Fairs / expositions - Personal sales - Public relations

Fig. 4: Marketing-Mix

4.5.1 Product Policy

Marketing-Mix – Product Policy	
Product policy - Market segment related adaptation of product/service offer - Product line - Development potential - Quality management - Service performance	Pricing policy - Price - Discount/rebate - Financing options (e.g. leasing)
Marketing-Mix	
Distribution policy - Physical distribution - Direct approach - Indirect approach - Choice of location	Communication policy - Advertisement - Sales promotion - Fairs / expositions - Personal sales - Public relations

Fig. 5: Marketing-Mix – Product Policy

Based on the market segmentation, the product policy determines which products/services and which characteristics (product development, design) will be offered. Due to the scarcity of resources, it is recommended to focus on the most promising segments.

The product policy also includes explanations on the planned quality and service policy to guarantee customer satisfaction. Describe briefly the planned **quality management system** and the planned services (customer training, maintenance options, reaction times, etc.)

Furthermore, one should also describe the development potential of the offered products and services.

4.5.2 Pricing Policy

Marketing-Mix – Pricing Policy

Product policy - Market segment related adaptation of product/service offer - Product line - Development potential - Quality management - Service performance	Pricing policy - Price - Discount/rebate - Financing options (e.g. leasing)
Marketing-Mix	
Distribution policy - Physical distribution - Direct approach - Indirect approach - Choice of location	Communication policy - Advertisement - Sales promotion - Fairs / expositions - Personal sales - Public relations

Fig. 6: Marketing-Mix – Pricing Policy

This section determines and explains the pricing strategy. The price is influenced among others by:

- The general pricing strategy, e.g. does one apply a skimming strategy (highest possible price based on a superior product/service) or a penetration pricing (lowest possible price to gain the biggest possible market share within a short time),
- The identified and probably already quantified customer benefit.
- The willingness of the customer to pay a certain price and
- The full cost accounting to determine the lowest-price limit.

When determining the price, one has to consider that the price is not the most important sales argument. What counts is the whole package. This also includes the terms and conditions policy regarding discounts, terms of payment, rebates and guarantee regulations.

Concerning the possibilities related to pricing, see Gierl und Helm 2003, p. 83ff.

Disregarding the chosen pricing strategy, it is recommended to periodically verify the strategy and adapt it if necessary.

4.5.3 Distribution Policy

Marketing-Mix – Distribution Policy

Product policy - Market segment related adaptation of product/service offer - Product line - Development potential - Quality management - Service performance	Pricing policy - Price - Discount/rebate - Financing options (e.g. leasing)
Marketing-Mix	
Distribution policy - Physical distribution - Direct approach - Indirect approach - Choice of location	Communication policy - Advertisement - Sales promotion - Fairs / expositions - Personal sales - Public relations

Fig. 7: Marketing-Mix – Distribution Policy

The distribution policy responds to the question **how** the offered products and services will reach the target customers. As with the pricing strategy, the adequate choice depends on many factors:

- Does the service offer require explanation?
- Does the policy address corporate customers and private customers alike?
- Does the policy follow a penetration pricing or a skimming strategy?
- What is the target group you want to reach?
- …

Generally, one must distinguish between **direct and indirect distribution channels**. Whereas direct distribution does not use an intermediary between the producer and the customer, the indirect distribution generally uses an intermediary (e.g. a retailer and a wholesaler).

One can choose between the following distribution forms:

- Franchising
- Retail/wholesale
- Distribution agents
- External representatives
- Branch offices / cooperation
- Call center
- Internet
- TV Shopping-channels
- ….

When choosing the distribution channel, one also has to take into account the considerable consequences on the business. Whereas the direct distribution generates high costs because of the distribution staff, the risk of the indirect distribution is to lose the direct customer contact and the customer feedback.

4.5.4 Communication Policy

Marketing-Mix – Communication Policy

Product policy	Pricing policy
- Market segment related adaptation of product/service offer - Product line - Development potential - Quality management - Service performance	- Price - Discount/rebate - Financing options (e.g. leasing)
Marketing-Mix	
Distribution policy	Communication policy
- Physical distribution - Direct approach - Indirect approach - Choice of location	- Advertisement - Sales promotion - Fairs / expositions - Personal sales - Public relations

Fig. 8: Marketing-Mix – Communication Policy

To inform the target customers of the service offer, the company can chose among a wide variety of different means of communication:

- Sales promotion (special offers, trade sample, games, etc.)
- Classical advertisement (television, radio, newspapers, etc.)
- Internet advertisement (homepage, banners, Pop-up's, use of virtual worlds for product placement)
- Public Relation (press release, non-profit activities, etc.)
- Fairs, expositions
- Customer visits
- Trainings
- Events
- …

For new businesses, low cost communication measures like the distribution of handouts, brochures, flyers, advertising in local newspapers or the use of the so-called **Guerilla Marketing** are particularly interesting.

The term "guerilla marketing" was coined in the mid-1980 in the US by a certain Jay C. Levinson. The Guerilla Marketing Handbook, edited since 1984, has been translated into 37 languages. Guerilla Marketing opens up new possibilities for small and young businesses; it is a cost-effective communication, which uses unconventional, innovative and creative measures to reach potential target customers. It is therefore the objective of the guerilla marketing,

"to use and implement unconventional, original ideas to gain maximum attention from the target customer group with a given small budget". (Volkmann und Tokarski 2006, p. 197)

Guerilla marketing is not an alternative or the opposite of classical advertising; it rather is an extraordinary addition. **Examples** are the acquisition of residual advertising seconds on television, the targeted writing of customer reviews for online bookshops or addressing letters to newspapers with hidden indications for one's own products or the writing of test reports on the internet as coming from alleged users, etc. The borders between controversial or misleading methods or between morally condemnable or illegal breaches of the rules are often not clearly defined.

On the basis of the chosen market segment, one has to decide on the communication strategy that reaches the target group with as little spreading loss as possible and therefore contributes – depending on the chosen positioning strategy – to the creation of a certain image.

4.5.5 Business Checklist – Marketing and Distribution

Business Checklist – Marketing and Distribution

- ☐ What sales price do you want or do you have to obtain?
  What is your pricing strategy (penetration versus skimming strategy)?
- ☐ What is your pricing strategy for individual market segments?
- ☐ What is your profit margin?
- ☐ What are the additional services you want to offer (service, maintenance, etc.)?
- ☐ What are the sales figures (numbers per unit) and the turnover (numbers per unit * price) you want to achieve per market segment?
- ☐ What is the relation between customer benefit (quantified) and price?
- ☐ Do you want to cover all segments with one product or do you want to clearly target your offer to certain segments?
- ☐ Through which market segments do you want to enter the market?
- ☐ Which target customer groups do you want to reach through which distribution channels?
- ☐ How much effort (time and capacity) do you have to provide to gain a new customer?
- ☐ What are the skills, qualifications and equipment necessary for the distribution?
- ☐ What are the measures planned to win over and keep a customer?
- ☐ What are the forms of distribution that allow you to reach your target customer group? Justify your answer!

4.6 Business System and Organization

The presentation of the business system and the organization illustrates the **business conception**, which does not necessary have to be established in every company. A company with 2 to 4 employees and a manageable value chain does hardly need to put much effort into the establishment of a business system and an organizational structure. The bigger and the more complex a company, the more effort should be put into these subjects.

