Effective Small Business Management

An Entrepreneurial Approach

Norman M. Scarborough

Presbyterian College

Thomas W. Zimmerer

Saint Leo University



CONTENTS

Preface xix

SECTION I: THE CHALLENGE OF ENTREPRENEURSHIP

Chapter 1 Entrepreneurs: The Driving Force Behind Small Business 1 What Is an Entrepreneur? 3 The Benefits of Owning a Small Business 9 The Potential Drawbacks of Entrepreneurship 11 Why the Boom: The Fuel Feeding the Entrepreneurial Fire 14 The Cultural Diversity of Entrepreneurship 16 The Contributions of Small Businesses 21 The Ten Deadly Mistakes of Entrepreneurship 23 Putting Failure into Perspective 27 How to Avoid the Pitfalls 27 Chapter Summary 31 **Discussion Questions** 32 "\ Step into the Real World 32 Take It to the Net 33 Endnotes 33 SECTION II: BUILDING THE BUSINESS PLAN: BEGINNING

SECTION II: BUILDING THE BUSINESS PLAN: BEGINNING CONSIDERATIONS 36

Chapter 2 Strategic Management and the En	ntrepreneur 36
Building a Competitive Advantage 38	3
The Strategic Management Process 40)
Step 1: Develop a Clear Vision and Translate	
Step 2: Assess the Company's Strengths and W	eaknesses 42
Step 3: Scan the Environment for Significant C	Opportunities and Threats Facing the Business 43
Step 4: Identify the Key Factors for Success	in the Business 44
Step 5: Analyze the Competition 47	
Step 6: Create Company Goals and Objectives	50
Step 7: Formulate Strategic Options and Select	the Appropriate Strategies 51
Step 8: Translate Strategic Plans into Action P	lans 57
Step 9: Establish Accurate Controls 58	
Conclusion 60	
Chapter Summary 61	
Discussion Questions 62	
Step into the Real World 62	
Take It to the Net 63	
Endnotes 63	

Chapter 3 Choosing a Form of Ownership 65 The Sole Proprietorship 67 Advantages of a Sole Proprietorship 67 Disadvantages of a Sole Proprietorship 70 The Partnership 73 The Uniform Partnership Act 74 Advantages of the Partnership 74 76 Disadvantages of the Partnership Dissolution and Termination of a Partnership 77 Limited Partnerships 78 Master Limited Partnerships 78 Limited Liability Partnerships 79 The Corporation 79 Requirements for Incorporation 80 Advantages of the Corporation 81 Disadvantages of the Corporation 83 The Professional Corporation 84 Alternative Forms of Ownership 84 The S Corporation 84 The Limited Liability Company (LLC) 86 The Joint Venture 89 Summary of the Major Forms of Ownership 8 **Chapter Summary** 89 90 **Discussion Questions** Step into the Real World 90 Take It to the Net 91 91 Endnotes 92 **Chapter 4** Franchising and the Entrepreneur What Is Franchising? 93 Types of Franchising 94 The Benefits of Buying a Franchise 94 Drawbacks of Buying a Franchise 100 Franchising and the Law 103 How to Buy a Franchise 106 Franchise Contracts 110 Trends in Franchising 113 Conclusion 117 Chapter Summary 118 **Discussion Questions** 118 Step into the Real World 119 Take It to the Net 119 Endnotes 119 Chapter 5 Buying an Existing Business 121

> Buying an Existing Business 122 Advantages of Buying an Existing Business 122 Disadvantages of Buying an Existing Business 124

How to Buy a Business126Self-Analysis of Our Skills, Abilities, and Interests127Develop a List of Criteria127
Prepare a List of Potential Candidates 127 Investigate and Evaluate the Most Likely Acquisition Candidates 128 Negotiate the Deal 129 Explore Financing Options 129 Ensure a Smooth Transition 129
Evaluating an Existing Business: Uncovering the Truth131Why Does the Owner Want to Sell?131What Is the Physical Condition of the Business?132What Is the Potential for the Company's Products or Services?134What Legal Aspects Are Important?135Is the Business Financially Sound?137
Methods for Determining the Value of a Business138Balance Sheet Method: Net Worth = Assets - Liabilities139Earnings Approach142Market Approach146Is There a Best Method?147
Understanding the Seller's Side147For the Seller, Timing of the Sale Is Important 148Plot an Exit Strategy and Structure the Deal149
Negotiating the Deal151Factors Affecting the Negotiation Process151The Negotiation Process152
Chapter Summary 154
Discussion Questions 155
Step into the Real World 155
Take It to the Net156
Endnotes 156

