

Entrepreneurship & Business Innovation
(Gathered Articles): A North America,
Europe, Asia, Africa & Oceania
Perspective 1st Edition

RUDOLPH.PATRICK.T.MUTESWA

©2018

ISBN 978-1-77920-214-7

EAN 9781779202147

FIRST EDITION

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(*Gathered Articles*): A North America,
Europe, Asia, Africa & Oceania
Perspective**

1st Edition

Rudolph. Patrick. T. Muteswa

BBA, BCom Honors & MCom (UKZN South Africa)

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ISBN 978-1-77920-214-7

EAN 9781779202147

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PREFACE TO THE FIRST EDITION

Today entrepreneurship is the new way of achieving societal development across the world as it leads to job creation, enhanced living standards, enhanced skills development through workplace training initiatives and the development of new life changing innovative products/services. The globalization of the global economy due to technological advancements such as the Internet has made modern day entrepreneurship very susceptible to technological innovations. Today the idea of starting your own business has become a guaranteed way in which individuals can earn a living to cater for their costs of living, play a significant role in contributing to their country's economic growth (*via imports/exports*) and be able to succeed in fulfilling their families' financial needs. The purpose of this book is to empower ordinary citizens in the continent of Africa, North America, Europe, Oceania and Asia countries with the necessary tools needed for them to start their own businesses and become highly productive lifetime entrepreneurs who create generational wealth whilst simultaneously contributing to their country's economic prosperity in an ethical manner. In addition this book seeks to clearly highlight the fact that anyone can become a successful entrepreneur in life if they (1) adopt '*a continuous learning attitude towards various business and legal concepts*', (2) accept the fact that the world has become borderless and adopt new information, communication and technology (ICT) related technologies in their business's operational activities, (3) seek advice from business management and legal experts on a regular basis, (4) clearly set '*continuous business innovation*' as one of their new business's goals. Another aim of this book was to clearly point-out that there is a positive interrelation between entrepreneurial success and innovation. In this book various examples of '*good-to-great iconic entrepreneurs*' were used including some of the world's leading organizations in order to encourage all aspiring entrepreneurs in the continent of Europe, North America, Africa, Oceania and Asia countries that anything is possible if you write down your business idea (*in the form of a business plan, conduct a feasibility study, learn more about the economic sector you want to start your business and raise adequate capital*) and effectively execute your business idea into action. Another aim of this book was to contribute to the field of entrepreneurship and business innovation by publishing a free *eBook* and a *print hard copy* to empower all aspiring entrepreneurs in the continent of North America, Europe, Africa, Oceania and Asia with basic entrepreneurship knowledge since a book is '*a source of wisdom*' that can positively influence others to become ethical and better people in society.

Acknowledgement:

I would like to thank my 6 (*four brothers & two sisters*) siblings for tirelessly supporting me towards my education and personal life goals. I would also like to take this opportunity to greatly thank my late parents, aunties and uncles for the great role they played in my childhood. Furthermore, I shall forever be grateful and indebted to the great men and women in the continent of North America, Europe, Oceania, Asia and Africa who contributed in the writing of this book in particular all the named leading ‘iconic’ entrepreneurs, organizations & information sources cited in this book.

Chapter 1: Introduction to entrepreneurship

After studying this chapter you should be able to:

- Identify the global statistics of small businesses and the definition of entrepreneurship.
- Describe the traits of successful entrepreneurs.
- Describe the four misconceptions about entrepreneurship.
- Identify the reasons why small businesses fail today.
- Describe the guidelines that help to prevent small business failure.
- Explain the rise of women entrepreneurs across the world.

1.1 Introduction

The world has become a single economy due to globalization mainly attributed by the Internet and this has also led to the revolution of the ‘world of entrepreneurship’ through e-commerce, internet marketing, low cost social media marketing communications and so on. Today the Internet has successfully led to the creation of many global startups that have so far played a significant role in the introduction of life changing new products/services into the global marketplace. A typical good example is when Redmond, Washington, United States of America headquartered high-tech firm Microsoft was launched on April 04, 1975 it was a global startup. Microsoft was founded by two great entrepreneurs called William H. Gates and Paul Allen and today Microsoft is the current worldwide leader in software, services, devices and solutions. Microsoft currently owns leading high-tech brands such as LinkedIn (*the world’s largest and most powerful network of professionals*) and Skype (*the Skype software provides Internet communications products*)¹ “Used with permission from Microsoft.” [*Entrepreneurship & Business Innovation :A North America, Europe, Africa, Oceania & Asia 21st Century Perspective 1st Edition*] is an independent [publication] and is neither affiliated with, nor authorized, sponsored, or approved by, Microsoft Corporation. Interestingly, the ‘entrepreneurial spirit’ is growing on a daily basis amongst people of diversified backgrounds (*in terms of*

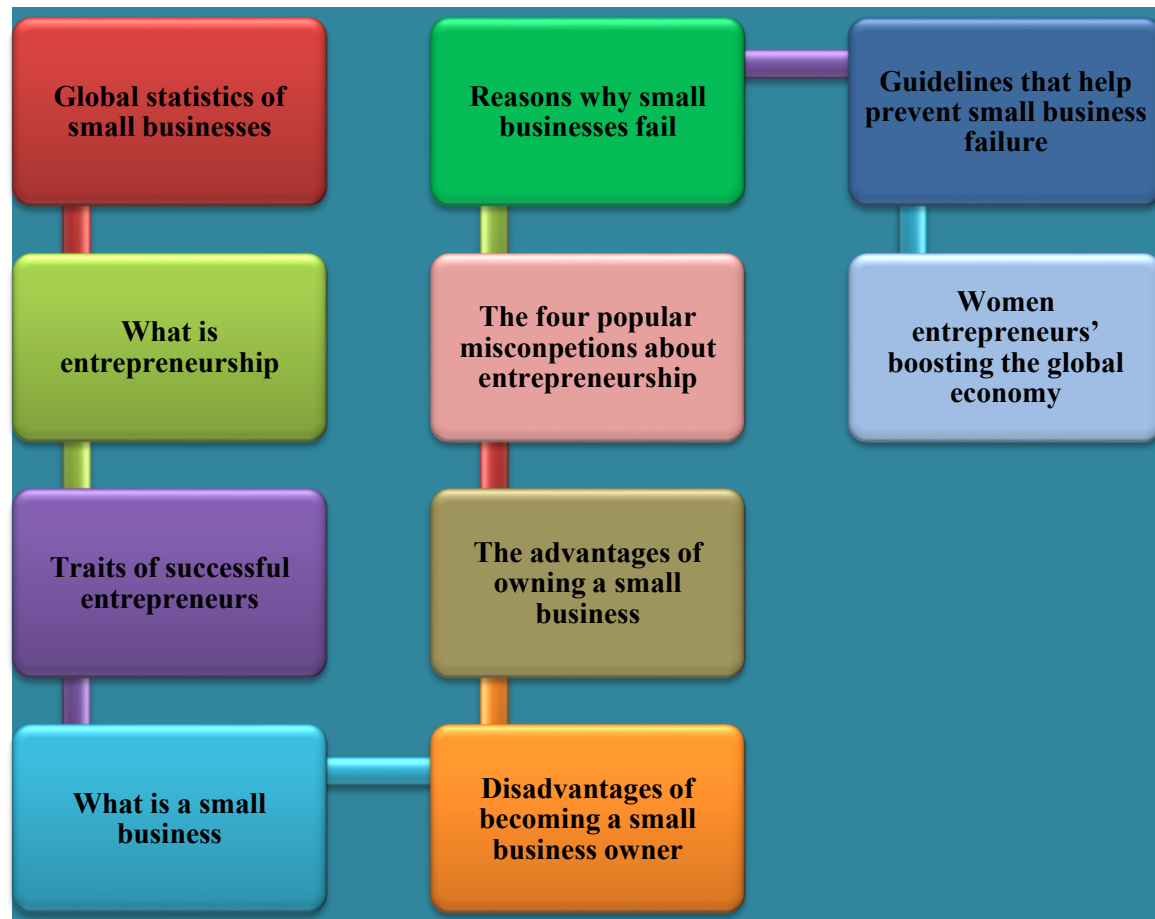
¹ Microsoft (2018) *Facts About Microsoft*. Available from: <https://news.microsoft.com/facts-about-microsoft/> “Used with permission from Microsoft”. [*Entrepreneurship & Business Innovation :A North America, Europe, Africa, Oceania & Asia 21st Century Perspective 1st Edition*] is an independent [publication] and is neither affiliated with, nor authorized, sponsored, or approved by, Microsoft Corporation.

religion, marital status, age, political opinion, gender, nationalities, culture and so on) across the world. Many people today are starting their own businesses so that they can achieve their personal life goals and contribute to their nation's economic growth. Numerous research studies have since discovered that many small businesses are being registered on a daily basis in various countries across the world and remarkably developing countries seem to be having a significantly high number of new startups on a daily basis and this helps to boost their economic growth rates and national employment statistics. Previously conducted research studies have since discovered that in developing continents such as Africa some of the examples of nations that attract a significant number of large capital investments include the following: Nigeria, Uganda, Kenya, South Africa, Tanzania, Ghana, Cameroon and Egypt as they all have the highest rates of startup investments across Africa with South Africa having the highest rate² (White, Zimmerman and van Halen, 2015:2).

In this chapter the sub-components of the introduction to entrepreneurship that will be covered are depicted in Figure 1.1 below.

² White, B., Zimmerman, B. and van Halen, T. (2015) *Venture finance in Africa*. Available from: <http://www.aspeninstitute.org/sites/default/files/content/docs/resources/Summary%20VC4Africa%202015%20Report%20-%20Venture%20Finance%20in%20Africa.pdf>

Figure 1.1 Ten sub-components of the introduction to entrepreneurship



1.2 Global statistics of small businesses

According to the European Commission (2013) small-medium enterprises (SMEs) make up 99% of all the European businesses and generally they create two out of three jobs in the private sector labour market³ (European Commission, 2013). “The number of businesses in the UK continued to grow to 2.67 million in March 2017 compared with 2.25 million in March 2016, which is consistent with the performance of the broader UK economy. The largest industry group is professional, scientific and technical, making up 17.9% of all registered businesses in the UK”⁴ (Office of National Statistics United Kingdom, 2018). “The usual definition of small and

³ European Commission (2013) *Enterprise and Commission*. Available from:

<http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/>

⁴ Office of National Statistics United Kingdom (2018) *UK Business: Activity, Size and Location in 2017*. Available from: <https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation> [Accessed 2018, 14 June]

medium sized enterprises (SMEs) is any business with fewer than 250 employees. There were 5.7 million SMEs in the UK in 2017, which was over 99% of all businesses. Micro-businesses have 0-9 employees. There were 5.4 million micro businesses in the UK in 2016, accounting for 96% of all businesses. Although the vast majority of businesses in the UK employ fewer than 10 people, this sort of business only accounts for 33% of employment and 22% of turnover. Large businesses, with more than 250 employees, accounted for 0.1% of businesses but 40% of employment and 49% of turnover, as the following chart shows”⁵⁶ (C. Rhodes, Business Statistics, House of Commons Library Briefing paper SN06152, 28 December 2017).

⁷According to the Government of Canada Innovation, Science and Economic Development Canada (2016) as of December 2015, the Canadian economy totalled 1.17 million employer businesses. Of these, 1.14 million (97.9 percent) were small businesses, 21,415 (1.8 percent) were medium-sized businesses and 2,933 (0.3 percent) were large businesses. In 2013, Canada exported goods totaling \$420 billion, of which \$106 billion was exported by SMEs (Government of Canada Innovation, Science and Economic Development Canada, 2016. “*Reproduced with the permission of the Minister of Industry, 2018*”). “At the end of 2016-17, there were 2,238,299 actively trading businesses in the market sector in Australia, an increase of 3.1% (66,755 units) from the end of 2015-16. During this period, the number of businesses entering the market sector (Entries) was 328,205, an increase of 5.7% (17,770 units) from 2015-16 (310,435 units)”⁸ (ABS,

© Office of National Statistics, 2018. This information is licensed under the Open Government Licence v3.0. To view this licence, visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/> OGL v3.0

⁵ C. Rhodes, Business Statistics, House of Commons Library Briefing paper SN06152, 28 December 2017.

⁶ Source: BIS, Business population estimates, 2017, p 1

⁷ Government of Canada Innovation, Science and Economic Development Canada (2016) *Key Small Business Statistics*. Available from: [https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf/\\$file/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf](https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf/$file/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf) “Reproduced with the permission of the Minister of Industry, 2018”).

⁸ Australian Bureau of Statistics, 2018, *Summary of Findings*, viewed 11 June 2018, <http://www.abs.gov.au/ausstats/abs@.nsf/mf/8165.0> © Commonwealth of Australia 2018.

2018). During the year 2015 a total of 30.2 million (99.9%) small businesses were recorded in the United States of America and they employed a total of 58.9 million employees (47.5%)⁹ (US Small Business Administration Office of Advocacy, 2018:1). “A total of 294,834 companies exported goods from the United States in 2015. Of these, 287,835, or 97.6%, were small firms; they generated 32.9% of the United States’s \$1.3 trillion in total exports”¹¹ (US Small Business Administration Office of Advocacy, 2018:3). In India during the year 2013 small medium enterprises (SMEs) contributed 9% of the Gross Domestic Product (GDP) while on the other hand in Germany during the year 2015 small medium enterprises (SMEs) contributed 53% of the GDP¹² (Global Entrepreneurship Monitor, 2018:60-65).

One of the leading global startup hub in the world after Silicon Valley today is Stockholm, Sweden due to the high number of ‘billion-dollar companies’ it has produced over the years per capita and according to the 2017 [Inc. 5000 Europe](#) it was listed as the number 2 city for fast growing companies¹³ ¹⁴(Henry, 2017, <https://www.inc.com>). The capital city of Sweden, Stockholm has around 134 fastest growing private companies in Europe and the third annual tally discovered that five of the top 10 companies that are privately owned with a three-year revenue growth come from Stockholm according to the ‘2017 [Inc. 5000 Europe](#)’ (Henry, 2017, <https://www.inc.com>). Today Sweden is the global startup hub as a result of the following: (1) its highly educated workforce and this made it easy for the country to provide highly conducive starting conditions for small businesses/entrepreneurs in terms of provision of highly productive labour supply, (2) there is limited government regulations in Sweden on issues such as small

⁹ US Small Business Administration Office of Advocacy (2018) *Small Business Profile: United States*. Available from: <https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-All.pdf>

¹⁰ BEA *Bureau of Economic Analysis*, US Department of Commerce

¹¹ ITA *International Trade Administration*, US Department of Commerce

¹² Global Entrepreneurship Monitor (2018) *Global Report 2017/18*. Available from: <https://www.gemconsortium.org/report/50012>

¹³ Henry, Z. (2017) *How a Country the Size of North Carolina Became a Global Startup Hub*. Available from: <https://www.inc.com/zoe-henry/stockholm-sweden-hub-fast-growing-private-companies-2017-inc5000-europe.html>

¹⁴ Inc.com (2018) *List*. Available from: <https://www.inc.com/inc5000eu/list/2017/>

business startup requirements in order to create conducive conditions for starting entrepreneurs, (3) historically Sweden has been very receptive to new technological advancements and during the year 1994 it built the world's largest open fiber network that easily enabled small businesses to easily access information technology infrastructure and in addition 9 out of 10 households in Sweden now have Internet access according to the 2015 European Commission [data](#).¹⁵ (Henry, 2017, <https://www.inc.com>).