To do so, one first defines the activities within the company as well as the role of upstream and downstream sectors and partners. This means that one also deals with the definition of one's own core competences and the integration of cooperation partners (Fueglistaller et al. 2004, p. 222)

The following figure illustrates a business system for a start-up in mechanical engineering.

Business System of a Start-up in Mechanical Engineering

Research & Development and technology screening	Plant engineering	Service center	Marketing and distribution	Service
partially in cooperation with know-how partners			focus of the start-up	

Fig. 9: Business System of a Start-up in Mechanical Engineering.

By determining the business system certain prerequisites for the establishment of an **organizational structure** have already been defined. Therefore, the organigram assigns identified missions to precise departments defining their competence and responsibilities. In the beginning, it is important to verify whether all the relevant posts can be filled and whether the planned workload can be managed with the number of posts available and the planned costs.

The figure below provides an example of a **function-oriented organizational structure**

Function-oriented Organizational Structure

Management					
			Staff unit: Controlling		
R&D	Purchasing	Production	Marketing/Distribution	Finances	Administration

Fig. 10: Function-oriented Organizational Structure

Depending on the business system, one can also draw a **process-oriented organizational structure**. For example, the already mentioned start-up in mechanical engineering selected this form of organization because it guarantees, in comparison with the functional organization and on a long-term basis, a reduction in the complexity of the internal system and the interfaces. Another reason for choosing the process-oriented organization model was its optimal adaptability to specific market developments and a precise customer orientation.

Process-oriented Organization Structure of a Start-up in Mechanical Engineering

Management			
Development and construction, technology screening	Production and services	Marketing and distribution	Finance and accounting
Process: Plant engineering			
Process: Service center			

Fig. 11: Process-oriented Organizational Structure of a Start-up in Mechanical Engineering.

When drawing an organigram it is also important that for all the different missions and tasks the responsibilities be clearly defined. In this process, one should also address the question of the representation so that each member of the team can replace another member during his/her absence.

Business Location

Explain the influence of your business location on the success of your company. Possible factors that influence the decision may be the vicinity of universities and research centers, the availability of qualified personnel or an adequate transport infrastructure.

Business Checklist – Business System and Organization

- ☐ How do your business system and your business organization respond to your problem-solving offer?
- ☐ What are the activities of your company?
  What are the services you have to purchase externally?
- ☐ What are the core segments of your activities?
- ☐ What are the resources you need for the production of your products and services?
- ☐ Do you plan to cooperate with (strategic) partners?
  If so, who are those partners?
- ☐ What are the cooperation advantages for you and your partner?
- ☐ What are your planned capacities (product and/or service)?
- ☐ How quickly can you adapt your capacities to changing market conditions?

4.7 Business Project Schedule

The business project schedule shows the content and the time-related framework for all essential activities that will be planned in the next 3 to 4 years. It is important to clearly define the milestones e.g. important events, and to adopt a precise schedule.

“This allows coordinating the individual implementation steps, to assign the resources and capacities and to plan the feedback sessions.” (Fueglistaller et al. 2004, p. 223)

Milestones may be technical (e.g. developing a prototype) financial (e.g. reaching the break-even point) or organizational (finalize the business organization). In venture capital financing, milestones are often used as a basis for the release of financial resources.

The business project schedule may be illustrated in a **network chart** or in a **Gantt chart**.

The **network chart** “is a graph theoretic procedure to plan and control complex project implementations.” It takes into account the following factors: costs, time and resources used (Kollmann 2005, p. 303).

The **Gantt chart** is mainly used for projects with a small or a medium number of activities. It shows the start and the end of project activities, highlights important milestones and illustrates, if necessary, the interdependence between different work packages. See also the figure below

---

Gantt Chart for the Business Project Schedule

Development

- Prototype development
- Patent Issue
- Simulation production process
- Software development

Production

- Set-up
- Production capacities
- Serial production

Marketing and distribution

- Market entry
- Opening of a branch office in
    - Austria

- Switzerland

Financing

- Financing round 1
- Financing round 2

Milestones

Fig. 12: Gantt Chart for the Business Project Schedule

Business Plan Checklist – Business Project Schedule

- ☐ Have all the important (technical, economic and organizational) milestones been defined and finalized?
- ☐ What are the milestones that have to be met to allow the implementation of further activities?
- ☐ What are the bottlenecks that may occur?
- ☐ Are there any other risks within the schedule?
- ☐ Is the time span attributed to the business project schedule adequate?

4.8 Opportunities and Threats

When opening a new business or a start-up one is confronted with a high degree of uncertainty and the imponderables are considerable. Consequently, it is important to list all the relevant opportunities and threats that may occur during the implementation phase of the business plan and to realistically and comprehensively interpret their possible consequences.

All the potential opportunities and threats in the following areas need to be identified:

- Business formation
- Customers
- Suppliers
- Competitors
- Market
- Technologies
- Finances

For a detailed identification, it is recommended to use the so-called SWOT analysis (SWOT meaning **S**trengths, **W**eaknesses, **O**pportunities and **T**hreats). This analysis allows to examine the chosen business model and to see to which extend the internal strengths and weaknesses – which can be influenced – meet the external changes (opportunities and threats) that cannot be influenced by the company.

SWOT Analysis

Analysis of external factors Market and competitor analysis		Analysis of internal factors Business analysis
Opportunities / Threats Market attractiveness	SWOT Analysis	Strengths / Weaknesses Competitive position
Potential opportunities and threats		

Fig. 13: SWOT Analysis

Procedure

First, one lists the internal strengths and weaknesses of the company that result from the performance potentials (e.g. technological, financial, time-related or personal) in relation to the competitors. The next step is an analysis of the opportunities and threats that might arise from the technological, political, legal, demographic, global or economic developments (Kerth et al. 2007, p. 181f).

The table below contains a list of questions that might be asked when conducting a SWOT analysis.

Opportunities	Strengths
– What are the interesting trends for the company? – What are the opportunities of the demographic development – What are the advantages of the increasing globalization? – ….	– Where are the technological advantages compared to the competitors' solutions? – What is the time-related development lead of the company? – Does the company have a more flexible organizational structure than its competitors do? – ….

Threats	Weaknesses
– What are the difficulties regarding the global economic situation or the market trends? – What are the research and development projects the competitors are engaged in? – What are the threats resulting from the present political and legal development (e.g. protection of non-smokers or protection of the climate)?	– What are the weaknesses in the financing of the company that need to be amended and avoided in the future? – Is the payment of the service providers the same as with the competitors? – Does the offer of products, services and maintenance meet the expectations of the customers? – …

Table 4: Questions to be Asked in a SWOT Analysis

It is also important to not only list the threats but to also indicate the measures that will be taken if the threat occurs.

The information collected within the SWOT analysis is not only helpful for the illustration of the opportunities and threats in this chapter; it can also be helpful when describing the market and competitor situation (see the related section on Market and Competition).

In this context, one should also explain the consequences on the business plan in a best-case and a worst-case scenario. This can be done by changing the decision-critical variables, e.g. the price or the quantity. These scenarios are an important tool for the entrepreneur and the potential investors. It allows to better evaluate the risk/threats and the bandwidth of possible developments.

Business Plan Checklist – Opportunities and Threats

- ☐ What are the fundamental threats during the implementation of the business plan concerning the market, the competition, the customers, the supplies, the technology, the financing or the staff?
- ☐ How will you meet possible threats (avoid, reduce, guarantee)?
- ☐ What are your options in the case of liquidity bottlenecks?
- ☐ What are your best-case and your worst-case scenarios for the next five business years?
- ☐ How do they influence the capital requirements and the return on investment?
- ☐ How realistic are the different scenarios from your point of view?