SECTION III: BUILDING A BUSINESS PLAN: MARKETING AND FINANCIAL MATTERS 1 57

Chapter 6 Crafting a Winning Business Plan 157 Why Develop a Business Plan? 158 The Elements of a Business Plan 161 Can Your Plan Pass These Tests? 174 Making the Business Plan Presentation 175 What Lenders and Investors Look for in a Business Plan 177 Conclusion 179 Suggested Business Plan Format 180 182 Chapter Summary **Discussion Questions** 183 Step into the Real World 183 Take It to the Net 184 Endnotes 184

Chapter 7 Building a Guerrilla Marketing Plan 185 Creating a Guerrilla Marketing Plan 186 Market Diversity: Pinpointing the Target Market 188 Determining Customer Needs and Wants Through Market Research 190 How to Conduct Market Research 192 Plotting a Guerrilla Marketing Strategy: Building a Competitive Edge 195 Guerrilla Marketing Principles 196 Marketing on the World Wide Web 209 The Marketing Mix 211 Product 211 Place 213 215 Price Promotion 215 **Chapter Summary** 215 **Discussion Questions** 216 Beyond the Classroom 216 Take It to the Net 217 Endnotes 217 Chapter 8 Creating a Solid Financial Plan 219 **Basic Financial Reports** 220 The Balance Sheet 220 The Income Statement 222 The Statement of Cash Flows 222 **Creating Projected Financial Statements** 224 Pro Forma Statements for the Small Business 224 Ratio Analysis 231 Twelve Key Ratios 233 **Interpreting Business Ratios** 242 What Do All of These Numbers Mean ? 243 Breakeven Analysis 247 Chapter Summary 252 **Discussion Questions** 253 Step into the Real World 253 Take It to the Net 254 Endnotes 254 Chapter 9 Managing Cash Flow 255 Cash Management 256 Cash and Profits Are Not the Same 258 The Cash Budget 259 260 Preparing a Cash Budget Step 1: Determining an Adequate Minimum Cash Balance 264 Step 2: Forecasting Sales 264 Step 3: Forecasting Cash Receipts 265 267 Step 4: Forecasting Cash Disbursements Step 5: Estimating the End-of-Month Cash Balance 269

Contents

The "Big Three" of Cash Management 269 Accounts Receivable 271 276 Accounts Payable Inventory 277 Avoiding the Cash Crunch 280 Bartering 280 Trimming Overhead Costs 281 283 Investing Surplus Cash Conclusion 283 284 **Chapter Summary Discussion Questions** 284 Step into the Real World 285 Take It to the Net 285 Endnotes 285

SECTION IV: SMALL BUSINESS MARKETING STRATEGIES 287

312

Chapter 10 Pricing and Credit Strategies 287 Pricing Strategies and Tactics 290 New Products: Penetration, Skimming, or Sliding 291 Established Goods and Services 292 Two Potent Pricing Forces: Image and Competition 295 Price Conveys Image 295 Competition and Prices 296 297 Pricing Techniques for Retailers Markup $2\bar{97}$ Follow-the-Leader Pricing 299 **Below-Market Pricing** 299 300 Pricing Techniques for Manufacturers Direct Costing and Price Formulation 300 Computing a Breakeven Selling Price 302 Pricing Techniques for Service Firms 303 The Impact of Credit on Pricing 305 Credit Strategies 305 307 E-Business and Credit Cards Installment Credit 308 Trade Credit 308 **Chapter Summary** 309 **Discussion Questions** 309 Step into the Real World 310 Take It to the Net 310 Endnotes 311 Chapter 11 Creative Use of Advertising and Promotion Developing an Advertising Strategy 313 Advertising Versus Promotion 317 Publicity 317 Personal Selling 318 Advertising 320