In general a small business helps to highlight the vision of the founders and their intended set goals when they started the business. Today even in large economic powerhouses across the world small businesses form the backbone of these economies and have managed to turn them into growth engines of the world. Small businesses offer their economies high innovation, high job creation and enhanced international trade¹⁶ (Ferrell and Hirt, 2002:139).¹⁷ According to the Global Entrepreneurship Monitor (2014) a survey was conducted that involved 73 countries in Africa, Latin America & Caribbean, Asia & Oceania, Europe and North America representing 72.4% of the total world population. The motivational reasons why entrepreneurs start their new businesses in Africa, Asia & Oceania and Latin America with 28% of the entrepreneurs stating that they are influenced by necessity. 54.9% of the entrepreneurs in innovation driven economies in Asia & Oceania, Latin America & Caribbean, European Union, Non-European Union (*Norway & Switzerland*) and North America (*Canada and USA*) were motivated by the improvement driven opportunities in comparison to 45.1% in efficiency driven economies or 47% in factor driven economies (Global Entrepreneurship Monitor, 2014:11-12).

However, it should be noted that for the purposes of this book the words '*business*', '*small business*' '*company*', '*organization*' and '*firm*' shall be used interchangeably to refer to a

¹⁵ European Commission (2015) *Digital Economy and Society Statistics Households and Individuals*. Available from: http://ec.europa.eu/eurostat/statistics-explained/index.php/Digital_economy_and_society_statistics_households_and_individuals

¹⁶ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p30 – 360.

¹⁷ Global Entrepreneurship Monitor Report (2014) *Global Entrepreneurship Monitor 2014 Global Report*. Available from: <http://www.babson.edu/Academics/centers/blank-center/global-research/gem/Documents/GEM%202014%20Global%20Report.pdf>

business whether it is large or small. It is important to point-out that the ‘sizes of firms’ shall be covered later on in the chapter. The meaning of entrepreneurship will be covered in the following section.

1.3 What is entrepreneurship?

¹⁸¹⁹According to Thomas, R. Eisemann (2013) ‘Entrepreneurship: A Working Definition’, *Harvard Business Review January Issue*, “As a professor, I suppose I am guilty of mincing words. But like the terms “strategy” and “business model,” the word “entrepreneurship” is elastic. For some, it refers to venture capital-backed startups and their kin; for others, to any small business. For some, “corporate entrepreneurship” is a rallying cry; for others, an oxymoron. The history of the word “entrepreneurship” is fascinating and scholars have indeed parsed its meaning. I’ll spare you the results, and focus instead on the definition we use at Harvard Business School. It was formulated by [Professor Howard Stevenson](#), the godfather of entrepreneurship studies at HBS. According to Stevenson, *entrepreneurship is the pursuit of opportunity beyond resources controlled*. **“Pursuit”** implies a singular, relentless focus. **“Opportunity”** implies an offering that is novel in one or more of four ways. The opportunity may entail: 1) pioneering a truly innovative product; 2) devising a new business model; 3) creating a better or cheaper version of an existing product; or 4) targeting an existing product to new sets of customers. **“Beyond resources controlled”** implies resource constraints. At a new venture’s outset, its founders control only their own human, social, and financial capital” (Thomas, R. Eisemann, 2013. Entrepreneurship: A Working Definition. *Harvard Business Review January Issue*). Generally the personal inner drive that pushes entrepreneurial behavior in people is in most instances ‘the strong desire’ to look for untapped business gaps in the market by first carrying-out market research to assess if any of the potential business opportunities identified will have the following: (1) a market, (2) if they will be profitable, (3) or will they be sustainable and so on. Furthermore, entrepreneurial behavior is driven by the strong desire to establish or develop a business idea that is totally new and life changing to society. The fact that

¹⁸ Thomas, R. Eisemann (2013) ‘Entrepreneurship: A Working Definition’, *Harvard Business Review January Issue*

¹⁹ Sinoway, E. and Meadow, M. (2012) *Howard's Gift: Uncommon Wisdom to Inspire Your Life's Work*. 1st Edition. St Martin’s Press, ISBN-13: 978-1250004246 ISBN-10: 1250004241

‘entrepreneurial activity’ is interrelated to economic development (*namely; exports, innovation, employment creation, contribution to the Gross Domestic Product of a country and so on*) tends to attract individuals to adopt an entrepreneurial mindset and choose the field of entrepreneurship as a career. In most instances the entrepreneurial spirit’ often thrives in people who have the following: (1) a high level of imagination, (2) who are highly energetic, (3) who consistently take calculated risks in today’s highly dynamic business world, (4) who have life goals that aim to distinguish themselves in the community through societal development (*job creation and carrying-out effective social responsibility activities*), (5) who are eager to succeed, (6) who consistently see ‘failure’ as motivation to try again and an opportunity to do things in a much better way next time, (7) who want to be self employed and so on.

One of the key points that every book in the field of entrepreneurship must clearly highlight is that all the businesspeople must ensure that they are fully knowledgeable of the fact that the term ‘entrepreneurship’ and an ‘entrepreneur’ have separate definitions. In addition these two terms must not be used interchangeably as if they share the same definition. *An entrepreneur* is a person who takes a bold step to establish his/her own business with the main aim of making a profit and in most instances they proceed to gather all the needed resources (*namely; money, labour, technology and the formation of an effective business model*) without fearing their immediate negative environmental factors that may hinder their chances of success. Another definition of *an entrepreneur* clearly states that ‘an entrepreneur’ is someone who takes calculated risks by first carrying-out two activities: (1) they conduct a market research to first test-out their business idea and (2) they draw up business plans, before they start their business in order to identify possible problems or competition the business will face in the future. While on the otherhand the term ‘*entrepreneurship*’ refers to a career field whereby individuals or entities form their own new businesses to make a profit, create jobs and contribute to economic growth without fearing their immediate negative environmental factors that may hinder their chances of success. Nowadays many people think of becoming entrepreneurs and surprisingly some of them successfully generate brilliant business ideas but the ‘fear of the unknown’ for instance the risk of failing strongly motivates them to give up on pursuing their dreams or ideas. Over the past decades researchers, commerce industry experts and academics across the world have successfully managed to carry-out numerous research studies to identify the true personal

qualities of entrepreneurs. Most of the researchers have found certain common traits or characteristics that are associated with successful entrepreneurs and these will be discussed in the following section.

1.4 Traits of successful entrepreneurs

Generally there is a plethora of evidence that clearly highlights the traits of successful entrepreneurs and the entrepreneurial process that they must first pass through in their life in order to realize their dream and this will be covered in this section. The traits that highly successful entrepreneurs possess are depicted in Figure 1.2 below.

Figure 1.2 Eight traits possessed by most successful entrepreneurs



1.4.1 They sincerely love their business

One of the most common trait or characteristic that is found in successful entrepreneurs is that they sincerely love their business (*what it stands for, mission, vision, values, people, brands and so on*). Most entrepreneurs have a strong interest in their business due to the fact that they spend many years learning and refining their business's (*ideas, products/services, business models, internal and external stakeholder relationships*) so that they can help satisfy customers' unfulfilled needs profitably. Entrepreneurs often have a strong inner desire and excitement

towards seeing their business ideas blossom into something beyond their expectations.²⁰ A good example of two ‘great entrepreneurs and philanthropists’ who have a strong interest in their business and who sincerely love what it stands for include; Warren. Edward. Buffett and Charlie T. Munger. The two great entrepreneurs are the current major shareholders of the Omaha, Nebraska (*United States of America*) headquartered Berkshire Hathaway Inc. an investment company that had a total of 63 subsidiary companies by May 2018 (Berkshire Hathaway Inc., 2018, <http://www.berkshirehathaway.com/>). A letter issued by Mr Warren Edward. Buffett to the shareholders of Berkshire Hathaway Inc. published in 1996 when he issued a booklet entitled “*An Owner’s Manual*” to Berkshire’s Class A and Class B shareholders supports the fact that entrepreneurs who are successful in most instances are those who sincerely love their business and what it stands for. Notably, at the end of the letter Mr. Warren Edward. Buffett clearly states that “*Lest we end on a morbid note, I also want to assure you that I have never felt better. I love running Berkshire, and if enjoying life promotes longevity, Methuselah’s record is in jeopardy. Warren*”²¹ (Warren Buffett, 1996:23). “Berkshire Hathaway and its subsidiaries engage in diverse business activities including insurance and reinsurance, utilities and energy, freight rail transportation, finance, manufacturing, retailing and services. Common stock of the company is listed on the New York Stock Exchange, trading symbols BRK.A and BRK.B.”²² (Berkshire Hathaway Inc., 2018). The fact that most of the highly successful entrepreneurs have a strong interest in their business often makes them to continue to be part of their business’s day-to-day management despite the fact that it has enormously grown from being a small business to a large organization. Today Mr. Warren. Edward. Buffett and Mr. Charlie T. Munger are still highly involved in the management of the world’s leading investment company Berkshire Hathaway Inc. with Mr. Warren .Edward. Buffett being the current Chief Executive Officer and Chairman of the Board while Mr. Charlie T. Munger is the current Chairman of the Board and President.

²⁰ Berkshire Hathaway Inc. (2018) *First Quarter Report. March*. Available from: <http://www.berkshirehathaway.com/qtrly/1stqtr18.pdf> “*The material is copyrighted and used with permission of the author*”. Debra Ray for Warren Buffett

²¹ Warren Buffett (1996) *An Owner’s Manual*. Available from: <http://www.berkshirehathaway.com/ownman.pdf> “*The material is copyrighted and used with permission of the author*”. Debra Ray for Warren Buffett.

²² Berkshire Hathaway Inc. (2018) *List of Subsidiaries*. Available from: <http://www.berkshirehathaway.com/subs/sublinks.html> “*The material is copyrighted and used with permission of the author*”. Debra Ray for Warren Buffett

By March 31, 2018 Berkshire Hathaway consolidated balance sheet highlighted that the investment company had a total asset value of USD\$702,651 billion²³ (Warren Buffett, 2018:17; Berkshire Hathaway Inc., 2018, www.berkshirehathaway.com). *“The material is copyrighted and used with permission of the author”*. Debra Ray for Warren Buffett.

1.4.2 They take calculated risk

One of the most common trait that is often shared by most of the successful entrepreneurs is that they take calculated risks in the way they start and manage their business. Before making any strategic business decisions they often have to first analyse the business’s internal and external environmental factors through conducting research and then they proceed to weigh the advantages and disadvantages of each decision in order to reduce the risk of failure. One of the most effective ways that is used by entrepreneurs to make calculated risks is establishing business models since they help them to determine how they will deal with the firm’s rivals in the market, spend the firm’s financial resources effectively, network with the firm’s various stakeholders and uphold the firm’s quality standards during its services/product transformation processes. A good business model helps a firm to continue to receive high sales revenue over a long period of time and this is one of the many reasons that strongly drives entrepreneurs to enter into the field of entrepreneurship while on the other hand it clearly highlights the fact that successful entrepreneurs take calculated risks in general.

1.4.3 Highly confident about their business idea

A common trait/characteristic that is found in most successful entrepreneurs nowadays is that they have a high level of confidence in their business idea and they tend to strongly believe that their business idea will work in the marketplace when they launch their small business. The process of starting a business is generally not an easy task due to the fact that numerous requirements (*must first be fulfilled and organized simultanously namely; legal, financial, human resources, technological, logistics and so on*) to successfully open the business on time, at the

²³ Warren Buffett (2017) To the Shareholders of Berkshire Hathaway Inc. Available from: <http://www.berkshirehathaway.com/letters/2017ltr.pdf> *“The material is copyrighted and used with permission of the author”*. Debra Ray for Warren Buffett

right place and offering the right products/services. It is important to note that the process of preparing to start a business may at times be overwhelming to a certain extent thus optimism may be required to motivate an individual to stay focused and overcome the current challenges he/she may be facing at that particular time so that they achieve their goal of making their business idea a success. ²⁴For example, one of the world's greatest entrepreneurs was the late Henry Ford. Many decades ago during 1908-1913 Henry Ford invented a cost effective automobile assembly line that pioneered the way organizations nowadays carryout the mass production of automobiles and he first introduced the Model T in 1908 (Ford Motor Company, 2018). "Henry Ford's Model T put the world on wheels with a simple affordable, durable automobile. Ford sold 15 million Model Ts before ceasing production in May 1927, making it one of the best-selling vehicles of all time, and arguably the most famous car in the world. In 1908, there were only about 18,000 miles of paved roads in the US. To deal with the primitive roads, Ford used light and strong vanadium steel alloy for critical parts. Ford's innovation eventually reduced the Model T's chassis assembly line from 12.5 to 1.5 hours, and in doing so precipitated a revolution in manufacturing. The accelerating speed with which Ford could produce cars helped him continue to lower the price of the Model T" ²⁵(Ford Motor Company, 2018). As a result of Henry Ford's high level of confidence in his production methods of automobiles during the year of 1913 most of the automobile manufacturers that later on joined the sector started to produce automobiles in high quantity levels at a low cost.

1.4.4 Ability to implement their business idea

Some people believe that *'the mind is a unique powerful creation which never runs-out of both good and bad ideas and it is like an ever flowing river which never runs-dry the whole year'* (Rudolph.Patrick. T. Muteswa, 2018). In essence people can think and dream the whole day and the fact that they do not write down some of their brilliant ideas and take the necessary steps needed for them to achieve their ideas makes the whole process of generating ideas a day dreaming exercise or simply put 'a waste of time' despite the fact that the mind keeps generating ideas everyday like a flowing river that never runs dry (Rudolph.Patrick. T. Muteswa, 2018).