4.9 Financial Planning

Layout

The financial statements illustrate the project plans in figures. Generally, the financial plan is guided by the typical elements contained in cost accounting systems. Its objective is mainly to evaluate the economic feasibility and the financeability of the business project.

The basic instruments for the financial statements include:

- Prospective profit and loss statement (P&L)
- Liquidity planning
- Balance sheet planning

These instruments may be completed and enlarged, if necessary, by other specific planning tools that reflect the specific financial requirements. They may include contribution costing, planning of the investment costs and labor costs.

The prospective profit and loss statement and the liquidity planning should be done monthly during the first year, quarterly during the second year and then once every year. For the balance sheet a plan once a year is enough. All these instruments should cover a period of 3 to 4 years. Explaining all the relevant planning assumptions, helps to assure a better comprehension of the financial planning activities.

If the financial and commercial know-how are not sufficient, it is important to seek support from qualified external advisors (e.g. tax consultants) during the financial planning phase.

4.9.1 Prospective Profit and Loss Statement (P&L)

The profit and loss statement illustrates whether a company is profitable or not. The success of a company is measured within a given period of time by balancing all expenses and revenues. The P&L therefore gives an overview of the different elements that contribute to the success (sales revenues, material expenses, salaries and wages, advertising, etc. turnover, change in stocks, etc.).

Profit and Loss Statement Planning on a monthly basis including a comparison between the plan and the actual situation				
Revenues and expenses	PLAN Month Year	ACTUAL Month Year	Variance (%)	
Sales revenues (products)				
Sales revenues (services)				
Sales revenues (maintenance/service)				
(+/- Change in stock of finished and unfinished products				
(+) internally produced and capitalized work				
Other revenues				
Material expenses				
Total				
Personnel (salaries/wages/social security)				
Depreciation				
Total of all operational expenses/charges				
Revenues from participations				
Revenues from securities and loans				
Other interests and similar revenues				
Depreciations on fixed assets and securities				
Interests and similar expenses				
Results on ordinary activities				
Extraordinary revenues				
Extraordinary expenses				
Total of extraordinary revenues and expenses				
Taxes on income and benefits				
Other taxes				
Monthly result				

Table 5: Example for a Profit and Loss Statement for a newly founded business in the production sector

4.9.2 Liquidity Planning

The liquidity planning compares revenues and expenses, showing the effective inflow and outflow of financial resources. It helps to guarantee the solvency; a company has to maintain a certain liquidity all the time. It is absolutely necessary so that the existence of the company is not threatened by insolvency. Therefore the liquidity planning should be done as detailed and carefully as possible and provide sufficient financial reserves for unexpected events.

When opening a small business, one should not forget that the liquidity planning also includes the costs for establishing the business (e.g. fees for the notary, tax advisor, lawyer, logo, registrations and licenses) and not only the costs for already existing companies.

The online version shows a chart too big to be shown in the print version.

4.9.3 Prospective Balance Sheets

The balance sheets reflect the development of the company's assets and capital. The asset-side describes the type and amount of the financial resources (**= application of funds**), the liability side indicates the origin of the resources (**= sources of funds**). The balance sheet also takes into account the fact that the equity should never be used up, because this would lead to insolvency due to over-indebtedness.

Assets	Liabilities
A. Fixed assets I. Intangible assets II. Tangible assets III. Financial assets	A. Equity capital I. Subscribed/Nominal capital II. Capital reserves III. Revenue reserve
B. Current assets I. Stocks II. Accounts receivable and other assets III. Securities IV. Cash, dues from Central Bank, from banks, checks	IV. Profit/loss carried forward V. Profit/loss for the year B. Provisions C. Liabilities D. Accrual and deferred income
C. Prepayment and accrued incomes	

Table 6: Balance Sheet Positions in reference to article 266 of the German Commercial Code.

4.9.4 Interrelationship between the Different Financial Statements

The following figure illustrates the interrelationship between the financial statements: profit and loss statement, liquidity planning and balance sheet by showing that profits and losses modify the equity capital position and that liquidities reflect the financial requirements and/or the cash surplus.

Interrelationship between the Profit and Loss Statement, the Liquidity Planning and the Balance Sheet

Liquidity Planning			Profit & Loss Statement	
In-payment	550			
Out-payment	350		Income	550
Former balance	200		Expense	350
Liquid funds available	400		Annual profit	200

Prospective Balance Sheet			
Assets		Liabilities	
Tangible assets Financial assets	500	Equity capital - Subscribes capital - Capital reserves - Profit/loss carried forward - Profit/loss for the year	 150 350 -100 200
Current assets - Stocks - Cash	 100 400	Liabilities - Banks - Advance payment	 250 150
Total	1000	Total	1000

Fig. 15: Interrelationship between the Profit and Loss Statement, the Liquidity Planning and the Balance Sheet.

4.9.5 Business Plan Checklist – Financial Planning

Business Plan Checklist – Financial Planning

- ☐ Have all relevant expenses (e.g. formation costs) been included?
- ☐ What are the assumptions underlying the essential planning parameters (development of turnover or labor costs)
- ☐ What kind of development do you expect concerning the turnover, the expenses, and the revenues?
- ☐ Does the liquidity planning provide a sufficient margin for unforeseeable developments?
- ☐ How do you want to invest the available financial resources (investment planning)?

- ☐ When will you reach the break-even point?
- ☐ What are the financial requirements of your company?
- ☐ What are the financial sources you will use to cover your financial requirements?
- ☐ What kind of offer will you present to potential investors?
- ☐ What kind of return do you expect from your business, what kind of return investors can expect?
- ☐ What are the exit options for the potential investors?

4.10 Appendix

Any information that would take up too much space in the business plan, can be added as an appendix. As with the business plan, it is the quality and not the quantity that counts! Avoid data graveyards!

The following documents might be added in the appendix:

- Patents, utility models, licenses, ..
- Letter of intend
- Market analyses
- Charters
- Expert reports
- Offers
- Awards
- Curricula
- Contracts
- Official authorizations
- Site analysis

To decide whether a document has to be included in the business plan or be part of the appendix, consider whether the business plan is still comprehensible without studying the appendix.

5. How to avoid errors when establishing a business plan

Experience shows that the same errors are made repeatedly when establishing a business plan. The commentaries below will help you to avoid common errors. It is not our aim to provide a complete list of all possible and avoidable errors, but to sensitize the reader for the main problem areas.

1. Establishing a Business Plan for the Purpose of Raising Capital only

Business plans are often established for the sole purpose to raise capital and are discarded once the financing has been granted. They are considered to be an “annoying task” to get the financing. Such an approach does not consider the use of a business plan as a navigation and monitoring instrument. The planning should be up-dated and amended periodically, depending on the business model every six or twelve months. This allows an early action instead of a late reaction.

2. Executive Summary

The executive summary is often too extensive, hard to understand and often more an introduction than a summary of the essential aspects.

3. Products and/or Services

Often the description of the products and services is too technical, using industry specific terminology.

4. Market and Competition

Market segmentation is not done in a useful and comprehensible way. Regarding competition, often only the directly recognizable competitors are identified. As numerous developments have shown, one also has to analyze the potential competitive environment. For example, food discounters are often potential competitors for PC businesses and travel agencies.