Selecting Advertising Media 320 Media Options 321 Preparing an Advertising Budget 339 How to Advertise Big on a Small Budget 340 Cooperative Advertising 341 Shared Advertising 342 **Publicity** 342 Other Ways to Save 342 343 Chapter Summary **Discussion Questions** 343 344 Step into the Real World Take It to the Net 344 Endnotes 344 Chapter 12 Global Marketing Strategies for Entrepreneurs 345 Why Go Global? 346 Strategies for Going Global 349 Employing a Presence on the World Wide Web 349 Trade Intermediaries 352 Joint Ventures 353 Foreign Licensing 356 International Franchising 357 Countertrading and Bartering 357 Exporting 360 365 Establishing International Locations **Barriers to International Trade** 366 Domestic Barriers 366 International Barriers 366 Political Barriers 367 **Business Barriers** 367 **Cultural Barriers** 368 International Trade Agreements 368 GATT 369 WTO 369 NAFTA 369 Conclusion 370 **Chapter Summary** 371 **Discussion Questions** 372 Step into the Real World 372 Take It to the Net 373 Endnotes 373 Chapter 13 E-Commerce and Entrepreneurship 374 Benefits of Selling on the Web 376 Factors to Consider Before Launching into E-Commerce 378 Twelve Myths of E-Commerce 379 Approaches to E-Commerce 385 Strategies for E-Success 389 Designing a Killer Web Site 393

Contents

Tracking Web Results 398 398 Software Solutions Return on Investment 399 Ensuring Web Privacy and Security 400 Privacy 400 Security 400 402 Chapter Summary **Discussion Questions** 404 Beyond the Classroom 404 Take It to the Net 405 405 Endnotes

SOURCES OF FUNDS 407

Chapter 14 Sources of Equity Financing 407 Planning for Capital Needs 409 411 Sources of Equity Financing Personal Savings 411 Friends and Family Members 412 Angels 413 Partners 415 Corporate Venture Capital 417 Venture Capital Companies 417 Public Stock Sale ("Going Public") 421 Simplified Registrations and Exemptions 428 Foreign Stock Markets 433 Chapter Summary 434 **Discussion Questions** 434 Beyond the Classroom 435 Take It to the Net 435 Endnotes 435 Chapter 15 Sources of Debt Financing 437 Sources of Debt Capital 439 Commercial Banks 439 Nonbank Sources of Debt Capital 443 Federally Sponsored Programs 451 Economic Development Administration 451 Department of Housing and Urban Development (HUD) 451 U.S. Department of Agriculture's Rural Business-Cooperative Service 452 Local Development Companies 452 Small Business Innovation Research Program 453 The Small Business Technology Transfer Program 453 Small Business Administration 453 SBA Loan Programs 454 State and Local Loan Development Programs 459 Internal Methods of Financing 460 Where Not to Seek Funds 462

Chapter Summary463Discussion Questions464Beyond the Classroom464Take It to the Net465Endnotes465

SECTION VI: LOCATION AND LAYOUT 467

Chapter 16 Location, Layout, and Physical Facilities 467
The Logic of Location: From Region to State to City to Site468Selecting the Region470Selecting the State472Selecting the City474The Final Site Selection Decision480
Location Criteria for Retail and Service Businesses 481 Trade Area Size 481 Customer Traffic 482 Adequate Parking 482 Room for Expansion 482 Visibility 483
Location Options for Retail and Service Businesses 483 Central Business District 483 Neighborhood Locations 484 Shopping Centers and Malls 484 Near Competitors 485 Outlying Areas 485 Home-Based Businesses 486
The Location Decision for Manufacturers486Foreign Trade Zones487Empowerment Zones487Business Incubators488
Layout Considerations: Analyzing the Building 489 Size 489 Construction and External Appearance 489 Entrances 491 The Americans with Disabilities Act 491 Signs 493 Interiors 493 Lights and Fixtures 494
Layout: Maximizing Revenues, Increasing Efficiency, and Reducing Costs Layout for Retailers 494 Layout for Manufacturers 500
Build, Buy, or Lease? 503 The Decision to Build 503 The Decision to Buy 503