²⁴ Ford Motor Company (2018) *Our Story*. Available from: <https://corporate.ford.com/history.html>

²⁵ Ford Motor Company (2018) *Fourth Quarterly Report 2017 SEC Filings*. Available from: <http://shareholder.ford.com/investors/financials/quarterly-reports/default.aspx>

Another common characteristic that is shared by most of the successful entrepreneurs is the ability to implement business ideas. In general it is quite challenging for an individual to implement a business idea and make their dream come alive. The implementation of a business idea by an entrepreneur involves the following activities: (1) establishing an effective way the business will generate cash revenue profitably, (2) mobilizing the required resources (*financial, human resources, technology, land, inventory, machinery and so on*) to start the business smoothly, (3) establishing new business contacts that will help build the business when it is launched over a long period of time, (4) adopting a culture of innovativeness so that there is the continuous improvement of business processes, ideas, products/services and so on. A typical good example of an entrepreneur who had the ability to implement his business idea was Henry Ford who built his first automobile in 1896 called the Quadricycle.²⁶ "Henry Ford's first vehicle rode on four bicycle wheels and was powered by a four-horsepower engine. Instead of a steering wheel, the Quadricycle had a tiller. The gearbox had only two forward gears with no reverse" (Ford Motor Company, 2018). Henry Ford is one of the world's unquestionable greatest iconic entrepreneurs and interestingly his ability to execute or implement his business idea of producing vehicles was revealed on June 16, 1903 when he founded the Ford Motor Company which is based in Dearborn, Detroit (*United States of America*). Henry Ford further showed his ability to strategically implement his business ideas during the year 1903 and 1904. "The Ford Motor Company was incorporated in 1903. With 12 investors and 1,000 shares the company had spent almost all of its \$28,000 cash investment by the time it sold the first 'Ford Model A' on July 23, 1903 Ford Motor Company had turned a profit of \$37,000. In 1904 Ford Motor Company of Canada is founded. Ford's first international plant was built in Walkerville (now Windsor) Ontario, right across the Detroit River from Ford's existing facilities. The company was a separate organization with its own set of shareholders. It was created to sell vehicles not just in Canada, but also across the then-current British empire"²⁷ (Ford Motor Company, 2018). As of 31 December 2017 the Ford Motor Company had a consolidated balance sheet showing total assets worth USD\$257,808 billion and by June 14, 2018 it employed a total of 166,000 people working in plants and offices in various countries (Ford Motor Company, 2017:82). Today one

²⁶ Ford Motor Company (2018) *Our Story*. Available from: <https://corporate.ford.com/history.html>

²⁷ Ford Motor Company (2018) *Fourth Quarterly Report 2017 SEC Filings*. Available from: <http://shareholder.ford.com/investors/financials/quarterly-reports/default.aspx>

of the slogans of the Ford Motor Company states that, “*We believe freedom of movement for everyone drives human progress. Which is why we’re committed to being the world’s most trusted mobility company, designing smart vehicles in a smart world*” (Ford Motor Company, 2018).

1.4.5 High level of persistence

A common word that is associated with entrepreneurs starting their new businesses is ‘uncertainty’ mainly caused by the rapid changes that occur in the business environment of the global economy and limited financial resources to use to make their new business a success. Even after a new small business has been established entrepreneurs are still faced with numerous challenges such as limited financial capital to market their products or services, inability to attract highly skilled labour in the job market and so on. Therefore, some of the entrepreneurs often fail to overcome these business challenges and they end up closing down their businesses and in certain instances some of them often decide not to start a new business again in their life. One of the common characteristic found in highly successful entrepreneurs is that they have a high level of persistence in general. Despite experiencing failure when running their small-large businesses they continue to maintain a high level of persistence in order to keep their ‘dream alive’ and they also tend to remain passionate about their business idea. In many instances new businesses are often faced with a high number of setbacks and the critical ingredient to success for the entrepreneur is to ‘never give up’ on their dream and values. The high level of persistence that is found in successful entrepreneurs inspires people around them, employees, customers or suppliers to work hard in life and never stop dreaming to pursue their business idea.

1.4.6 Maintain good health

Generally all human beings fall sick in their life time. One of the common characteristic that is shared by successful entrepreneurs is that they ensure that they maintain their good health. Of course in some instances some of the entrepreneurs end up falling sick overtime which is common to any living human being. Furthermore, it is important to first understand the definition

of 'health' and how it applies to entrepreneurs. ²⁸"*Health* is a state of complete physical, mental and social well-being and not merely the absence of disease or infirmity" (World Health Organization, 2014). "Translated with permission of the publisher from Publication *Mental Health: a State of Well-Being*, World Health Organization, 2014." The field of entrepreneurship is generally demanding since it needs people who are highly energetic and healthy (*for instance managing a business is associated with high stress levels*) so that they may easily cope with the day-to-day pressures or challenges they will face in running and coordinating their business's operations.

1.4.7 Foresee the future

Another trait that is commonly shared by highly successful entrepreneurs is the ability to foresee the future. This fact is supported by the mission and vision statements of the already existing successful companies in the world. In addition it is important to point-out that all businesses started after one or more individual entrepreneurs' first thought of a vision and how they will achieve that vision. Successful entrepreneurs often first assess the future outlook of their business and its operating environment (*internal and external*) when planning, organizing, or making decisions to ensure that their decisions are in direct alignment with their clearly set-out vision. Entrepreneurs who tend to be futuristic in general often foresee most of their challenges in advance and this enables them to properly find the appropriate solution before the challenge negatively affects their business's success. Over the past few decades it has since been discovered that there is an interrelationship between highly futuristic entrepreneurs and innovation. Entrepreneurs who foresee the future often spend a lot of time thinking about new possible ideas or products/services they can use to fulfill the currently existing unfulfilled gaps in the marketplace when conducting a routine overall future outlook of their business. A typical good example of entrepreneurs who foresee the future are Larry Page and Sergei Brin the founders of the high-tech company Google Inc. and its parent company Alphabet Inc. which is

²⁸ World Health Organization (2014) *Mental Health: a State of Well-Being*. Available from: http://www.who.int/features/factfiles/mental_health/en/ "Translated with permission of the publisher from Publication *Mental Health: a State of Well-Being*, World Health Organization, 2014."

headquarereated in Mountain View, California, United States of America. Larry Page and Sergei Brin established their high-tech company in 1998 and today they have proved that they are indeed future oriented entrepreneurs who have managed to enormously grow their company. Google Inc. started off as a search engine but later on diversified its product offering to include Google Maps, Google Translator, Cloud Services, Hardware products (*namely, Pixel phones and Google Home smart speakers*), paid advertisement clicks, Google Earth, Gmail, Chrome, Nexus business, Android and so on. The parent company of Google is called Alphabet Inc. by the 31st of December 2017 it employed a total number of 80,110 employees. On the 1st of February 2018 Alphabet Inc. announced its fourth quarter financial results for the financial year ending 31 December 2017. Alphabet Inc. during the year 2016 it earned USD\$90,272 billion worth of sales revenue while during the year 2017 it earned USD\$110,855 billion worth of sales revenue²⁹ (Alphabet, 2018:4; courtesy of Google Inc.). Alphabet Inc. earned over USD\$100 billion worth of sales revenue during the year 2017 for the first time since it was established. ©2017 Google LLC, used with permission. ³⁰Google and the Google logo are registered trademarks of Google LLC. Further evidence that supports that the Google Inc. co-founders foresee the future is revealed in the letters published by Larry Page and some of the extracted information states the following; *““As Sergey and I wrote in the original founders letter 11 years ago, “Google is not a conventional company. We do not intend to become one.” As part of that, we also said that you could expect us to make “smaller bets in areas that might seem very speculative or even strange when compared to our current businesses.” From the start, we’ve always strived to do more, and to do important and meaningful things with the resources we have. What is Alphabet? Alphabet is mostly a collection of companies. The largest of which, of course, is Google. This newer Google is a bit slimmed down, with the companies that are pretty far afield of our main internet products contained in Alphabet instead. What do we mean by far afield? Good examples are our*

²⁹ Alphabet (2018) *Alphabet Announces Fourth Quarter and Fiscal Year 2017 Results*. Available from: https://abc.xyz/investor/pdf/2017Q4_alphabet_earnings_release.pdf p1-11. ©2017 Google LLC, used with permission. Google and the Google logo are registered trademarks of Google LLC.

³⁰ Larry Page (2018) *G is for Google*. Available from: <https://abc.xyz/> [Accessed 2018, 14 June] ©2017 Google LLC, used with permission. Google and the Google logo are registered trademarks of Google LLC.

health efforts: Life Sciences (that works on the glucose-sensing contact lens), and Calico (focused on longevity). Fundamentally, we believe this allows us more management scale, as we can run things independently that aren't very related. Google itself is also making all sorts of new products, and I know Sundar will always be focused on innovation—continuing to stretch boundaries. I know he deeply cares that we can continue to make big strides on our core mission to organize the world's information. Recent launches like Google Photos and Google Now using machine learning are amazing progress. We are excited about...

- *Getting more ambitious things done.*
- *Taking the long-term view....”* (Larry Page, Co-founder of Google Inc. and Alphabet Inc., 2018). ©2017 Google LLC, used with permission. Google and the Google logo are registered trademarks of Google LLC.

1.4.8 Highly flexible

In this 21st century the business world is rapidly changing, everything is now rapidly fast and requires high customization in order to be profitable. Entrepreneurs who create product or services that suit their customer's needs and wants are more likely to be successful and highly flexible in general. Successful entrepreneurs often place high value on flexibility and they are willing to go the extra mile in achieving it by changing their current business model, pricing structures and so on to maintain flexibility that enables their business to be efficient and effective. ““I've always been taught to be decisive. Some of my best early managers were particularly good at taking all available information and making a quick decision. In today's competitive environment of technology-fueled 24/7 marketing, we also need to be flexible. Gone are the days where we can create business and marketing plans a year ahead of time and expect them to be etched in stone. Sure, planning is a necessity, particularly for long-term vision, positioning and innovation, but just as important is short-term activity. Movement is key, and responsiveness drives movement. Antiquated and inflexible ways of doing business are exiting stage left . . . just look at the number of brick-and-mortar store closing every week. The way we do business has dramatically shifted and anything that isn't flexible enough for the ride will be

left behind”³¹ (Joseph, 2017, www.entrepreneur.com). Flexibility is one aspect that is inevitable nowadays and it is practically impossible to overstate it. The definition of a small business will be covered in the following section.

1.5 What is a small business?

The answer to the above question varies according to each and every country’s government department that is responsible for trade and commerce industry or small business development. In most countries the government trade and commerce or small enterprises development departments are usually responsible for setting up the legal requirements needed when registering a new business including the classification of businesses as small, micro, medium and large (SMMEs). “No single definition of a small business will suit all the needs of government or the private sector. This is reflected in the many different ways a small business can be defined. The two most common ways of defining an Australian small business is by annual turnover, the number of employees, or a combination of the two”³² (Australian Government Department of Innovation, Industry, Science and Research, 2011:8). According to the US Small Business Administration (2018) a size standard, which is usually stated in the number of employees or average annual receipts, represents the largest size that a business (including its subsidiaries and affiliates) may need in order to remain classified as a small business for SBA and federal contracting programs. The definition of “small” varies by industry³³ (US Small Business Administration, 2018). It is important to point-out the fact that in some of the developed countries small businesses employ less than 500 people. “For statistical purposes, the Australian Bureau of Statistics (ABS) defines a small business as an actively trading business with 0–19 employees. Micro businesses are small businesses with 0–4 employees. Actively trading

³¹ Joseph, J. (2017) *Why Your Business Needs to Be More Flexible Than Ever*. Available from:

<https://www.entrepreneur.com/article/296735>

³² Australian Government Department of Innovation, Industry, Science and Research (2011) *Key Statistics*

Australian Small Business. Available from:

<https://static.treasury.gov.au/uploads/sites/1/2017/06/SmallBusinessPublication.rtf> © Commonwealth of Australia 2018.

³³ US Small Business Administration (2018) *Table of Size Standards*. Available from:

<https://www.sba.gov/document/support--table-size-standards>

businesses are businesses that have an ABN and are actively remitting in respect of a GST role (or are businesses that are monitored directly by the ABS and are determined to be ‘active’). The ABS defines a medium-sized business as an actively trading business with 20–199 employees, and a large business as an actively trading business with 200 or more employees” (Australian Government Department of Innovation, Industry, Science and Research, 2011:8). In the United Kingdom small medium enterprises (SMEs) are categorized as businesses that employ 250 or less people³⁴ (C. Rhodes, Business Statistics, House of Commons Library Briefing paper SN06152, 28 December 2017). While on the other hand it is important to point-out the fact that in some of the developing nations across the world a large company can be categorized as a business that employs 200 - 500 employees or more due to the small size of these economies. There are several misconceptions about entrepreneurship and these will be discussed in the next section.

1.6 The four popular misconceptions about entrepreneurship

1.6.1 The assumption that ‘success comes from one brilliant idea’

Indeed it is true that there are some entrepreneurs who have managed to successfully generate brilliant business ideas after identifying unfulfilled needs in the marketplace and further took bold steps to create viable products/services that helped to fulfill all the unmet needs in the marketplace. As a result of their brilliant ideas most of the entrepreneurs have successfully built remarkable business empires. It is important to highlight the fact that the success of any business is ‘99 percent based on the implementation of an idea’ while the generation of an idea contributes just 1 percent. Many entrepreneurs often misunderstand the fact that setting up a small business requires more than one good idea³⁵ (Gomez, 2017, www.virgin.com/).

³⁴ C. Rhodes, Business Statistics, House of Commons Library Briefing paper SN06152, 28 December 2017.

³⁵ Gomez, J. (2017) *Three Common Misconceptions About Entrepreneurship*. Available from: <https://www.virgin.com/entrepreneur/three-common-misconceptions-about-entrepreneurship>

1.6.2 The assumption that people management skills are irrelevant when starting a new business

The most strategic asset in any business is its human resources and most of the highly successful entrepreneurs have good people skills. Many aspiring entrepreneurs fall under the misconception that people skills are irrelevant in starting and managing a small business. Entrepreneurs must ensure that they effectively measure their employees' work performance, provide them with up-to-date compensation and design up-to-date training programs to boost their business's and employees' productivity levels (Gomez, 2017, www.virgin.com/).

1.6.3 The assumption that you need a university qualification to be an entrepreneur

Many aspiring entrepreneurs often assume that in order for them to become successful entrepreneurs they have to possess a university qualification. Generally, this misconception is completely wrong especially in this present-day highly globalized economy. Today there are very successful entrepreneurs who have managed to establish powerful social media and internet voice communication firms despite the fact that they did not even graduate from university. The art of 'true entrepreneurship' lies in your (1) level of commitment, (2) passion for the product/service your business will provide to its targeted customers, (3) ability to identify your target market and (4) how you will strategically implement your business idea including seeking expert advice from other successful entrepreneurs. However, it is important to point-out the fact that knowledge is critical in any business and it is encouraged that entrepreneurs must have college/university qualifications despite the fact that it is not a guarantee that they will launch a successful business.

1.6.4 The assumption that you must discover 'something that never existed before'

One of the most common misconceptions about entrepreneurship is that successful entrepreneurs are individuals who have only invented original new products/services ideas is wrong. The truth of the matter is that nowadays there are many highly successful entrepreneurs who have developed brilliant ideas by innovating already existing ideas and this is very common in sectors such as automobile manufacturing, aeroplane design and manufacturing, mobile/personal computer manufacturing and so on. They are several benefits that are enjoyed by entrepreneurs

who take the bold step of starting their small business and these will be covered in the following section.