5. Business Team

The business team is often not convincing regarding the necessary, business model related skills and the know-how. In many cases, the team lacks the necessary commercial qualifications.

6. Marketing and Distribution

As a consequence of the lack of a good market segmentation, the Marketing and Distribution section often plans the use of marketing instruments without explaining how they suite the objective. Furthermore, in many cases the marketing strategy is not convincing.

7. Opportunities and Threats

The faith in one owns business concept often leads to underestimating the possible threats while at the same time overestimating the opportunities. Therefore, a critical and careful analysis and presentation of the opportunities and threats is essential.

8. Financial Statements

In many cases, future entrepreneurs try to write financial statements and plans themselves without having the necessary financial and economic knowledge and background. This unprofessional approach often leads to completely wrong results (for example, concerning the financial requirements). It is therefore highly recommended to appeal to the competent experts. Furthermore, these plans are often unrealistic "sunshine plans" based on overly optimistic planning assumptions.

9. Appendix

In numerous cases, either essential documents are not included or too much information is "packed" into the appendix which leads to a confusing "data graveyard".

6. Tasks Including Solutions and Solution Propositions

Task 1

What are the key elements of a business plan?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 2

Name three target groups which are addressed through the business plan?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 3

Why do many business founders first engage in a costly information collection process before establishing a business plan?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 4

What is an executive summary and what are the main points to pay attention to when establishing an executive summary?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 5

Name five essential errors, which should be absolutely avoided when establishing a business plan?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 6

What do you understand by “nice to have” products or services?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 7

In which dimensions can one describe the customer benefit?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 8

What are the inexpensive communication instruments you would recommend to small businesses and start-ups?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 9

How should objectives be formulated, to make them clear and verifiable?

Please give an example.

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 10

Name three possible competitive strategies and explain them briefly.

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 11

What is a SWOT analysis? Please explain the procedure. How can the SWOT analysis be used in the context of a business formation?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

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7. Tasks to Send In

Please answer the following questions and send your answers to your mentor.

1. What are the key elements of a business plan?

2. What kind of market segmentations do you know?

3. What is the objective of financial planning in the framework of a business plan and what are the instruments essentially used?

4. Name four reasons why one should consider establishing a business plan.

Please note the indications in the learning room concerning the latest send-in date!

Summary

In this section you learnt about the necessary basic knowledge to establish an adequate business plan.

One essential message of this section is that the business plan is not only a planning instrument when starting a new business but also a navigation and monitoring tool that can be used throughout the whole life cycle of a company.

A business plan needs to be continuously adapted and revised at regular intervals.

III - Start-up and Growth Financing

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Academic Institution: University of Applied Sciences Luebeck
Field of Activity: Business and Management Economics
Competence Center: Business Formation and Management

Start!

Disclaimer

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Overview

Securing the necessary funding for a start-up or a growing business is one of the essential tasks of an entrepreneur. He therefore needs good knowledge in the general rules and strategies to be applied, in the available financing sources and financing motives as well as in the different analyzing and evaluation methods, which will help him to secure adequate funding. This chapter provides the necessary basic knowledge without pretending to fully cover all the related subjects.

Learning Objectives

- Overview of the financing sources and motives
- Basic knowledge on the impact of venture capital financing
- Evaluation and selection of financing alternatives

Layout

1. General Rules and Strategies for Entrepreneurs
2. Financing Motives and Sources
3. Financing Sources
4. Analysis and Evaluation of the Impact of Venture Capital Financing as a Basis for Decision Making
5. Tasks Including Solutions and Solution Propositions
6. Tasks to Send In.

Time Management

The time needed to treat this learning unit is approx. 11 hours (including the exercises and the tasks to send in).

1. General Rules and Strategies for Entrepreneurs

Financing is a very important topic for the security and the development of the business and therefore always an entrepreneur's task he must not delegate to anybody else. When engaging in the equity capital procurement process, the entrepreneur constantly has to be aware that he has to consider certain elements of his business, e.g. products, for which he will have to develop adequate marketing and distribution concepts.

The entrepreneur also has to consider that the best time to think of capital procurement is when you think you do not need it (yet). If for unforeseeable reasons (problems or chances), you suddenly and urgently need to raise capital, the financing costs are generally higher. Therefore, one should periodically check the optimal time to begin the next financing round.

From the beginning one should establish, within the business plan, a financing concept that includes several rounds and phases and that should be reviewed permanently and, if necessary, adapted.

It is important to always draw from a large number of different financing instruments to avoid depending on one or only a few financing sources.

Just as with your employees, make sure that your financing partners fit into the overall concept of your new business.

2. Financing Motives and Sources

To secure the financing of start-ups and growing businesses, a great variety of financing sources for different financing motives are available.

Concerning the financing motives, one may distinguish three stages based on the life cycle model of a business: Early Stage, Expansion Stage and Late Stage Financing.

The **Early-Stage-Phase** may finance the brainstorming process to find new business ideas (seed financing) or the preparation of the market introduction (start-up financing). During the **Expansion-Stage-Phase,** the financing is oriented toward the growth financing of the business expansion on the national level and the bridge financing before the initial public offering (IPO). The financing in the **Later-Stage Phase** mainly deals with the capital restructuring or topics like MBO (Management-Buyout) / MBI (Management Buyin) (Fueglistaller et al. 2004, p. 266).

Financing motives related to the business life cycle model

Formation expenses:
Idea-finding process
Evaluation and selection of alternatives
Market potential analysis
Establishing a BP
Financing
Preparation of production/services

Turnover:

Market entry

Market penetration

Market saturation

Market degradation

Time

Formation cycle --- Market cycle

Early Stage
- Seed financing
- Start-up financing

Expansion Stage
- Growth financing
- Bridge financing

Later Stage
- Capital restructuring
- Turnaround financing
- MBO/MBI

Fig. 1: Financing motives related to the business life cycle model

3. Financing Sources

Layout

3. Financing Sources
3.1 Government Subsidies
3.2 Equity Financing through Venture Capital (=VC)
3.2.1 Institutional Captive Funds
3.2.2 Corporate Venture Capital (= CVC)
3.2.3 Business Angels

Generally, one can choose between two types of **financing sources**: internal and external financing. Whereas in the financing of a start-up business the possibilities of **internal financing** e.g. through profits or depreciations are certainly less relevant than for young entrepreneurs who can finance part of their growth through internal financing sources. **External financing tools**, e.g. debt financing and equity financing (see the figure below), are relevant both for the financing of start-ups and growing businesses.

Financing Sources

Financing modes

Internal financing – financing through depreciations, profits, etc.

External financing – use of external sources

Dept financing – capital including repayment claims

Loans/credit in current account

Promotional credit

Customers' advance payment

Supplier credit

Equity financing – capital without repayment claims

Venture capital –

  Corporate Venture Capital

  Institutional Venture Capital

  Business Angels

Subsidies

Business Founder

Fig. 2: Financing Sources

The essential difference between debt and equity financing is the fact that **debt capital** involves a repayment right (e.g. loans, supplier credits, promotional credits).

Concerning debt financing see also Olfert und Reichel 2005.

On the other hand, the **equity financing** provides you with capital without a repayment guarantee. That is why, it is also called risk capital, a term that does not do justice to this form of financing. In fact, if the value of the company increases, the equity holders benefit from this increase, therefore one could also use the term "chance capital".