494

508

The Decision to Lease

Step into the Real World

Chapter Summary

Take It to the Net

Endnotes

Discussion Questions

505

507

508

506

508

SECTION VII: MANAGING A SMALL BUSINESS: TECHNIQUES FOR ENHANCING PROFITABILITY 509

509

Chapter 17 Purchasing, Quality Management, and Vendor Analysis
The Purchasing Plan 510
Quality 511 Total Quality Management 511
Quantity: The Economic Order Quantity515Cost of Units517Holding (Carrying) Costs517Setup (Ordering) Costs518Solving for EOQ519EOQ with Usage522
Price523Trade Discounts525Quantity Discounts525Cash Discounts526
Timing—When to Order 529
Vendor Analysis533Vendor Certification533The Final Decision537
Legal Issues Affecting Purchasing 539 <i>Title</i> 539 <i>Identification</i> 539 <i>Risk of Loss</i> 539 <i>Insurable Interest</i> 541 <i>Receiving Merchandise</i> 541 <i>Selling on Consignment</i> 542
Chapter Summary 542
Discussion Questions 543
Step into the Real World 544
Take It to the Net 544
Endnotes 545
Chapter 18 Managing Inventory 546
Inventory Control Systems548Perpetual Inventory Systems548Visual Inventory Control Systems550Partial Inventory Control Systems551Physical Inventory Count554
Just-in-Time Inventory Control Techniques 557 Just-in-Time II Techniques 560
Turning Slow-Moving Inventory into Cash561Protecting Inventory from Theft562Employee Theft562Shoplifting569
Conclusion 574
Chapter Summary 574
Discussion Questions 576

Step into the Real World576Take It to the Net577Endnotes577

SECTION VIM: MANAGING PEOPLE: A COMPANY'S MOST VALUABLE RESOURCE 578

Chapter 19 Staffing and Leading a Growing Company 578 The Entrepreneur's Role as Leader 579 Hiring the Right Employees 581 Create Practical Job Descriptions and Job Specifications 582 Plan an Effective Interview 583 Conduct the Interview 585 588 Check References Conduct Employment Tests 588 Building the Right Culture and Structure 589 Culture 589 Management Style, Organizational Culture, and Organizational Structure 591 **Communicating Effectively** 596 Improving Communication 597 That Informal Communication Network: The "Grapevine" 599 599 The Challenge of Motivating Employees Empowerment 600 Job Design 602 Rewards and Compensation 604 Feedback 606 Chapter Summary 610 **Discussion Questions** 611 Step into the Real World 612 Take It to the Net 613 Endnotes 613

SECTION IX: LEGAL ASPECTS OF SMALL BUSINESS: SUCCESSION, ETHICS, AND GOVERNMENT REGULATION 614

Chapter 20 Management Succession and Risk Management Strategies in the Family Business 614

Family Businesses 615

Exit Strategies618Selling to Outsiders618Selling to Insiders618

Management Succession 621

Developing a Management Succession Plan 624 Step 1: Select the Successor 625 Step 2: Create a Survival Kit for the Successor 625 Step 3: Groom the Successor 626 Step 4: Promote an Environment of Trust and Respect 627 Step 5: Cope with the Financial Realities of Estate and Gift Taxes 627

Contents

Risk Management Strategies 632
The Basics of Insurance634Types of Insurance637Controlling Insurance Costs643
Chapter Summary 645
Discussion Questions 646
Step into the Real World 647
Take It to the Net 647
Endnotes 647
Chapter 21 Ethics, Social Responsibility, and the Entrepreneur 649
An Ethical Perspective 650 Establishing an Ethical Framework 652
Who Is Responsible for Ethical Behavior? 654 Gaining the Benefits of Moral Management 654 Why Ethical Lapses Occur 654
Establishing Ethical Standards 659 Implementing and Maintaining Ethical Standards 659
The Issue of Social Responsibility 661
Putting Social Responsibility into Practice 663
Business's Responsibility to the Environment 663
Business's Responsibility to Employees 664
Cultural Diversity in the Workplace 665 Drug Testing 667 AIDS 668 Sexual Harassment 670 Privacy 674
Business's Responsibility to Customers 674 <i>Right to Safety</i> 674 <i>Right to Know</i> 675
Right to Be Heard 675 Right to Education 675 Right to Choice 676
Business's Responsibility to Investors 676
Business's Responsibility to the Community 676
Conclusion 677
Chapter Summary 677
Discussion Questions 678
Step into the Real World 679
Take It to the Net680
Endnotes 680
Chapter 22 The Legal Environment: Business Law and Government Regulation
The Law of Contracts 682
Agreement 683 Consideration 684
Consideration 684 Contractual Capacity 685
Legality 686
Genuineness of Assent and the Form of Contracts 686

Breach of Contract 687

681

The Uniform Commercial Code 688 Sales and Sales Contracts 688 Breach of Sales Contracts 690 Sales Warranties and Product Liability 691 694 Protection of Intellectual Property Rights Patents 694 Trademarks 697 698 *Copyrights* Protecting Intellectual Property 698 The Law of Agency 699 Bankruptcy 700 Forms of Bankruptcy 700 **Government Regulation** 702 Trade Practices 703 706 Consumer Protection 707 Consumer Credit Environmental Law 708 Chapter Summary 709 **Discussion Questions** 710 Step into the Real World 711 Take It to the Net 711 Endnotes 711

Index 713