1.7 The advantages of owning a small business

Generally there are numerous advantages that entrepreneurs enjoy when they form their own small business and these are depicted in Figure 1.3 below.

Figure 1.3 Seven common advantages of owning a small business



Source: Modified: (Dahl, 2018, www.inc.com)

1.7.1 The ability to control your career, dreams and future

The field of entrepreneurship helps to provide entrepreneurs with an opportunity to directly control their business career in a way they have always dreamed. On the other hand owning a business helps the entrepreneur to steer their future in any direction they want. A typical good example of an iconic entrepreneur who managed to successfully control his career, future and dreams is Henry Ford. *““One hundred years ago, my great-grandfather had a vision to build safe and efficient transportation for everyone,” said Ford Executive Chairman Bill Ford. “I am proud he was able to bring the freedom of mobility to millions by making cars affordable to families and that his vision of serving people still drives everything we do today.””*³⁶ (Bill Ford

³⁶ Ford Motor Company (2018) *Our Story*. Available from: <https://corporate.ford.com/history.html>

the Executive Chairman cited in Ford Motor Corporation, 2018). Another advantage commonly enjoyed by entrepreneurs who start their own businesses is that they can dictate every aspect of their life in any manner they wish to do so.

1.7.2 It helps to provide a customized work/life balance

The provision of a flexible work/life balance schedule is one of the benefits that is enjoyed by entrepreneurs nowadays when they form their own businesses. An entrepreneur can allocate themselves the preferred appropriate working hours they believe will enable them to enjoy a balanced work/life schedule and they can even decide on their own whether to carry their work at home or not without seeking anyone's permission. In the business world some people thrive when they work independently and they set their own preferred working pace³⁷ (Dahl, 2018, www.inc.com).

1.7.3 Ability to select your own employees

In general some people enjoy fun and happy workplace environments and these are generally very difficult to find in some of the organizations. This is due to the fact that when people seek employment they do not get the opportunity to select the people they believe they can happily work with at the workplace. Therefore, when individuals start their own businesses they get the opportunity to choose the people they want to work with in their new business and in most instances they choose people they believe will have a good person-organization fit with their organizational values, culture, personality, vision and so on (Dahl, 2018, www.inc.com).

1.7.4 It helps to provide an opportunity to set much higher standards for yourself

When an entrepreneur starts his/her own business in most instances they take full control of their day-to-day management activities of the business and every single day helps to: (1) provide them with the opportunity to challenge themselves, (2) enhance their innovativeness skills and (3)

³⁷ Dahl, D. (2011) *Top 10 Reasons to Run Your Own Business*. Available from:

<https://www.inc.com/guides/201101/top-10-reasons-to-run-your-own-business.html>

acquire new knowledge. There are several challenging tasks that must be done by an entrepreneur on a daily basis namely: payroll administration, book keeping, inventory control and management, handling customer queries or complaints, liaising with the business's various internal and external stakeholders, developing effective marketing communication strategies, carrying out maintenance repairs of their firm's premises, machines and many other activities (Dahl, 2018, www.inc.com).

1.7.5 It helps create generational wealth

One good reason some entrepreneurs venture into the field of entrepreneurship is to be able to leave generational wealth for their children and grand children. A well led and profitable business that puts customers' needs at the forefront has perpetual life that can last for centuries. A typical good example is that of Lürssen Yachts headquartered in Bremen, Germany which was founded by Friedrich Lürssen on June 27, 1875. According to Lürssen (2018) after training as a boatbuilder, Friedrich Lürssen wants to join the boatyard of his father, Lüder Lürssen. Lüder advises his son to start a yard of his own – a single company would be insufficient to support two families. On June 27, 24-year-old Friedrich sets up a boatbuilding workshop in Aumund, near Bremen, Germany. His first vessel demonstrates his trademarks: originality and high quality. Friedrich Lürssen's shipyard grows and thrives, and at one point he even begins placing orders with his father. In 1907 the second generation Friedrich Lürssen's only son Otto joins the firm as a partner, contributing far-reaching practical and theoretical knowledge. As a shipbuilding engineer he combines tried and trusted craftsmanship with new technical expertise, improving on past methods. In 1932 the abrupt death of 52-year-old Otto Lürssen, who directed the company in a spirit of open-mindedness and passion for innovation, is a bitter loss for the shipyard and the entire industry. His wife, Frieda Lürssen, the strong-willed daughter of a captain of a large cruise ship, fills the gap and takes over at the helm of the Lürssen yard. In 1938 the third generation takes on more responsibility at Lürssen: Gert Lürssen comes on board – bringing along the passion for motorboats he inherited from his father. In 1939, he sets an impressive world speed record on the lower reaches of the Weser River in a Lürssen diesel-powered speedboat, achieving a speed of exactly 68.2 km/h. In 1948 business is difficult in the wake of the war. Everyone has to start from scratch and the Lürssen shipyard is no exception. During this time of change, the brothers Gert and Fritz-Otto Lürssen agree on the division of shares in company,

which they hold from then on jointly with their mother Frieda Lürssen. In 1962 Frieda Lürssen, who has led the company with greater perseverance and technical expertise, hands over responsibility for the firm to her sons Gert and Fritz-Otto. That same year the 55-meter yacht PEGASUS II is delivered, like her predecessor, to a London shipowner. In 1975 Centennial Lürssen celebrates a century in business. Friedrich and Peter Lürssen, sons of owners Gert and Fritz-Otto Lürssen, receive their first shares in the firm. In 1977 Friedrich Lürssen joins the company at the age of 27. After earning a degree in business administration and experience at various jobs in international companies, he starts to work his way through all departments of the shipyard. He soon assumes a senior position. In 1987 Peter Lürssen joins the company after studying shipbuilding and industrial engineering in Germany and business administration in the United States as well as gathering considerable professional experience, Peter Lürssen comes on board. In previous positions, he had spent a year as a construction inspector at different Japanese shipyards, and already familiarized himself with various Lürssen departments. In 2000 one-and-a-quarter centuries after its founding by Friedrich Lürssen, the company celebrates an important anniversary Jubilee of 125 years since founding. The small boatbuilding company on the Weser River has grown into a large shipyard that builds military vessels as well as modern megayachts³⁸ (Lürssen, 2018, www.lurssen.com/en/about/history/).

1.7.6 It helps to provide an opportunity to gather personal wealth

Every profit-oriented business has a high probability of yielding exceptionally high financial profits over a specific period of time if properly managed and well led. Properly managed businesses often generate high sales and profit income and this enables the entrepreneur to reap high financial rewards which also helps to increase their personal wealth (Dahl, 2018, www.inc.com).

1.7.7 It helps to provide an opportunity to give back to the community

One of the most critical ingredient to every organization's success is people (*namely, customers, suppliers, employees and so on*). A community is made up of people and when an entrepreneur opens up a new business and it succeeds in general they automatically establish a positive

³⁸ Lürssen (2018) *Lürssen: Leading Innovation Since 1875*. Available from:

<https://www.lurssen.com/en/about/history/>

goodwill for themselves in the community their business operates. In general entrepreneurs with minds that are full of wisdom often invest in people or communities through giving back to society in order to show their appreciation for all the support they received in making their business a success. Today most of the richest entrepreneurs in the world have numerous trust foundations that help them carry-out philanthropic work in various countries their businesses operate.³⁹ A good example of an inspirational entrepreneur and philanthropist is Mexico City, Mexico based Mr. Carlos Slim Helú founder of América Móvil and Grupo Carso an industrial conglomerate company based in Mexico. Today América Móvil is one of Latin America's largest telecommunication company, América Móvil; which has as one of its members of the Board of Directors a great visionary, charismatic business leader and Mexican entrepreneur/philanthropist Carlos Slim Helú who was rated as the richest man in the world during the year 2013. América Móvil by June 2015 was operating in 20 countries around the world with a total of 367.7 million access lines (*288.8 million wireless subscribers, 34.6 million landlines, 22.8 million broadband accesses and 21.5 million Pay TV units*) with Brazil being the largest market of access lines with 107.7 million (*30% of the firm's market share*) followed by Mexico with 94.2 million (26%) access lines (América Móvil Second Quarter, 2015). The telecommunications global company by 2013 had established different initiatives with social impact, their year highlights were the implementation of 6700 free Wi-Fi site locations for customers, the establishment of 3600 Telmex Digital Libraries, and reaching out to 3.5 million people in Mexico through the Telmex Digital and Culture Program (América Móvil Sustainability Report 2013:6). As a follow up to their various education initiatives, with the purpose of promoting quality education and training for all, in 2016 América Móvil in collaboration with Carlos Slim Foundation deployed Aprende.org app. Both the app and platform offer free access to a diversity of 182 courses regarding all levels of education, employment, culture, and health (WSIS Stocking, 2018). Mr. Carlos Slim Helú is one of world's leading 'iconic entrepreneur' and philanthropist who has successfully managed to distinguish himself in society through his great philanthropic work via his Carlos Slim Foundation, Carso Institute for Health and Telmex Foundation⁴⁰ (Carlos Slim, 2015, www.carlosslim.com). "On June, 2010 the

³⁹ America Movil (2015) *America Movil Second Quarter of 2015 Financial & Operating Profit*. Available from: www.americamovil.com/mailling/2Q15.pdf

⁴⁰ Carlos Slim (2015) *Biography*. Available from: www.carlosslim.com/biografia_ing.html

Carlos Slim Foundation, the Bill & Melinda Gates Foundation, the government of Spain and the IDB, launched the Mesoamerica Health 2015 Initiative. The aim of this Initiative is to reduce the gap in health equality faced by the poorest 20% of population living in Central America and Southern Mexico. In September of 2012, TELMEX Foundation announced the following achievements: 259,445 grants, 746 institutions benefited from the computer-equipment donations; 329,960 bicycles for the program ‘Ayúdame a llegar’ (*Help me to get at*); 923,486 extra-mural surgeries; 7,363 organ and tissue transplantations; 94,284 social bailouts; 13,232,000 nutritional candy 1kg packets; 28,758 tons of humanitarian aid, and 12,341 male and female soccer teams participating in TELMEX tournaments (Copa TELMEX cited in Carlos Slim, 2015, <http://www.carlosslim.com>). *“Used with permission from Microsoft”. [Entrepreneurship & Business Innovation :A North America, Europe, Africa, Oceania & Asia 21st Century Perspective 1st Edition] is an independent [publication] and is neither affiliated with, nor authorized, sponsored, or approved by, Microsoft Corporation.* The disadvantages of becoming a small business owner will be discussed in the next section.

1.8 Disadvantages of becoming a small business owner

The disadvantages that are experienced by entrepreneurs when they start their business are many and these are depicted in Figure 1.4 below.

Figure 1.4 Four common disadvantages of becoming a small business owner



1.8.1 An entrepreneur must be willing to go the extra mile in terms of commitment

The process of starting a small business can be overwhelming most of the times and the entrepreneur must be willing to go the extra mile in terms of devoting their time to attain their set business goals on a regular basis. In most instances entrepreneurs often work for longer hours, days including weekends and public holidays. In addition the entrepreneur often has to multi-task in order to properly keep their business running smoothly. The disadvantage of having excessively high workloads on a daily basis is that the entrepreneur may end up falling sick due to high stress levels and other stress related illnesses.

1.8.2 During the first few months or year the sales income is unreliable

In general when a new small business is launched the sales revenue often tends to be highly unreliable. Most of the entrepreneurs often face serious difficulties in carrying-out their planning activities due to limited and unreliable financial cash inflows often associated with new

businesses. There are numerous reasons that make a newly launched business to generate inconsistent sales income namely; (1) poor brand recognition since the firm's products/services will still be new in the marketplace, and (2) poor marketing strategies as the firm will still be trying to find the right integrated marketing communication strategies to develop effective relationships with customers in the market and so on. Many entrepreneurs start their business to earn a living and when inconsistent sales income starts flowing into the business on a regular basis it often negatively affects their financial health and they often end up over borrowing to meet their costs of living.

1.8.3 High levels of competition can destroy your business

Globalization has led to the creation of global competitors and the world has become borderless as a result of the Internet thus small businesses that thrive nowadays invest large sums of money into creating effective marketing strategies and high quality services/products to help them remain highly competitive in the market. Competitors that are more financially resourced than the firm can offer better quality products/services similar to the ones offered by the firm and this may cause the firm to receive poor sales revenue until it finally closes down as a result of bankruptcy. When a small business closes down the entrepreneur loses his/her life savings they used as capital to start the business.

1.8.4 The entrepreneur may carry-out unpleasant responsibilities

In general it is important to point-out that not everyone has the ability to manage a business. Some people can start a small business and fail to properly manage it due to inadequate management competency skills. Entrepreneurs who take full control of running their small business's day-to-day operational activities often end up carrying out unpleasant tasks such as implementing disciplinary action procedures on incompetent employees, providing negative feedback about job performance appraisals and in certain instances the entrepreneur must retrench or dismiss incompetent employees. The reasons why many businesses close down or fail nowadays will be covered in the following section.

1.9 Reasons why small businesses fail

Many reasons lead to the failure of small businesses globally. ⁴¹⁴²According to the US Small Business Administration Office of Advocacy (2018:1) many businesses close because of personal reasons. Of the businesses with employees that closed in 2015, the top reasons for closing were low sales, the owner(s) retiring, and the owner(s) selling the business (Chart 2). With the next top reasons being opening another firm and illness/injury, it shows that many owners close for personal or health reasons not just business reasons. (“Other reasons” was also relatively high.) *Source: U.S. Census Bureau, Annual Survey of Entrepreneurs.* Reasons for closing businesses are changing as the economy improves and owner’s age. Compared to 2007 which had the Great Recession begin in its December month, many businesses were closing because of low sales and credit was down and retirement was up. This is not surprising with a strong economy and aging population in the past recent years⁴³ (Headd, 2018:1, <https://cdn.advocacy.sba.gov/>). The other additional reasons that cause small businesses to fail are depicted in Figure 1.5 below.

⁴¹ Headd, B. (2018) *Small Business Facts*. Available from: https://cdn.advocacy.sba.gov/wp-content/uploads/2019/06/06192013/Small_Biz_Facts_Why_Do_Businesses_Close_May_2018_0.pdf

⁴² U.S. Census Bureau, *Annual Survey of Entrepreneurs*

⁴³ U.S. Census Bureau, *Annual Survey of Entrepreneurs and Survey of Business Owners*

Figure 1.5 Eight common reasons why small businesses fail



1.9.1 Poor adaptation of modern information, communication and technology resources

Surprisingly, today many entrepreneurs still do not see the importance of establishing a website and using various social media platforms to communicate or sell their products/services. The global economy today is rapidly growing as a result of the Internet revolution that has led to the

rise of e-Commerce and social media communication technology. The continuous increase in the number of internet users makes mobile internet connectivity gadgets to transform from being a luxury to an important basic need that is crucial for a person to survive in today's highly digitalized global economy. Therefore, small businesses that fail to adapt new modern ICT technologies are more likely to fail due to less brand recognition, poor sales, lack of innovativeness and so on.