Furthermore, the volume of the equity capital also has a signal function, the more the founder of a business participates in the equity capital, the higher his own risk, the more interesting and confidence-providing he also seems for other capital providers if necessary (Fittgen 2002, p. 286).

The table below illustrates the main differences between equity capital and debt capital:

Differences between Equity Capital and Debt Capital	
Equity capital (EC)	Debt capital (DC)
– Capital provided by the owner(s) – EC generally available for an unlimited time – If available, prorate profit-sharing – EC = capital without repayment right	– Capital through bank loans, supplier credits, promotional credits, customers' advance payment – DC is available for a limited amount of time – DC provider generally receives interests not related to the profit – DC = capital with a repayment guarantee

Fig. 3: Difference between Equity Capital and Debt Capital

The choice of the financing source depends on the financing phase and on a variety of factors e.g. the business model, the amount of capital needed and the personal interests of the entrepreneur.

If the entrepreneur wants a long-term involvement, the equity majority is a decisive element. At the same time, this means limited financial resources from professional investors for the growth financing. In such a case, financing preferably comes from family, friends or banks.

If, on the other hand, the entrepreneur wants a rapid expansion, he generally requires financing through **venture capital**. This approach often means that after several financing rounds, one looses the majority in the equity capital. Professional investors do not want to manage the business, they want to actively support the business team (e.g. through contacts, market know-how, etc.) and contribute to the successful development of the company.

3.1 Government Subsidies

In any case, one should also see whether there are any government subsidies programs available. A well-established business plan is often a prerequisite for public subsidies. Figure 4 shows an overview of the basic financing possibilities.

Government Subsidies		
Substitute equity capital	**Soft loans**	**Grants**
e.g. through equity capital-like loans to increase credit	e.g. to protect from the risks of increasing interest rates	e.g. for technological developments or to replace a

worthiness		lack of securities

Fig. 4: Overview of the Government Subsidies Tools

In this context, it is important to underline that government subsidies can never cover the total financial requirements. Nevertheless, the different financing tools available may complete the financing concept as well as reduce the risks for all stakeholders.

Since there are a great variety of different programs available, we advise readers to consult the corresponding banks and specialized government subsidies advisors.

For a comprehensive overview and the basic rules for government subsidies tools also see Herzog 2003, p.15ff.

3.2 Equity Financing through Venture Capital (=VC)

Layout

3.2 Equity Financing through Venture Capital (= VC)
3.2.1 Institutional Captive Funds
3.2.2 Corporate Venture Capital (= CVC)
3.2.3 Business Angels

Venture capital is risk capital or, in more positive terms, chance capital. For a comprehensive overview of venture capital firms please refer to the Bundesverband Deutscher Kapitalbeteiligungsgesellschaften (German Association of Investment Companies) www.bvk-ev.de

Generally, the financial capital is provided by owning equity in young high potential companies – or growth companies.

The main interest of VC firms is less focused on the continuous returns than on an over-proportionally added value of their participation through the increase in the company's value. Consequently, venture capital is a partnership limited in time!

As a general rule, venture capitalists invest 3 to 7 years in a company. If you consider a VC financing, your business plan should also indicate the possible exit scenarios. For example, through an Initial Public Offering – IPO (first sale of stock by a private company to the public) or a trade sale (sale of stocks to another company often in the same industry). In these cases, the entrepreneur may have to accept an obligation to sell in the investment contract.

To support both the company's increase in value and the risk minimization, some venture capitalists do not only provide the capital but also the know-how by directly supporting the management (= value adding). Consequently, the business team does not only get the necessary financial capital but also the help of experienced professionals who may be involved in the following areas:

- Consultation and coaching during the start-up and the growth phase.
- Access to a comprehensive network of contacts in the relevant sectors.
- Support in the field of marketing and distribution (e.g. by recruiting reference customers)
- Support during the internationalization process by identifying the appropriate partners on site
- Finding the right cooperation partners
- Staff recruitment.

See Nathusius 2001, p. 194

Among the venture capitalists, you will find **institutional captive funds**, **corporate venture capital** and **business angels**.

3.2.1 Institutional Captive Funds

Institutional captive funds are companies that receive their financial capital through a financial institution, which acts as the parent company (e.g. banks, insurance companies or asset management companies).
"They are organized as a business unit or a department of the parent company or as a legally independent subsidiary and act as venture capitalists on the market." (Nathusius 2001, p. 178)

As with corporate venture capital firms, these companies often focus on the strategic objectives of the parent company.

3.2.2 Corporate Venture Capital (= CVC)

A CVC is an equity that an established company invests in innovative, legally independent companies (SME or start-up businesses). The established companies are often medium-sized enterprises or subsidiaries of big companies engaged in strategic investments mostly related to their core business.

In comparison to other venture capital firms, the CVCs look both for good interests on the invested capital and for added value which results from the cooperation between the established company and the start-ups or growing businesses they invest in.

The strategic interests are definitely the main objective of the corporate venture capitalists. Therefore, CVC investments are often a tool for innovation management. Diversification or guaranteeing sources of supply may be other reasons for investing equity. Once the strategic targets have been met, there may be a complete integration of the new business into the holding of the CVC.

A good argument why the decision for a corporate venture capital may still be an interesting approach for both sides is illustrated by the following comparison which compares the strengths and weaknesses of young technology company (YTC) with the strengths and weaknesses of the established parent company (PC) (an industrial investor).

Example – Strengths and Weaknesses, a comparison

<table>
<tr><td colspan="2">STRENGTHS of the young technology company</td><td colspan="2">STRENGTHS of the parent company</td></tr>
<tr><td colspan="2">– High flexibility and reactivity
– Rapid and cost-effective R&D
– Founder is a strong promoter of ideas
– Creative freedom
– Highly motivated
– Intensive internal and external communication</td><td colspan="2">– Resources (financial, material, immaterial)
– Risk spreading
– Cost and quality advantages in production
– Established distribution and contact network and products
– Highly qualified and specialized staff</td></tr>
<tr><td></td><td colspan="2">Management
Technology development
Infrastructure
Production/Marketing & Distribution</td><td>Profit margin</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td colspan="2">WEAKNESSES of the young technology company</td><td colspan="2">WEAKNESSES of the parent company</td></tr>
<tr><td colspan="2">– Scarcity of resources (financial, material, immaterial)
– Cost disadvantage in production
– Lack of experience in production, technique
– Lack of distribution network, sector-based</td><td colspan="2">– Long development times, lack of R&D management
– Conflicting interests between managers of established product units and risk-adverse behavior
– Inflexible, complex recruiting system</td></tr>
</table>

knowledge and established products – Lack of management qualifications – Difficulties in staff recruitment	

Fig. 5: Strengths and Weaknesses between a Technology-oriented Startup Company and an Industrial Investor

See: Voigt und Landwehr 2004, p. 15

Because of the strengths of the industrial investor (= corporate venture capitalist) and the corresponding weaknesses of the startup company, support and help – for example through the use of already existing and established international distribution channels or through the conclusion of cooperation contracts – may compensate the weaknesses of the startup. This may lead to a more rapid and more significant increase in the company's value.

For a comprehensive overview of venture capital firms please refer to the Bundesverband Deutscher Kapitalbeteiligungsgesellschaften (German Association of Investment Companies) www.bvk-ev.de

3.2.3 Business Angels

The so-called business angels are (wealthy) private persons who prefer to invest in startups or still very young companies. Especially during the start-up phase, these companies have a relatively limited capital requirement. By combining the investments of several business angels, even higher capital demands can be met.

Business Angels may not only invest their money but also share their experience and their contacts or provide consultancy and coaching services.

For more information on business angels please refer to the Business Angels Netzwerk Deutschland e.V (German Business Angels' Network) http://www.business-angels.de.

4. Analysis and Evaluation of the Impact of Venture Capital Financing as a Basis for Decision-Making

Layout

4. Analysis and Evaluation of the Impact of Venture Capital Financing as a Basis for Decision-Making

4.1 Developing a Vision

4.2 Selection, Evaluation and Comparison
4.3 Combining and Decision on Selection Criteria

Venture capital used to finance the early stage of business development has been considerably reduced in recent years because of its high risks for the venture capitalists. Even though the situation has improved, venture capital financing is mainly interesting for already existing young companies and especially **growing businesses**.

The problem: whereas for many financing alternatives the economically most advantageous are relatively easy to determine (effective annual interest rates, repayment modalities, etc.), the decision for the right venture capitalist during the growth phase is not always easy.
Causes may be that all three alternatives – institutional captive funds, corporate venture capital and business angels – do not only provide equity that includes secondary liability at certain conditions, but may also provide a variety of extra services for example contact networks, management support, etc.

When choosing a certain venture capitalist, it is more difficult for the young entrepreneur to evaluate and compare the impact of the **value added** support for his business. Besides analyzing and evaluating the financing conditions, for example the ratio between the volume of the financing and the number of shares (= quantitative evaluation), one also has to analyze and evaluate the impact of the different value-adding activities (=qualitative evaluation).

Therefore, the following section will present a global process to analyze and evaluate the impact of the different venture capitalist financing approaches.

Developing a Vision	– Determine the company's vision – Define the relevant equity financing alternatives
Selection, Evaluation and Comparison	– Select and evaluate the adequate evaluation criteria – Compare alternatives (e.g. through a better-worse comparison)
Combing and Decision	– Combine the evaluation results with the company's vision – Select alternatives
Implementation	

Fig. 6: Analysis and Evaluation Process for Venture Capital Financing Alternatives

4.1 Developing a Vision

Developing a Vision	– Determine the company's vision – Define the relevant equity financing alternatives
Selection, Evaluation and Comparison	– Select and evaluate the adequate evaluation criteria – Compare alternatives (e.g. through a better-worse comparison)
Combining and Decision	– Combine the evaluation results with the company's vision – Select alternatives
Implementation	

Fig. 7: Developing a Vision

"If you want to build a ship, don't drum up people to gather wood, to cut the boards and assign them tasks. Instead, teach them to yearn for the vast and endless sea."
Antoine de Saint-Exupery

"There is no favorable wind for the one who does not know which direction he wants to sail"
William of Orange-Nassau, prince of Orange (15333-1584)

Determining the Company's Vision (= Reference System Building)

The two quotes above give a good description of the purpose of the company's vision that is *motivation* and *giving directions*. Both points are essential for startups and growing businesses since they have to highly motivate their team to accomplish the high demands, but also because the daily decisions must be taken in a way to contribute to the realization of the set vision. The reason: *Visions show where the company wants to be e.g. in 5 years*.

To determine the company's vision (= reference system for the future) one can answer the following questions:

- What are the company's objectives you want to meet with the financing?
- What are the criteria that determine whether the objective has been met?
- What is the time horizon for the vision?
- How much complexity do I need for an adequate evaluation process?
- Who should participate in formulating the vision?

The vision is not the same as the mission or the summary of the company's objectives. The vision rather helps to formulate the adequate mission and to deduce the business strategies and the business objectives, which contribute to the success of the company.

Determining the Relevant Alternatives for Equity Financing

Knowing where the company wants to be in 3 to 5 years and therefore being able to evaluate the kind of management support that might be relevant, one can determine the type and the volume of the relevant alternatives for the equity financing. To do so, one evaluates all the potential captive funds, corporate venture capital firms and business angels. Extra support is available through the links mentioned in the section on equity financing through venture capital.

4.2 Selection, Evaluation and Comparison

Developing a Vision	– Determine the company's vision – Define the relevant equity financing alternatives
Selection, Evaluation and Comparison	– Select and evaluate the adequate evaluation criteria – Compare alternatives (e.g. through a better-worse comparison)
Combining and Decision	– Combine the evaluation results with the company's vision – Select alternatives
Implementation	

Fig. 8: Selection, Evaluation and Comparison

Selection of the adequate evaluation criteria

Based on the vision and the form of management support necessary, one can not only determine the possible financing alternatives but also determine the appropriate evaluation criteria, which allow evaluating the individual alternatives.

This can be done both for the qualitative and the quantitative evaluation criteria.

Selection of qualitative evaluation criteria

Based on the five-factor-model all the relations between prerequisites and consequences in all relevant sectors are determined.

On a general level, the five-factor-model allows an analysis and the formation of systems (companies, departments, …). In our case, the model serves as a global analysis of the financing impacts of different venture capitalists who, besides providing equity capital, also contribute with so called value adding activities (= management support) to the successful formation and the increased growth of the company (for the five-factor-model see: Pfeiffer et al. 1999, p. 76ff.).

The interactive diagram below illustrates the general evaluation criteria for a VC investment in a technology oriented startup company. With these criteria, the potential investor analyzes and evaluates the potential management measures and other support measures. The selection of evaluation criteria and their analysis obviously depend on the existing VC alternatives, the sector (e.g. commercial or industrial business), the business model, etc.

- In the online version an interactive multimedia element will be included here.

The next section presents the essential contents of these elements. To get an idea about all the elements, please refer to the online version.

Example of Evaluation Criteria and Characteristics pertaining to Physical Resources /Technology

Physical Resources / Technology
Input – Organization – Output
Staff

Impact on the technology-oriented start-up business
- Use of the resources of the VC-Investor:
    Technologies
    Patents/licenses
    Fixed assets

- Transfer of R&D services
- ….

Five-Factor Model

Fig. 9: Examples of Evaluation Criteria and Characteristics pertaining to Physical Resources / Technology

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Examples of Evaluation Criteria and Characteristics pertaining to the Input

Physical Resources / Technology

Input – Organization – Output

Staff

Impact on the technology-oriented start-up business

- Combination of procurement activities (“central purchasing activities”)
- Improvement of purchasing conditions
- Image gain with suppliers and banks

Five-Factor Model

Fig. 10: Examples of Evaluation Criteria and Characteristics pertaining to the Input

---

Examples of Evaluation Criteria and Characteristics pertaining to Organization

Physical Resources / Technology

Input – Organization – Output

Staff

Impact on the technology-oriented start-up business

- Optimization of the production and service organization
- Support in the creation of a national and international distribution and service organization
- Consultancy in the selection and the introduction of software
- Transfer of customs activities

Five-Factor Model

Fig. 11: Examples of Evaluation Criteria and Characteristics pertaining to Organization

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Examples of Evaluation Criteria and Characteristics pertaining to the Output

Physical Resources / Technology

Input – Organization – Output

Staff

Impact on the technology-oriented start-up business

- Image gain depending on the reputation of the VI-investor
- Access to the contact network to other companies, persons or organizations to:

Increase access to (international) distribution and service activities

Secure international guarantee claims

- Support in marketing and distribution
- Introduction to reference customers.