1.9.2 Inadequate management skills and knowledge

Some of the entrepreneurs when they launch their new small business they often fail to distinguish two things namely, (1) 'owning' and (2) 'managing' a business. Anyone can own anything but managing a business requires sufficient management skills and the technical knowhow to grow the business at a profit over a long period of time. The misconception that is often made by most new entrepreneurs is that *'I will learn to manage the business in due time'* is completely wrong and this is one of the many reasons why some of the small businesses fail immediately after being launched. Some entrepreneurs strongly believe that if they own a business they will automatically be able to successfully manage it without the required skills and knowledge in business management. Every business requires its owner-managers to perform various management functions such as payroll processing, book keeping, planning, organizing, controlling, directing, inventory management, establishing effective marketing strategies and so on. Therefore inadequate management skills and knowledge cause a high number of small business failures across the world.

1.9.3 Failure to understand and follow the mission statement and vision

In general many entrepreneurs often ignore the importance of writing down a mission statement and vision before launching their small business. In addition many entrepreneurs also make an effort to draft their new business's mission and vision statements when they are registering their new business at the government's 'Company Registrar's Office'. Thus, when their new business starts to operate they do not prioritize consistent reading of the mission statement by management/employees and this often results in the business failing to align its day-to-day business activities to its mission/vision statements. A mission statement helps to provide answers pertaining to *'why the business was formed'* and *'what it really stands for'* while on the other

hand the vision helps to clearly outline the direction the business must take in order to reach its ultimate destination (*desired success level*). Therefore, one of the main reasons why businesses fail is a result of failure to understand and align the business's operational activities to its mission statement and set-out vision.

1.9.4 Unattractive physical location of the business

Some entrepreneurs fail to understand that one of the critical ingredients to the success of any traditional brick and mortar business model is the physical location of the business. A large number of entrepreneurs tend to be ignorant about the importance of first carrying out market research before starting their own business as this helps them to properly identify a good strategic physical location. Entrepreneurs fail to understand that carrying-out research helps them to accurately: (1) identify where their target market is located, (2) choose buildings with excellent safety features, (3) select business locations with high customer traffic and that offer their customers convenience such as good parking spaces, restrooms and so on. One of the most popular reasons why entrepreneurs fail when they start their small businesses is that they prefer to open their new businesses at poor physical locations in order to enjoy cheap rental payments and as a result of poor location their business fails to attract high customer traffic leading to business closure.

1.9.5 Lack of employee training and support

The most important resource in any organization is its human resources. Small businesses that do not invest money in training and developing their employees often fail dismally in the marketplace. The common characteristics associated with businesses that do not invest in employee training include: (1) poor customer service, (2) production of poor quality services/products, (3) incompetent managers and employees and so on. Lack of training is one of the main reasons that causes many small businesses to generate low sales revenues as employees will not be able to effectively market the firm's products and services better than its competitors.

1.9.6 Poor quality services/products

Competition is now everywhere nowadays due to the globalization of the world economy. Small businesses fail as a result of selling poor quality products/services in the marketplace. The selling of poor quality products/services results in the business earning low sales revenue and the fact that they are selling or producing poor quality products/services greatly empowers their competition to takeover their market share. Small businesses often lack the required financial resources that are needed to effectively conduct research and development (*R&D*) and market testing before finally producing new products/services for commercial purposes.

1.9.7 Poor financing

One of the most common reasons why small businesses fail today is due to ‘poor financing’. In general most of the small businesses have limited capital funding due to inadequate financial planning by their owners to foresee the accurate costs of starting and running a successful business. Most of the small businesses generally do not own fixed assets as a result of their small size therefore they often fail to secure collateral that is needed to support their business loan applications at various financial institutions/lenders. When a business lacks adequate financial capital it ends up failing to fulfil its short and long term financial obligations and this will eventually cause it to permanently shut down its operations.

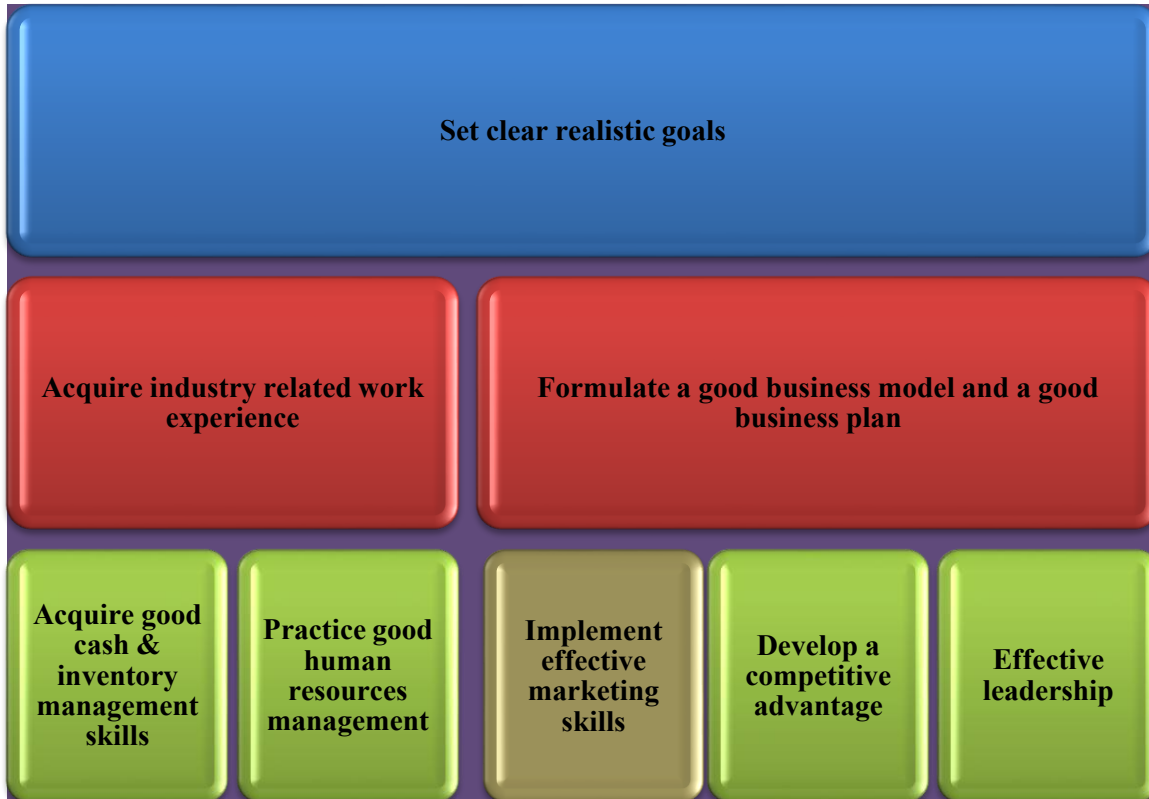
1.9.8 Failure to change from being an entrepreneur to a manager

It has been discovered in many studies that most start up businesses that often succeed tend to operate for at least 5 years. When a small business starts to grow over time numerous changes take place such as the introduction of new technology, processes, systems, new products/services, expansion into new markets, the acquisition of new fixed assets and so on. The number one reason for small business failure is that when a small business starts to grow most of the entrepreneurs often fail to transition from being a business owner to a strategic manager and thus they fail dismally to adapt to the fast changes that will be happening in their new business and operating environment. There are several guidelines that can be used by entrepreneurs to increase the perpetual life of their small businesses and these will be covered in the following section.

1.10 Guidelines that help prevent small business failure

Researchers and industry experts in the field of entrepreneurship have discovered certain principles or guidelines that entrepreneurs must follow to avoid failing in the business world and some of these guidelines are depicted in Figure 1.6 below.

Figure 1.6 Eight guidelines that help prevent small business failure



1.10.1 Set clear realistic goals

A *goal* is generally defined as ‘list of activities or accomplishments’ that must be attained by an individual, entity or team within a specific period of time for instance in 5-10 years. A small business that sets goals that are: (1) specific, (2) that relate to its intended plans, (3) time framed, (4) achievable and (5) measurable often operates effectively. Clear set goals help to enhance employee confidence and morale in performing their day-to-day work activities since everyone will be fully knowledgeable about what the organization intends to achieve within a set period of time.

1.10.2 Acquire industry related work experience

Most businesses fail due to inadequate experience of the owners. Before an entrepreneur opens up a business he or she should ensure that they work in the industry sector they want to open up their own business in order to understand the basic concepts, processes and systems of that particular type of business in order to gain the overall technical knowhow (*practical aspects*) related to that kind of business. It is also important to point-out the fact that theoretical knowledge is useful in running a successful small business. Therefore it is encouraged that entrepreneurs or businesspeople must make an effort to study towards a course in the field they intend to start their new business at a college or university of their choice. A good example of some of the world's leading global teaching and research orientated universities that offer programs that assist entrepreneurs and businesspeople from various parts of the world today to acquire new skills include: the premier University of KwaZulu-Natal (*UKZN*) in South Africa; Hochschule München/Munich University of Applied Sciences (*MUAS*) in the city of Munich in Germany; the Chalmers University of Technology in the city of Gothenburg in Sweden; the University of Copenhagen in the city of Copenhagen in Denmark and Boston University in the city of Boston in the United States of America. "The University of KwaZulu-Natal was formed on 1 January 2004 as a result of the merger between the University of Durban-Westville and the University of Natal. The new university brings together the rich histories of both the former Universities"⁴⁴ (University of KwaZulu-Natal, 2018, www.ukzn.ac.za/about-ukzn/history/). The University of KwaZulu-Natal currently offers several globally recognized economics, entrepreneurship and business management degree programs (University of KwaZulu-Natal, 2018, <https://clms.ukzn.ac.za/>). "Chalmers University of Technology conducts research and offers education in technology, science, shipping and architecture with a sustainable future as its global vision. Chalmers is well-known for providing an effective environment for innovation"⁴⁵ (Chalmers University of Technology, 2018, <https://www.chalmers.se/en/education/programmes/masters-info/Pages/Entrepreneurship-and-Business-Design.aspx>). Today Chalmers University of Technology offers degree programs in

⁴⁴ University of KwaZulu-Natal (2018) *History*. Available from: www.ukzn.ac.za/about-ukzn/history/

⁴⁵ Chalmers University of Technology (2018) *Education - Programmes*. Available from:

<https://www.chalmers.se/en/education/programmes/masters-info/Pages/Entrepreneurship-and-Business-Design.aspx>

entrepreneurship and business design (Chalmers University of Technology, 2018). The Hochschule München/Munich University of Applied Sciences (*MUAS*) in Munich, Germany is another globally recognized university where entrepreneurs or businesspeople can gain knowledge and skills in the field of management. “Munich University of Applied Sciences is the second largest university of applied sciences in Germany. It recognises the future demands of society and industry and is changing, with a critical yet open vision for current issues, such as the current digitalisation of all areas of life. University”⁴⁶ (Munich University of Applied Sciences, 2018, <https://www.hm.edu/en/muas/profile/index.en.html>). “Munich is rated #1 in Germany for quality of life and is one of the safest cities in Europe. We foster the entrepreneurial, sustainable and international thinking needed in the professional world of today and tomorrow” (Munich University of Applied Sciences, 2018, <https://www.hm.edu/en/muas/munich/index.en.html>).

⁴⁷“Boston University is an international, comprehensive, private research university, committed to educating students to be reflective, resourceful individuals ready to live, adapt, and lead in an interconnected world. Boston University is committed to generating new knowledge to benefit society. Boston University comprises a remarkable range of undergraduate, graduate and professional programs” (Boston University, 2018, <http://www.bu.edu/info/about/mission-statement/>). Today Boston University currently offers degree concentrations in business administration & management (*general management, entrepreneurship, finance, accounting and so on*) (Boston University, 2018, <https://www.bu.edu/admissions/academics/programs/majors/>).

In addition the University of Copenhagen is driven by intellectual creativity and critical thinking since 1479 and it offers degree programs in Economics⁴⁸ (University of Copenhagen, 2018, <https://introduction.ku.dk/profile-history/>) “*All universities have been cited with permission*”. Extensive research or reading is also helpful for instance using books, trade publications and the internet book libraries. Seeking expert advice is another way entrepreneurs can use to acquire detailed knowledge about the industry they want to start their new business for instance, seeking advice from academics (*found in various business schools across the world*), industry trade associations such as the Chartered Institute of Marketing (*CIM*) and or suppliers in the field.

⁴⁶ Munich University of Applied Sciences (2018) *MUAS*. Available from:

<https://www.hm.edu/en/muas/munich/index.en.html>

⁴⁷ Boston University (2018) *Mission Statement*. Available from: <http://www.bu.edu/info/about/mission-statement/>

⁴⁸ University of Copenhagen (2018) *Profile History*. Available from: <https://introduction.ku.dk/profile-history/>

1.10.3 Formulate a good business model and business plan

One of the common mistakes that is done by most of the aspiring entrepreneurs is that they ignore the importance of writing down a business plan and designing an effective business model before starting their small business. The chances of failure by a small business are more likely to be high if an entrepreneur launches his/her new business without first identifying and understanding how their business will generate cash revenue to sustain itself in the long run. Business failure can be avoided if entrepreneurs formulate good business models and draft a business plan before launching their small businesses and even after they have opened their doors for business a business plan must be consistently read by management and employees. A business plan helps to guide the business to: (1) identify and outmaneuver its rivals in the marketplace, (2) consistently remind management/employees about the core purpose of the business so that they align their operational activities to the values of the business, (3) outline how the firm will utilize its financial and human resources, (4) manage its (*customer, employee and supplier*) relationships and effectively handle customer grievances, (5) help the firm to maintain a high level of innovation/creativity through teamwork, introduction of new products/services and so on.

1.10.4 Acquire good cash and inventory management skills

Most small business owner-managers fail to understand the fact that excessive inventory levels negatively affect the business's profit levels as the business incurs costs such as pilferage, outdated products, breakages and so on. While on the other hand extremely low levels of inventory negatively affect the business's reputation in the market as it is more likely to experience consistent product shortages or production schedule disruptions as a result of running out of materials during the production/transformation process. Therefore, before an entrepreneur opens up a small business they need to have some form of basic education especially book-keeping and inventory management skills. This can be easily done by studying towards a course in accounting and purchasing & operations management at a college or university. The moment a business is opened and it starts to incur expenses, generate day-to-day income all these transactions need to be recorded (*creating the profit and loss account, balance sheet and cash flow statement*). Accounting skills help the entrepreneur with the inventory management skills such as the calculating of stock using the economic order quantity method, last-in first-out

(LIFO), first-in first-out (FIFO) and many other concepts. It is important that an entrepreneur who fails to acquire accounting skills outsources this critical business activity or employs a full time book-keeper in order to protect the business from becoming bankrupt or experiencing liquidity challenges.

1.10.5 Practice good human resources management or organizational behaviour

It does not matter if a business is big or small every business has to deal with the various day-to-day people related issues. Entrepreneurs should always be aware of the fact that the success of their business lies with their employees who ‘*make and sell*’ the firm’s products or services while simultaneously liaising with customers or suppliers on a day-to-day basis. Entrepreneurs who lack human resources management skills can register to study for a course at a college or university. Typical good examples of leading global universities that offer human resources management & labor relations related courses include; the premier University of KwaZulu-Natal (UKZN) (*South Africa*), Queen’s University Industrial Relations Centre (IRC) (*Canada*) and Boston University (*United States of America*) (*All the above mentioned universities have been cited with permission*)⁴⁹. They can also do extensive reading using books, human resources management journals or online publications in the field to help strengthen their human resources skills and be able to apply them in their day-to-day work activities. Many entrepreneurs who have inadequate human resources management skills are more likely to do the following:

- pay inadequate compensation,
- provide poor working conditions,
- provide inadequate training due limited theoretical and practical knowledge of the subject matter that employees need to be trained,
- recruit employees without the relevant qualifications or work experience,
- they conduct biased performance appraisals,
- apply ineffective leadership styles and fail to lead by example,
- their businesses tend to experience high employee turnover, and

⁴⁹ Queens University Industrial Relations Centre (2018) *About Us*. Available from: <https://irc.queensu.ca>

- they poorly manage change initiations in the business⁵⁰ (Muteswa and Ortlepp, 2011:14).

An entrepreneur who practices good professional human resources management offers employees consistent: (1) up-to-date training programs, (2) effective performance evaluation and feedback, (3) promotes worker participation at the workplace (*on issues such as decision making, idea suggestions, collective bargaining negotiations and so on*), (4) upholds good compensation plans that rewards outstanding work performance by using performance-based bonus incentives (Hunter, 2002), (5) develops a code of ethics handbook that is made available to every employee in the firm to help maintain discipline at the workplace, (6) they consistently re-design jobs to reduce boredom, (7) they consistently ensure that they adopt and effectively manage diversity at the workplace with utmost care to successfully appeal to the diversified global marketplace⁵¹ (Laubscher, 2001:18). Good entrepreneurs that want their business to prosper ensure that they properly manage the shift of diversity management to inclusion in their human resources department⁵² (Jordan, 2011). "*Diversity* means all the ways we differ. Some of these differences we are born with and cannot change. Anything that makes us unique is part of this definition of diversity. *Inclusion* involves bringing together and harnessing these diverse forces and resources, in a way that is beneficial. Inclusion puts the concept and practice of diversity into action by creating an environment of involvement, respect and connection - where the richness of ideas, backgrounds, and perspectives are harnessed to create business value. Organizations need both diversity and inclusion to be successful" (Jordan, 2011). For example, one of the world's well known organizations that has a top notch diversity management policy and program is multinational consumer goods manufacturer Procter & Gamble, headquartered in Cincinnati, Ohio, USA producers of personal care, grooming, hair care, baby diapers and feminine hygiene brands that include, Pampers, Always, Head & Shoulders, Pantene, Ariel, Gillette (razors, shaving cream, after-shave, shampoo, deodorants and so on), Vicks (cough & cold medicines)

⁵⁰ Muteswa, R. and Ortlepp, K. (2011) *Contributing Factors to Potential Turnover in a Sample of South African Management Level Employees*. Acta Commercii Journal, p1-17.

⁵¹ Laubscher, C (2001) *Managing Diversity*. *People Dynamics*, p16-18.

⁵² Jordan, T. H. (2011) *Moving from Diversity to Inclusion*. *Profiles in Diversity Journal*. Available from: www.diversityjournal.com/1471-moving-from-diversity-to-inclusion/

and many others⁵³ (Procter & Gamble, 2015). Procter & Gamble's human resources management acknowledges the following: that every employee is talented in their own way that helps to differentiate them from the rest of the other employees; amidst the highly exposed differences at each and every workplace at the end of the day people come from different cultures, have diverse opinions and unique personal experiences in life (Procter & Gamble, 2015). Diversity management at Procter & Gamble is not a sole responsibility of the human resources management but an organizational effort that requires commitment from the board of directors, top management, middle management, lower level management and the employees. Therefore the mission of Diversity and Inclusion is: *"Everyone valued. Everyone included. Everyone performing at their peak"* (Procter & Gamble, 2015). Procter & Gamble's human resources management function created a supportive and motivating workplace that can easily encourage its talented employees to be willing to go the extra mile when doing their tasks or duties and it also fully acknowledges that in order for the firm to prosper, it must value, respect and highly involve the employees who enable Procter & Gamble (P&G) to be what it is today in the marketplace (Procter & Gamble, 2015). "Diversity & Inclusion is a critical enabler of value creation. It is an intentional choice to understand and value the diversity of the consumers we serve as well as our fellow employees. It is that simple. We make Diversity & Inclusion a strategic priority. Our 'where to play' business strategies are focused on serving diverse consumers, and our 'how to win' strategies begin with developing and leveraging a highly diverse and inclusive organization"⁵⁴ (Procter & Gamble, 2015:4). "For P&G's Disability & Inclusion leaders, the symposium is just the beginning. "Over 20% of the workforce has some sort of disability," declares Mike Gartner" (Procter & Gamble, 2015:12). P&G was recognized by the leading Hispanic Network Magazine as the 'Best of the Best Top Disability-Friendly Employers' (Procter & Gamble, 2015:4).

⁵³ Procter & Gamble (2015) *Diversity & Inclusion*. Available from:

www.us.pg.com/who_we_are/our_approach/diversity_inclusion

⁵⁴ Procter & Gamble (2015) *Diversity & Inclusion Annual Report: Enabling a Culture of Innovation & Productivity*.

Available from: <https://za.pg.com/>

[/media/PGCOMUS/Documents/PDF/Who_We_Are/DiversityandInclusion/PD_DiversityInclusion_AR_2012%20pdf.pdf?la=en-ZA&v=1&hash=4FFCAD808ADD64852EFE61FCE388C996DEC99D05](https://za.pg.com/-/media/PGCOMUS/Documents/PDF/Who_We_Are/DiversityandInclusion/PD_DiversityInclusion_AR_2012%20pdf.pdf?la=en-ZA&v=1&hash=4FFCAD808ADD64852EFE61FCE388C996DEC99D05)

1.10.6 Implement effective marketing skills

Every business is formed to sell its products or services to its target customers. Entrepreneurs should implement effective marketing strategies that help them reach-out to their target market and persuade them to buy their products or services. Effective marketing is when the business strategically promotes its products or services through digital media such as social media platforms, company websites, mobile phone technologies and so on. In addition effective marketing occurs when a small business promotes its products or services using integrated marketing communication strategies (*namely advertising, direct marketing, public relations, personal selling and sales promotions*). Carefully designed and executed marketing strategies result in the organization gaining a higher market share, a good image in the market, gaining a powerful brand status, increased sales revenue, high profit income, increased customer loyalty and so on. Entrepreneurs who do not want their small businesses to fail must ensure that they employ people with good marketing work experience, skills and qualifications to effectively handle their business's day-to-day marketing activities. It is also advisable for entrepreneurs to do extensive research and reading marketing books, journals or online publications in the field to help reduce the risk of their business closing down due to the lack of marketing management skills.

1.10.7 Develop a competitive advantage

One of the ways an entrepreneur can avoid his or her business from failing is by ensuring that it uniquely differentiates itself from its competitors in terms of pricing, products/services, quality, skills, business performance, effective leadership and so on. A *competitive advantage* can be defined as something the business can do profitably that is unique to itself and it can do in a highly distinctive manner that completely enables it to be recognized as completely different from its competitors in the marketplace for instance highly innovative products/services, pricing, quality, customer service, business performance, effective leadership and so on. Good quality leadership also helps many organizations to create a competitive advantage in the market over a long time period. Most of the successful businesses today are well known for their excellent leadership succession plans and good-to-great leaders. A good example of a successful global organization that has historically created a competitive advantage of having good-to-great

leaders is the Mumbai, India headquartered the Tata Sons Private Limited. ⁵⁵“*We are the Tata group. India’s only value based corporation-a visionary, a pioneer, a leader, since 1868. 1868: A startup. Today: A global enterprise.* As a 29-year-old, Jamsetji Tata set up a trading firm in 1868. Today, the operating companies of the Tata group lead the nation in ten business verticals. *66% of Tata Sons is owned by trusts.* The Tata Trusts promote education, health, culture and livelihood initiatives in India. The Trusts are focused on providing quality education for children, especially those from marginalized backgrounds. \$110.7bn in revenues in 2017 – 18. The combined market cap of Tata companies is \$145.3 billion (as on March 31, 2018). Bombay House in Mumbai is the headquarters of the Tata group. There are 706,511 of us. And counting. The companies of the Tata group employ many of India’s best and finest, strengthened by a culture of ethics and integrity. *Community-the purpose of our existence.* We are inspired by Jamsetji’s words and deeds which have helped us contribute to society and help build fine institutions. Tata Medical Center, Kolkata, provides free or subsidised cancer care to underprivileged patients in the region”⁵⁶ (Tata Sons Private Limited, 2019, <https://www.tata.com/about-us>). “*N Chandrasekaran Executive Chairman.* Natarajan Chandrasekaran is Chairman of the board of Tata Sons, the holding company and promoter of more than 100 Tata operating companies with aggregate annual revenues of more than US\$100 billion. He joined the board of Tata Sons in October 2016 and was appointed Chairman in January 2017. Chandra also chairs the Boards of several group operating companies, including Tata Steel, Tata Motors, Tata Power, Tata Global Beverages Limited, Indian Hotels Company Limited and Tata Consultancy Services (TCS) – of which he was Chief Executive Officer from 2009-17. The Tata group companies include 29 publicly-listed corporations with a combined market capitalization that exceeded US\$120 billion at the start of 2017”⁵⁷ (Tata Sons Private Limited, 2019, <https://www.tata.com/management-team#/management-team/n-chandrasekaran>). ⁵⁸“*Ratan N Tata Chairman Emeritus.* Ratan N Tata was the Chairman of Tata Sons, one of the

⁵⁵ Tata Sons Private Limited (2019) *About Us*. Available from: <https://www.tata.com/about-us>

⁵⁶ Tata Sons Private Limited (2019) *About Us*. Available from: <https://www.tata.com/about-us>

⁵⁷ Tata Sons Private Limited (2019) *N. Chandrasekaran: Executive Chairman*. Available from: <https://www.tata.com/management-team#/management-team/n-chandrasekaran>

⁵⁸ Tata Sons Private Limited (2019) *Ratan N Tata Chairman Emeritus*. Available from: <https://www.tata.com/management-team#/management-team/rnt>

two promoter holding companies of the Tata group, from 1991 till his retirement on December 28, 2012. He was also chairman of the major Tata companies, including Tata Motors, Tata Steel, Tata Consultancy Services, Tata Power, Tata Global Beverages, Tata Chemicals, Indian Hotels and Tata Teleservices. During his tenure, the group's revenues grew manifold, totalling over \$100 billion in 2011-12. Mr. Tata is also associated with various organisations in India and overseas. He is the chairman of two of the largest private-sector-promoted philanthropic trusts in India. He is a member of the Indian Prime Minister's Council on Trade and Industry. He is the president of the Court of the Indian Institute of Science and chairman of the Council of Management of the Tata Institute of Fundamental Research. He also serves on the board of trustees of Cornell University and the University of Southern California. Mr. Tata serves on the board of directors of Alcoa, and is also on the international advisory boards of Mitsubishi Corporation, JP Morgan Chase, Rolls-Royce, Temasek Holdings and the Monetary Authority of Singapore. The Government of India honoured Mr. Tata with its second-highest civilian award, the Padma Vibhushan, in 2008. He has also received honorary doctorates from several universities in India and overseas" (Tata Sons Private Limited, 2019, <https://www.tata.com/management-team#/management-team/rnt>).

1.10.8 Effective leadership

The moment an entrepreneur registers and launches their small business they automatically become the leader of their employees. ⁵⁹According to Michael Porter (1990) today's competitive realities demand leadership. Leaders believe in change; they energize their organizations to innovate continuously; they recognize the importance of their home country as integral to their competitive success and work to upgrade it (Michael Porter, 1990. *The Competitive Advantage of Nations. Harvard Business Review, March-April*). Entrepreneurs who become effective leaders in their businesses avoid incidences of business failure since poor leadership is one of the most common reasons why small businesses fail nowadays. Good-to-great leaders in most businesses 'lead by example' which means that leaders should practice what they advise others to do in order for them to successfully gain the support and commitment of the people they lead. It has since been discovered by numerous academics and researchers that employees who work in an organization that is well led often have high organizational commitment levels and

⁵⁹ Michael Porter, 1990. *The Competitive Advantage of Nations. Harvard Business Review, March-April*

performance standards which leads to increased profits for the organization. There are many successful women entrepreneurs in the world today and this will be discussed in greater detail in the following section.

1.11 Women entrepreneurs’ boosting the global economy

Historically a very limited number of women participated in the field of entrepreneurship and generally men were the key players in the entrepreneurial field. Notably in the present day business world in particular ‘the field of entrepreneurship’ it now has quite a number of leading female entrepreneurs and some of them are consistently ranked as the richest and most successful entrepreneurs in the world. Nowadays almost every month, 6 months or year there are several women business leaders being nominated for various leadership awards such as the ‘best businessperson of the month or year’ by several leading global academic institutions, professionals associations, academic business journals, leading entrepreneurship magazines, newspaper surveys and so on. The participation of women in the field of entrepreneurship has increased at an accelerated rate over the past decades. ⁶⁰⁶¹According to VanderBrug, J. (2013) *The Global Rise of Female Entrepreneurs. Harvard Business Review*, “Women-owned entities in the formal sector represent approximately 37% of enterprises globally — a market worthy of attention by businesses and policy makers alike. While aggregated data is often challenging to find, the recent Global Entrepreneurship Monitor (GEM) found 126 million women starting or running businesses, and 98 million operating established (*over three and a half years*) businesses. That’s 224 million women impacting the global economy — and this survey counts only 67 of the 188 countries recognized by the World Bank. These entrepreneurs cross the spectrum of micro to high growth — from supporting life to creating wealth” ⁶²(VanderBrug, J, 2013. *The Global Rise of Female Entrepreneurs. Harvard Business Review September Issue*).

⁶⁰ “*Strengthening Access to Finance for Women-Owned SMEs in Developing Countries,*” International Finance Corporation, World Bank Group, October 2011.