Five-Factor Model

Fig. 12: Examples of Evaluation Criteria and Characteristics pertaining to the Output

Examples of Evaluation Criteria and Characteristics pertaining to the Staff

Physical Resources / Technology

Input – Organization – Output

Staff

Impact on the technology-oriented start-up business

- Access to management capacities of the VC investor
- Support with staff recruitment
- Management support
- Staff motivation (e.g. through share program)

Five-Factor Model

Fig. 13: Examples of Evaluation Criteria and Characteristics pertaining to the Staff

By listing the often only partially or hardly quantifiable financing impacts of the venture capitalist, one creates the basis for the right decision on a significantly higher information level than with a purely quantitative comparison.

Selection of quantitative evaluation criteria

After having selected the appropriate evaluation criteria, one can start to collect quantitative data and/or determine the values of the characteristics for the individual financing alternatives (see the diagram below).

Indicators		Adequate evaluation criteria	Evaluation of Financing alternative A	Evaluation of Financing alternative B
	Input	– Improvement of the purchase conditions – Image gain with suppliers and banks – …		
	Personal	– Use of management capacities of the VC investor – Management support – …		
	Organization	– Optimization of the service-provision organization – Support in establishing a national and international distribution and service organization – …		
	Fixed assets/technology	– Use of the available technologies patents/licenses fixed assets of the VC investor's or its other participations – Transfer of R&D activities to the investor – …		

qualitative	Output	– Use of contact network e.g. the (international) distribution and service activities of the investor – Contact to reference customers – …		
quantitative	Costs	– Ratio financing volume/parts acquired – Capital acquisition costs – …		

Fig. 14: Assessment of the Identified Evaluation Criteria

Ideally, the results obtained are included in a profile diagram. By visualizing the impact on the technology-oriented start-up in a profile diagram, the evaluation criteria can be more easily compared in relation to the available financing alternatives.

“The profile diagram takes into account “future and current positive and negative system impacts that still show significant results in a low-order scaling (better/worse)” (Klein 2001).

Comparing Financing Alternatives

The following diagram shows a profile diagram for the alternatives CVC and VC (= captive funds) financing

Evaluation criteria and characteristics		Comparison CVC vs. VC	Explanations
Indicator	Sub-indicator	CVC financing compared to VC financing	Remarks concerning financing tools Comparison CVC – VC
		considerably worse worse slightly worse indifferent slightly better better considerably better	

Input	- Purchasing conditions Image gain with suppliers and banks - Combining procurement activities (central purchasing unit) - Number of investors (independence)		
Staff	- Access to staff capacities of the investor - Influence of the investor on the recruitment - Management support - staff motivation (share program)		

Fig. 15: Comparing alternatives through a better/worse evaluation

4.3 Combining and Decision

Developing a Vision	– Determine the company’s vision – Define the relevant equity financing alternatives
Selection, Evaluation and Comparison	– Select and evaluate the adequate evaluation criteria – Compare alternatives (e.g. through a better-worse comparison)
Combining and Decision	– Combine the evaluation results with the company’s vision – Select alternatives
Implementation	

Fig. 16: Combining and Selecting Alternatives

As a result of the above described analysis and evaluation, one can define the **relatively** most appropriate VC financing as compared to the other alternatives. Still, this result is not enough for the final decision; one still has to verify whether this alternative is also the **absolutely** best alternative with regard to the initially defined company's vision.

It is therefore necessary to systematically analyze and interpret the relatively best alternative with relation to the vision formulated at the beginning of the evaluation process. In other words: are the capital and the "value added" activities able to transform the vision into reality.

Combining the Evaluation Results with the Decision on the Selection Alternatives

Company's vision --- selection decision

Combining implementation

Is the "relatively" best financing alternative also the absolute best alternative regarding the company's vision)?

Evaluation Results

Fig. 17: Combining the Evaluation Results with the Decision on the Selection Alternatives

If this process allowed to find the adequate and system-optimal financing alternative, which, in relative terms, is adequate as compared to the other decision alternatives and, in absolute terms, adequate as compared to the company's vision, the final decision can be taken on a much better information status that took into account both quantitative and qualitative parameters.

5. Tasks including Solutions and Solution Propositions

Task 1

What are the different financing sources and what are those most appropriate for start-ups and growing businesses?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 2

What is the main difference between debt capital and equity capital?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 3

What kind of management support to young businesses a venture capitalist may provide?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 4

What does one understand by corporate venture capital?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

6. Tasks to Send In.

Please answer the following question and send your answers to your mentor.

- Please name the main financing motives and illustrate them each with two examples.

Please note the indications in the learning room concerning the latest send-in date!

Summary

Securing the financing of start-ups and growing businesses is one of the main tasks of an entrepreneur. Time needed for this task depends generally on the capital requirements, the risks related to the financing (financing motives) as well as the size of the company.

To cover the capital requirements and depending on the different financing motives (e.g. financing of startups, growing businesses or turnaround financing), one can chose between different financing sources (internal and external financing) available.

Since every financing source has a different impact on the business formation, one has to perform a comprehensive analysis of the financing impact, both qualitatively and quantitatively.

The example of a technology oriented start-up illustrated the appropriate analysis, evaluation and selection process.

This process will have to be adapted to the specific situation of the individual business.

IV - Market Entry Strategies

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Field of Activity: Business and Management Economics
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Start!

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Overview

Whereas the entrepreneurial marketing is often well-focused and consistent, nascent entrepreneurs tend to disregard questions concerning the optimal market entry strategy when establishing their business plan.

An astonishing fact, if one considers that a newly founded small business or a young business will only be successful on the market if it not only prepares an effective and efficient marketing concept to assert itself against potential competitors but also, and more importantly, if it applies the appropriate market entry strategy.

While in learning unit 2 “Business Plan” (Marketing and Distribution) we explained how to efficiently develop the appropriate marketing concept including the marketing-mix, this learning unit will concentrate on the market entry strategies.

Learning Objectives

- Consider the different market entry strategies
- Knowledge on the advantages and disadvantages of the First-/Follower-Strategy
- Cross-national timing strategies

Layout

7. Market Entry Strategies
8. Timing Strategies for the Market Entry
9. Tasks Including Solutions and Solution Propositions
10. Tasks to Send In.

Time Management

The time needed to treat this learning unit is estimated at approx. 5 hours (including the exercises and the tasks to be sent in).

1. Market Entry Strategies

Market entry strategies are measures by which a company tries to overcome market barriers to introduce its own range of products and services. The term market entry strategy is often used in international marketing.

One can choose between several market entry strategies which can also be combined:

- Creating a business alone versus creating a business in a team
- Starting small versus starting big (e.g. with venture capital)
- Innovation-oriented versus imitation-oriented
- New business versus acquisition of an existing business
- …

(see Schiller 2002, p. 215)

Classically, a market entry may be prepared for example through the use of competitive strategies according to Porter.

The **competitive strategy** is built on the results of the market and competitor analysis (see learning unit 2, chapter 4.4) which uses the results of the analysis of the competitive environment to decide on the following basic competitive strategies:

- **Cost leadership**
  Objective: gain competitive advantage based on lower costs. This strategy allows offering products for a relatively low price on the market.

- **Differentiation strategy**
  Objective: from the customer's perspective one's own services should distinguish themselves against the competitors' offers through the unique selling proposition (USP), for example through their price, quality, design, etc.

- **Niche strategy**
  Objective: concentration on certain priorities, for example, aimed at certain target audiences, geographic markets, etc.

(Porter 1999)

2. Timing Strategies for the Market Entry

Besides considering the question of the optimal market entry strategy, one should also look for the optimal timing for the market entry and the chronological order of the market entry in the target markets and/or the target market segments.

Layout

2. Timing Strategies for the Market Entry
2.1 Right Moment for the Market Entry (Country-Specific Timing Strategy)

2.1 Right Moment for the Market Entry (Country-Specific Timing Strategy)

“Especially in technology intensive, rapidly growing markets, the right moment of the market entry may be of crucial importance.” (Volkmann und Tokarski 2006, p. 221)

Basically, companies may choose between two strategies: the first mover and the follower strategy

First Mover or First Loser?
From the perspective of the business founder, there are different pros and cons for a first mover or a follower strategy. Depending on the individual case, it is essential to carefully consider different options – taking into consideration the market and competitive situation and the strengths and weaknesses profile – to find the strategy that seems to be most promising on a national or international level. We will explain the two strategies briefly and indicate their advantages and disadvantages.

First-Mover-Strategy (Pioneer Strategy)
With the help of the first-mover-strategy business founders try to be the first to introduce an innovative problem-solving offer (product and/or service) on a chosen market. By being the first, the entrepreneur tries to gain a competitive advantage against his competitors.

Follower-Strategy
The follower first wants to see how the market reacts to an initiative of a first mover and therefore enters the market some time later.

Both strategies have their advantages and their disadvantages illustrated by the figure 1 below.

Advantages and Disadvantages of the First-Mover and the Follower Strategy

	First-Mover-Strategy	Follower-Strategy
Advantage	– Early customer feedback – Possibility to set standards – Distribution advantages (first to occupy certain channels) – Skim off the pioneer profits	– Company may learn from the errors of the first mover – Possible cost savings when following – Taking over set standards – Use of advantages of an already open market – Possible use of more abundant market information
→	**Competitive Advantages**	**Risk Minimization Advantages**
Disadvantage	– High costs for the market opening – Technological change may destroy the investment – Risk of imitation and free-rider-effect	– Difficulty to occupy good distribution channels – Overcome market entry barriers – Catch up with the experience lead of the first mover – Breaking-up of existing business relations necessary
→	**Risk Disadvantages**	**Time Disadvantages**

Fig. 1: Advantages and Disadvantages of the First-Mover and the Follower-Strategy

Which strategy one finally adopts, will depend, as described above, on a variety of internal and external factors as well as on the above mentioned advantages and disadvantages in relation to the individual case.

There is certainly a big difference whether a startup with an attractive, technology-oriented innovation potential wants to enter a market with short innovation and product life cycles, or whether a startup potential should be implemented on a market where the time disadvantage plays a small role. Today, these markets tend to disappear!

For more detailed information on the two strategies see: Pfeffer et al. 1991, p. 44ff; Weiss 1995, p. 187ff; as well as on the prime role of the first-mover strategy: Weiss, 1989.

2.2 Chronological Order of the Market Entry (Cross-National Timing Strategy)

Layout

2.2 Chronological Order of the Market Entry

2.2.1 Waterfall Strategy

2.2.2 Sprinkler Strategy

2.2.3 Combining the Waterfall and the Sprinkler Strategy

2.2.4 Comparing Different Timing Strategies

When business models are not only applied to a local or a national market, the question of the optimal internationalization strategy will be asked soon after the formation of the business. It is mainly related to the chronological order according to which one enters the markets of different countries.

Essentially, the following timing strategies may be used:

Timing Strategies for the International Market Entry

	Chronological order of the market entry	
Waterfall strategy	Sprinkler strategy	Combination of waterfall and sprinkler strategy

Fig. 2: Timing Strategies for the International Market Entry

These international market entry strategies may also be used as a basis by startup companies that have to decide whether, within one country, all possible market segments should be entered simultaneously or one after the other. For example, a startup specialized in the innovative technology of laser plastic welding may ask whether all potential markets (medical technology, car parts suppliers, consumer goods industry) within a country should be entered at the same time or one after the other.

2.2.1 Waterfall Strategy

In the waterfall strategy, also called slow-speed-strategy, the different countries are treated progressively; ideally they have many characteristics in common with the original market.

- In the online version an interactive multimedia element will be included here.

In the following, the essential contents of those elements will be enumerated. To comprehend all the aspects of these elements please refer to the online version.

Example Waterfall Strategy

Market Entry Start

Home market → Foreign market 1 – Foreign market 2 ….

Years

Fig. 3: Example Waterfall Strategy

2.2.2 Sprinkler Strategy

The sprinkler strategy, also called global attack strategy, is an expansion strategy which opens foreign markets simultaneously.

Example Sprinkler Strategy

Market entry – Home market – Foreign market 1 – Foreign market 2 …..

Start Time

Fig. 4: Sprinkler Strategy

2.2.3 Combining the Waterfall and the Sprinkler Strategy

There is also the possibility to combine both strategies to optimize the market entry strategy:

- In the online version an interactive multimedia element will be included here.

In the following, the essential contents of those elements will be enumerated. To comprehend all the aspects of these elements please refer to the online version.

Example Combining the Waterfall and the Sprinkler Strategy

Market entry Start

Home market – Foreign market 1 – Foreign market 2 …..

Years

Fig. 5: Example Combining the Waterfall and the Sprinkler Strategy

2.2.4 Comparing Different Timing Strategies

When choosing the optimal timing strategy one has to consider the specific market and competition situation, the financial situation of the young entrepreneur and the following advantages and disadvantages:

Comparing the Advantages and Disadvantages of Different Timing Strategies

	Waterfall Strategy	Sprinkler Strategy
Advantage	– Possibility to profit from the learning curve effects – Profits from the market entry in one country can be uses for the next country – Less resources necessary at the beginning – Progressive development contains less risks	– Rapid market entry in many countries – Possibility to set standards – Surprise effect for the competitors and the customers – First mover advantages can be used
Disadvantage	– Competitors may profit from the first mover advantages in other countries – Danger of the later market entry, esp. with products having short product life cycles – False evaluations because of not transferable country-specific conditions	– Higher resources (capital/staff) – No possibility to learn from other countries – High risk of failure
→	**Less risks, appropriate for companies with limited resources**	**More successful in markets with a growing global competition**

Fig. 6: Comparing the Advantages and Disadvantages of Different Timing Strategies

3. Tasks Including Solutions and Solution Propositions

Task 1

What is the difference between a first mover and a follower strategy?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 2

What are the different timing strategies that can be used for the chronological order of the market entry?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

Task 3

What are the advantages of the waterfall strategy for young entrepreneurs?

At this point, the online version will provide a button, which opens a window displaying the solution to the question.

4. Tasks to Send In.

Please answer the following questions and send your answers to your mentor.

- What are the advantages of the first mover strategy and what are the disadvantages of the follower strategy?

Please note the indications in the learning room concerning the latest send-in date!

Summary

The choice of the optimal market entry strategy, e.g. the ideal point in time and/or the chronological order is not a trivial question. The advantages and disadvantages listed above will support the choice of the individual specific strategy. Furthermore, it is important to also take into account internal (strengths/weaknesses) and external (market and competitive environment) parameters.

For startups and young entrepreneurs the scarcity of resources is certainly the limiting factor when it comes to choosing a strategy.