⁶¹ VanderBrug, J. (2013) *The Global Rise of Female Entrepreneurs. Harvard Business Review*

⁶² Global Entrepreneurship Monitor (GEM) (2012) *Global Entrepreneurship Monitor Women’s Report*. Available from: <https://www.gemconsortium.org/> [Accessed 2018, 20 July]

⁶³According to the US Small Business Administration Office of Advocacy (2012) there were 9.9 million women-owned businesses in the United States of America with USD\$1.4 Trillion of annual receipts and employing 8.4 million people (US Small Business Administration Office of Advocacy, 2012:1).

⁶⁴According to the Government of Canada Innovation, Science and Economic Development Canada (2016:23) Statistics Canada's *Survey on Financing and Growth of Small and Medium Enterprises*, 2014 distinguishes five types of business ownership based upon gender: female-only ownership, majority female, equal partnership between male and female owners, minority female and no female ownership. Based upon the survey data presented, equal partnerships between male and female owners account for nearly 20 percent of all SMEs. Majority ownership by males is four times higher than majority ownership by females at 64.7 percent compared with 15.7 percent respectively. Statistics Canada's *Survey on Financing and Growth of Small and Medium Enterprises*, 2014 indicated that SMEs owned by females are concentrated in the service sector, most commonly in information, administration, health care and recreation; and other services (24.1 percent and 23.0 percent respectively). Construction and agriculture/primary have the lowest values for majority ownership by females (5.1 percent and 6.2 percent respectively). Agriculture/primary has the highest share of equal partnerships between male and female owners (32.6 percent). Wholesale trade and manufacturing have the same proportion of majority ownership by females (8.8 percent) ⁶⁵⁶⁶(Government of Canada Innovation, Science and Economic Development Canada, 2016:23. "Reproduced with the permission of the Minister of Industry, 2018"). Nowadays several women entrepreneurs have become powerful business

⁶³ US Small Business Administration Office of Advocacy (2018) *Small Business Profile: United States*. Available from: <https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-All.pdf>

⁶⁴ Government of Canada Innovation, Science and Economic Development Canada (2016) *Key Small Business Statistics*. Available from: [https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf/\\$file/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf](https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf/$file/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf)

⁶⁵ Government of Canada Innovation, Science and Economic Development Canada (2016) *Key Small Business Statistics*. Available from: [https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf/\\$file/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf](https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf/$file/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf)

⁶⁶ Statistics Canada, *Survey on Financing and Growth of Small and Medium Enterprises*, 2014; and Innovation, Science and Economic Development Canada calculations.

people in many notable companies across the world. A good example of one of the world's leading and remarkable female entrepreneurs is popular talk show host **Oprah Winfrey**, Founder of Oprah Winfrey Leadership Academy for Girls, today Oprah Winfrey now co-owns one of the world's largest television channels called OWN (*Oprah Winfrey Network*) which was launched during the year 2011. In addition, one of the dominant female entrepreneurs who has significantly contributed to the economic development of the global economy and society in general is German-based **Susanne Quandt Klatten** a shareholder of one of the world's largest automobile manufacturing companies called the BMW Group. Susanne Klatten is one of the remarkable female entrepreneurs who has managed to set a good example to all the aspiring entrepreneurs both men and women. Furthermore, Mrs. Susanne Klatten is one of the leading global entrepreneurs who has managed to go the extra mile in uplifting and supporting other entrepreneurs in her home country of Germany by establishing the UnternehmerTUM (*Centre for Innovation and Business Creation at TUM*). "UnternehmerTUM was founded in 2002 by the entrepreneur Susanne Klatten. With more than 50 high-growth technology start-ups each year and its unique offering, it is the leading center for business creation in Germany. *Through my commitment, I want to encourage entrepreneurship in Germany. As an entrepreneur I know that the work of UnternehmerTUM is an important step towards a new culture of entrepreneurship in our society*"⁶⁷ (Susanne Klatten, Associate and Supervisory Board Chairwoman of UnternehmerTUM GmbH cited in UnternehmerTUM GmbH, 2018). According to UnternehmerTUM (2018) UnternehmerTUM offers founders and startups a complete service from the initial idea to IPO. A team of experienced entrepreneurs, scientists, managers and investors supports the founders with the development of their products, services and business models. The experts accompany them actively with building up their companies, market entry and financing – also via Venture Capital. The accelerator programme TechFounders coaches technology startups over a period of 20 weeks up to an initial venture round, and paves the way for joint ventures with established companies. For industry partners, UnternehmerTUM is a unique platform for cooperation with new companies, and for expansion of their innovative strength and culture. Covering 1500 square metres, 'MakerSpace', Europe's largest publicly accessible high-tech workshop, enables companies, startups and creatives to produce prototypes and small batches using state-of-the-art machines such as large 3D printers (UnternehmerTUM,

⁶⁷ UnternehmerTUM (2018) *About Us*. Available from: <https://www.unternehmertum.de/about-us.html?lang=en>

2018). ⁶⁸Interestingly, Susanne Quandt Klatten has been an entrepreneur since 1991 and earned her Business Administration degree at the University of Buckingham (*Bachelor of Science*) and during the year 1988 she earned a Master of Business Administration (*MBA*) at the International Institute for Management Development in Lausanne. She has been a Member of the Supervisory Board of the BMW Group since 1997 up until 2019 (BMW Group, 2018). ⁶⁹Global automobile manufacturer Bayerische Motoren Werke AG known as BMW which is headquartered in Munich, Germany was founded on 21 July 1917 as Rapp Motoren Werke but was renamed to Bayerische Motoren Werke. After the Great War the brand “BMW” as well as all assets of the (aero-) engine business were transferred from this company to Bayerische Flugzeugwerke [BFW], which was founded on 7 March 1916. Since then, the BFW was named “Bayerische Motoren Werke” (BMW Group, 2018). Historically the BMW Group has a history of being led by great leaders with exceptional leadership qualities starting in 1959 when a new management restructuring exercise under the effective leadership of Herbert Quandt was conducted which greatly uplifted and positively turned around BMW to become a successful company it is today (BMW Group, 2018).

1.12 Conclusion

It can be concluded that cultural diversity is now a critical element of successful entrepreneurship in the modern business environment. Global entrepreneurship statistics have highlighted that more people are being attracted to the entrepreneurial field every year. The entrepreneurial behavior shall continue to thrive as long as entrepreneurs continue to search for unfulfilled business gaps in the market. Entrepreneurs who tend to be successful in general sincerely love their business, take calculated risks, have the ability to implement their business idea and persevere despite failing several times. Most of the small businesses fail due to inadequate management skills, under capitalization, poor location and mismanagement of growth. Therefore, in order to avoid business failure entrepreneurs should draw up business

⁶⁸ BMW Group (2018) *Supervisory Board*. Available from: <https://www.bmwgroup.com/en/company/company-portrait.html>

⁶⁹ BMW Group (2018) *Five BMW Milestones*. Available from: <https://www.bmwgroup.com/en/company.html>

plans, regularly conduct market research, seek adequate funding from financial institutions, practice effective leadership and employ people with good business management qualifications.

1.13 Discussion questions

1. Define entrepreneurship and an entrepreneur? What do you think is causing this sudden increase or interest in the field of entrepreneurship?
2. Describe the characteristics of successful entrepreneurs and please provide relevant examples? Explain why do you think entrepreneurs should sincerely like their business and maintain high levels of consistency when they start a business?
3. Outline the advantages and disadvantages of owning a small business?
4. What are the four misconceptions often made by entrepreneurs?
5. Explain the 8 reasons why small businesses fail? Outline what can be done to avoid small business failure?

Chapter 2: Business innovation, idea generation & building a competitive advantage

After studying this chapter you should be able to:

- Understand the meaning of the term innovation and creativity.
- Describe some of the few inspirational innovation centered global businesses.
- Identify the importance of innovation to a business.
- Outline the traits of innovative and creative people and the five idea generating techniques.
- Describe the causes of idea generation failure in small businesses.
- Outline how small businesses can create a competitive advantage.

2.1 Introduction

Transformative innovation in small businesses today has been adopted at a highly accelerated rate as a result of the relentless efforts of governments from the continents of Africa, Europe, North America, Oceania, Asia and South America. Interestingly, the various governments from the continents of Africa, Europe, North America, Oceania, Asia and South America currently have unquestionable, multi-faceted good relationships that are intertwined by the diverse cultural connections (*stemming from the historical global emigration patterns*) and global trade. In the modern day business world almost everything around us is changing on a daily basis due to increased technological advancements. In some parts of the world innovation has been halted by competition-restraining regulations which often reduce the rate at which businesses manage to keep-up with new technological developments⁷⁰ (OECD, 2007:14). Remarkably, countries such as Australia, Canada, France, Denmark, Sweden, Germany, the United Kingdom and Belgium continue to succeed in achieving highly impactful innovation in the information, communication and technology (ICT) related fields as a result of their light competition-restraining regulations that attract high research & development & direct investments in their ICT sectors (OECD,

⁷⁰ OECD (2007) *Innovation and Growth: Rationale For An Innovation Strategy*,

<https://www.oecd.org/sti/inno/39374789.pdf>

2007:14). ⁷¹“In particular, investment in ICTs is positively correlated with uptake and diffusion of innovation (OECD 2004b). The use of ICT is closely linked to the ability of firms to innovate, i.e. introduce new products, services, business processes and applications. Moreover, ICT has helped to facilitate the innovation process, for example by speeding up scientific discovery” (OECD, 2007:14). According to OECD (2007:6) the role of innovation for growth is strengthened by advances in new technologies, and a greater focus on knowledge creation and use. Much of the rise in living standards is due to innovation — this has been the case since the Industrial Revolution. Today, innovative performance is a crucial factor in determining competitiveness and national progress. Moreover, innovation is important to help address global challenges, such as climate change and sustainable development. But it is the application of advances in technology, in conjunction with entrepreneurship and innovative approaches to the creation and delivery of goods and services, which translates scientific and technological advances into more productive economic activity^{72 73}(OECD, 2007:6). Furthermore, according to OECD (2007:8) as a result, major emerging market economies are no longer simply low value added producers but are adding their weight to the creation and commercialization of innovative products, processes and services. Trade data on the four most significant economies (*Brazil, Russia, India and China; “BRIC”*) show that these have become more active in higher technology industries over the past decade. Figure 2 shows that between 1996 and 2004 the share of high technology goods has doubled to reach about 30 percent of total trade (exports plus imports) in manufactured goods by the BRIC countries. It should be noted that most of this rise is accounted for by China⁷⁴ (OECD, 2007:8; OECD, Bilateral Trade Database).

Today in the field of entrepreneurship in most countries around the world there is immense competition on how to attain an innovation led competitive advantage. Businesses that manage to keep up with the fast changing business practices, processes, systems and so on happening in

⁷¹ OECD (2004b) *The Economic Impact of ICT*.

⁷² OECD (2007) *Innovation and Growth: Rationale For An Innovation Strategy*,
<https://www.oecd.org/sti/inno/39374789.pdf>

⁷³ OECD (2005c) *Science, Technology and Industry Scoreboard 2005*.

⁷⁴ OECD, Bilateral Trade Database.

today's business world are those that have adopted an innovation led culture. An organization's intellectual capital is the main driver of business innovation and in most instances a business that has high intellectual capital has a high innovation capability including the ability to identify viable business opportunities in the market. Generally an innovation oriented small business focuses on generating new brilliant ideas, nurturing them and carefully executing them. It is important to highlight the fact that creativity is one of the outcomes of innovation orientated businesses and thus it is a sub-component of innovation.⁷⁵ A small business that embraces innovation as a way of life will definitely prosper at its creativity initiatives and it will remain rich with original concepts and it is more likely to remain innovation centred. One of the key benefits of innovation in a firm is that it helps to engage and inspire employees to tap into the power of the internal crowd, and empower employees to create, invent and innovate new products, processes and services⁷⁶ (Imagination.com.au, 2016, www.imagination.com.au). "America's innovation-driven, high-tech economy isn't concentrated around a few hubs like Silicon Valley; it is widely diffused—and every state and congressional district has a stake in its success"⁷⁷ (Wu, Nager and Chuzhin, 2016). Over the past years the United States of America's innovation-driven high-tech economy has successfully blossomed in various areas namely; the Route 128 tech corridor around Boston, Massachusetts; Research Triangle Park in Raleigh, Durham, and Chapel Hill, North Carolina; Austin, Texas; Seattle, Washington; and, of course, California's vibrant Silicon Valley (Wu, Nager and Chuzhin, 2016). "Recent technological advancements—such as faster computing, better algorithms, and more robust communication networks—have made it easier and cheaper to collect, store, analyze, use, and disseminate data. These changes have led to the emergence of the data economy: an economy where success depends on how effectively firms can leverage data to generate insights and unlock value. Better use of data will be a crucial driver of economic and societal progress in the coming decades. The widespread adoption of data analytics and artificial intelligence is expected to contribute

⁷⁵ Imagination.com (2017) *Innovate Eco-systems*. Available from:

<http://www.imagination.com.au/tag/innovative-eco-systems/>

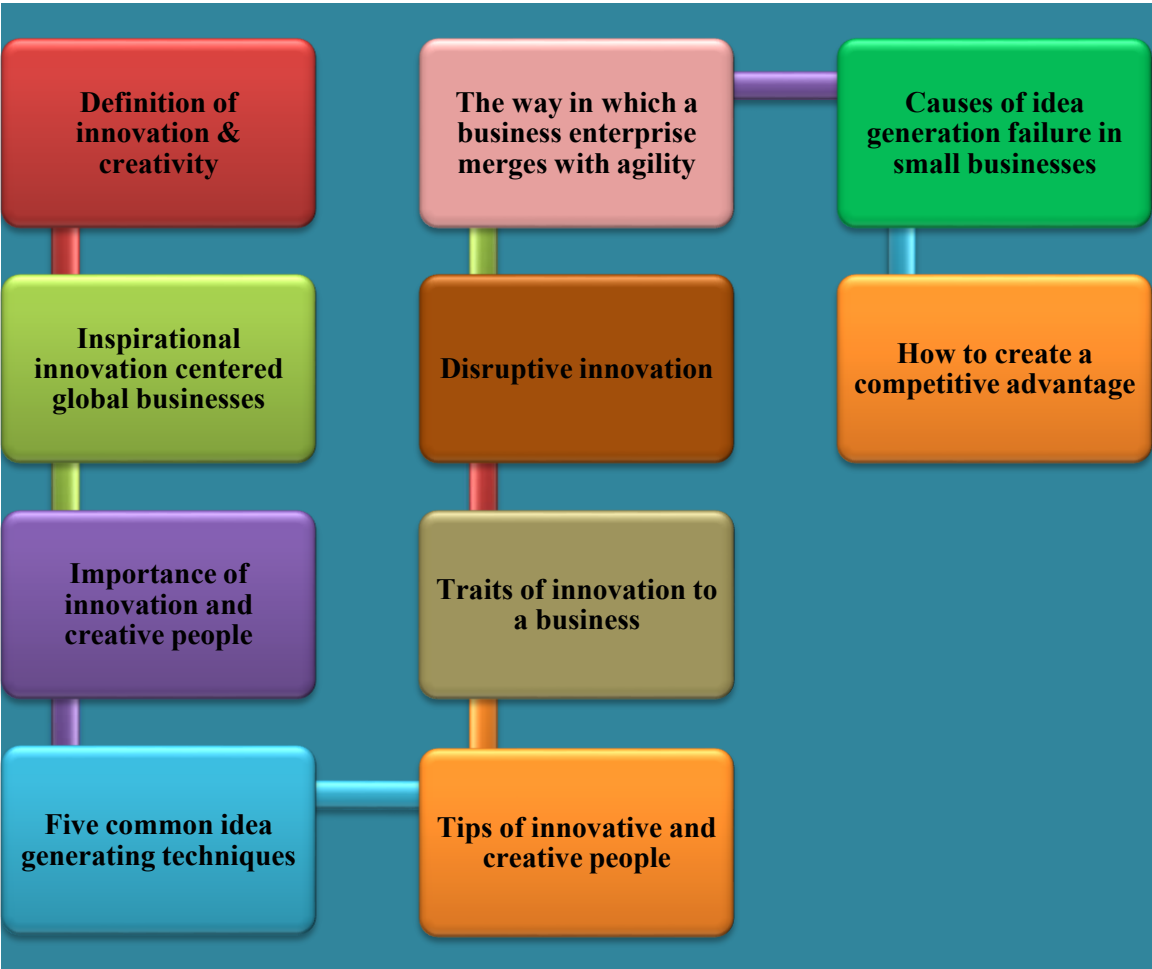
⁷⁶ Imagination.com.au (2016) *8 Reasons Why Innovation is Important to Businesses Today*. Available from:

<http://www.imagination.com.au/innovation-blog/8-reasons-innovation-important-businesses-today/>

⁷⁷ Wu, J., Nager, A. and Chuzhin, J. (2016) *High-Tech Nation: How Technological Innovation Shapes America's 435 Congressional Districts*. Available from: <https://itif.org/publications/2016/11/28/technation>

hundreds of billions of dollars to the U.S. GDP in the coming years in sectors such as finance, transportation, and manufacturing, while unlocking new opportunities to improve outcomes in fields such as education and health care” (Castro, New and Wu, 2017). The new global phenomenal is data-driven innovation and countries such as the United States of America have already begun to thrive in the data economy (Castro, New and Wu, 2017). In this chapter the sub-components of innovation and creativity that will be covered are depicted in Figure 2.1 below.

Figure 2.1 Ten sub-components of innovation & creativity



2.2 Definition of innovation and creativity

⁷⁸“At ImagineNation™ we acknowledge that *innovation* is about creating “*changes that add value*” and involves knowing how to see, respond & solve problems in creative ways that people value & cherish! *Business enterprise innovation* involves making changes that add value in terms of either revenue growth or increased operational efficiency. It may involve the creation of new products and services that deliver value to customers, in a manner that is supported by a sustainable and profitable business model”⁷⁹ (Imagination.com.au, 2017, www.imagination.com.au). In addition, *innovation* can also be defined as a process of introducing, translating and implementing something new in the form of an idea, device, system or method to create value for the organization. *Creativity* is defined as a phenomenal act of producing new, original and imaginative ideas. While on the other hand *creativity* can be referred to as an act of generating ideas that can be used to solve problems currently being faced by customers or society in general through creating something new with unique benefits. According to an article by Michael Porter titled, ‘*The Competitive Advantage of Nations*’. *Harvard Business Review*, March-April (1990) innovation can be manifested in a new product design, a new production process, a new marketing approach, or a new way of conducting training. Once a company achieves competitive advantage through an innovation, it can sustain it only through relentless improvement. Almost any advantage can be imitated⁸⁰ (Michael Porter, 1990). The various global businesses that are innovation centered will be covered in the next section.

2.3 Inspirational innovation centered global businesses

According to an article by Michael Porter titled, ‘*The Competitive Advantage of Nations*’. *Harvard Business Review*, March-April (1990) Korean companies have already matched the ability of their Japanese rivals to mass-produce standard color televisions and VCRs; Brazilian companies have assembled technology and designs comparable to Italian competitors in casual

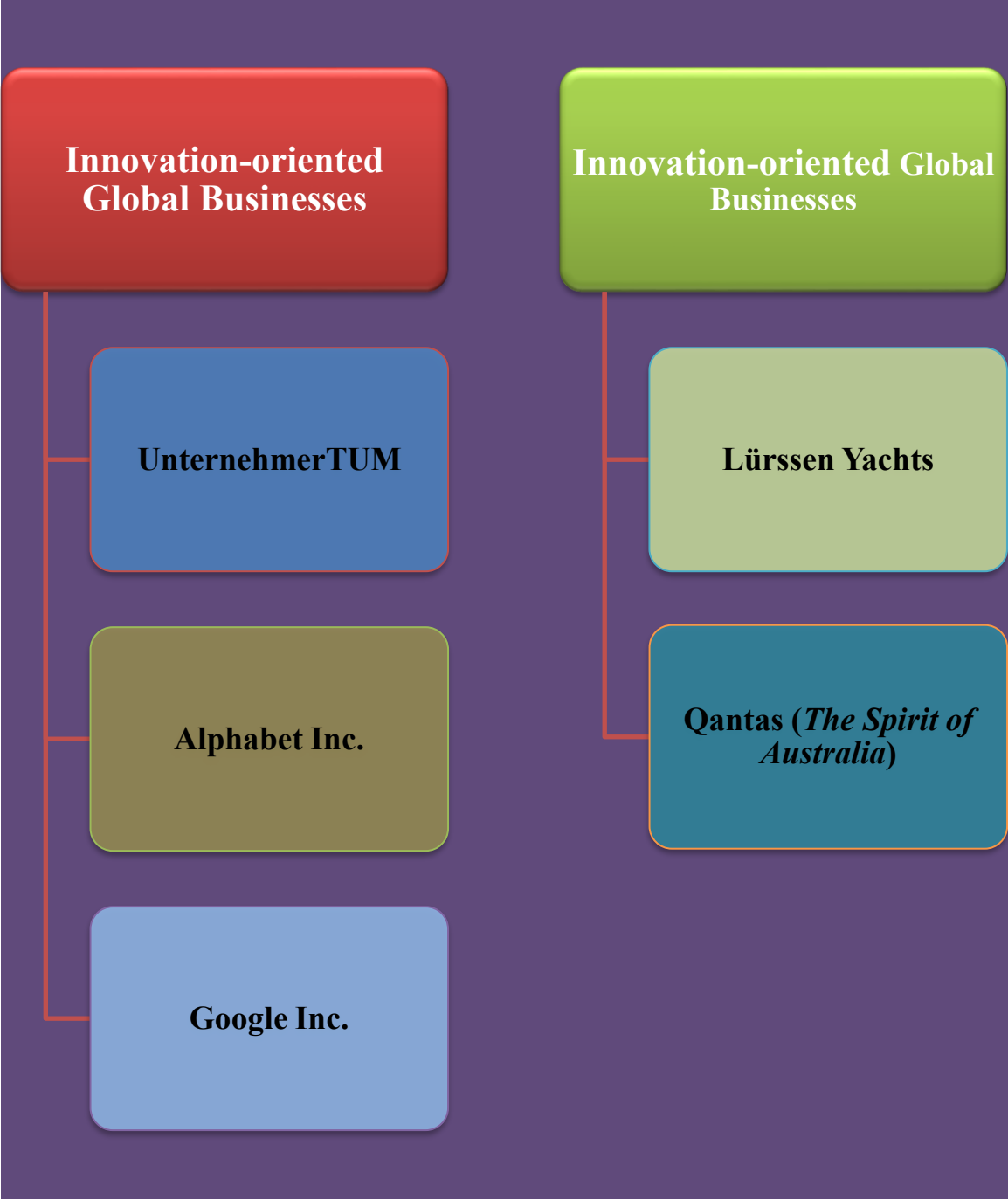
⁷⁸ Imagination.com.au (2016) *8 Reasons Why Innovation is Important to Businesses Today*. Available from: <http://www.imagination.com.au/innovation-blog/8-reasons-innovation-important-businesses-today/>

⁷⁹ Imagination.com (2017) *Innovate Eco-systems*. Available from: <http://www.imagination.com.au/tag/innovative-eco-systems/>

⁸⁰ Michael Porter (1990) ‘*The Competitive Advantage of Nations*’. *Harvard Business Review*, March-April.

leather footwear (Michael Porter, 1990). Some of the few examples of businesses that are innovation-driven are depicted in Figure 2.2 below.

Figure 2.2 Inspirational innovation oriented global businesses



Source: Modified: (UnternehmerTUM, 2018; Alphabet Inc., 2018; Google Inc., 2018; Qantas, 2018; Lürssen Yachts, 2018).

2.3.1 The UnternehmerTUM (*Centre for Innovation and Business Creation at TUM*)

A good example of an organization that has a consistent well embedded business innovation focused culture is the Munich, Germany based UnternehmerTUM (*Centre for Innovation and Business Creation at TUM*). The UnternehmerTUM (*Centre for Innovation and Business Creation at TUM*) was founded in 2002 by Mrs Susanne Klatten one of the world's leading 'iconic' entrepreneur⁸¹ (UnternehmerTUM, 2018, www.unternehmertum.de).⁸² According to UnternehmerTUM (2018) UnternehmerTUM is organized into four companies: (1) *UNTERNEHMERTUM GMBH* - inspires and empowers students, researchers and professionals by providing outstanding, hands-on entrepreneurship training, by incubating technology-based startup teams and by giving access to prototyping infrastructure, (2) *UNTERNEHMERTUM PROJEKT GMBH* - runs the start-up accelerator program TechFounders and collaborates with young and established companies to identify, develop and realize joint projects to successfully generate new business, (3) *UNTERNEHMERTUM VENTURE CAPITAL PARTNERS GMBH* - runs a venture capital fund to finance cutting-edge technology start-ups with international market potential, (4) *UNTERNEHMERTUM MAKERSPACE GMBH* - is a membership-based, open access, high-tech workshop and fabrication studio (UnternehmerTUM, 2018, www.unternehmertum.de).⁸³ According to UnternehmerTUM (2018) UnternehmerTUM offers founders and start-ups a complete service, from the initial idea all the way to IPO. A team of experienced entrepreneurs, scientists and managers supports founders with the development of their products, services and business models. The experts accompany them actively with building up their companies, market entry and financing – also via Venture Capital (UnternehmerTUM, 2018). Remarkably, UnternehmerTUM (*Centre for Innovation and Business Creation at TUM*) also helps entrepreneurs to identify and develop new businesses and launching them through the following methods: (1) *individual support* – the UnternehmerTUM (*Centre for Innovation and Business Creation at TUM*) offers students, academics, founders, start-ups and established companies individual support and systematic coaching in developing new products and services,

⁸¹ UnternehmerTUM (2018) *About Us*. Available from: <https://www.unternehmertum.de/about-us.html?lang=en>

⁸² UnternehmerTUM (2018) *Munich Urban Colab*. Available from: <https://www.unternehmertum.de/munich-urban-colab.html?lang=en>

⁸³ UnternehmerTUM (2018) *Innovation - Business Creation - Venture Capital*. Available from: <https://www.unternehmertum.de/index.html?lang=en>

in building up a successful business, when entering the market and in the growth stage, (2) *focus on future industries* - our work focuses on the future industries of Information and Communication, Medical Engineering and CleanTech, (3) *innovative methods* - to make ideas and technologies into successful products and services, UnternehmerTUM works with *Business Design*. *Business Design* combines principles drawn from design and strategic management, providing targeted help to identify and realise opportunities for new and sustainable business, (4) *venture capital* - Unternehmertum Venture Capital Partners provides venture capital for promising young technology companies in the areas of Industrial Technologies & Smart Enterprises with market potential (UnternehmerTUM, 2018, www.unternehmertum.de).

⁸⁴According to UnternehmerTUM (2018) UnternehmerTUM, one of the largest non-profit innovation and entrepreneurship centers in Europe, joins forces with leading public sector, industry and tech players in the appliedAI initiative. Combining corporate experience, entrepreneurship, latest research, and creative mindset – we accelerate the adoption of Artificial Intelligence in industry as well as society. To achieve this goal, we provide a broad spectrum of products and services, all focused on the understanding, development, and implementation of latest AI. We give our ecosystem access to cutting edge technology, cross-industry knowledge and best-practices. Our three activities:

- The *appliedAI Initiative* offers a unique training program for decision makers, project managers and developers to prepare for the age of AI. Our experts explain what is really going on and what the limitations are. We develop three new roles with you in your company. Send your best and we will make sure that you are set towards adopting AI:
- *Walk the talk!* *appliedAI* does not stop at teaching but helps you build your first proof of - concept. Be it a real-world project such as a drone or a ship or a pure data-centric project, appliedAI can help. We have worked with some of the best in the field and will help and build you PoC with you.⁸⁵

⁸⁴ UnternehmerTUM (2018) *Enabler For Start-Ups and Innovations*. Available from:

<https://www.unternehmertum.de/about-us.html?lang=en>

⁸⁵ UnternehmerTUM (2018) *Innovation - Business Creation - Venture Capital*. Available from:

<https://www.unternehmertum.de/index.html?lang=en>

• *Exchanging on a neutral ground* is the most important and most valuable asset a company can have in times where even the market-leaders do not exactly know where things are going. AppliedAI understands this challenge and facilitates the exchange on a national level between its partners to build up joint projects and competencies (UnternehmerTUM, 2018). Furthermore, according to UnternehmerTUM (2018) our technological focus - four areas stand out for their impact on both society and industry. To master these challenges and shape the post-AI world, we as an ecosystem need to be at the forefront of their understanding and implementation. The four areas include:

- *Advanced analytics* - understanding what was measured is now, understanding what to measure is next,
- *Next reality* - language translation is now, sensory translation is next
- *Next machines* - robots in the assembly line is now, autonomous systems in the wild is next.
- *Next intelligence* - task-supporting machines is now, human-supporting machines is next (UnternehmerTUM, 2018, www.unternehmertum.de).

2.3.2 Alphabet Inc.

Alphabet Inc. is Mountain View, California, United States of America headquartered investment conglomerate which was founded on October 2, 2015 by one of the world's leading iconic two entrepreneurs Larry Page and Sergey Brin. Interestingly, Alphabet Inc. by the 31st of December 2017 it employed a total number of 80,110 employees. On the 1st of February 2018 Alphabet Inc. announced its fourth quarter financial results for the financial year ending 31 December 2017 of USD\$110,855 billion worth of sales revenue⁸⁶ (Alphabet, 2018:4; courtesy of Google Inc.). ©2017 Google LLC, used with permission. Google and the Google logo are registered trademarks of Google LLC. When Alphabet was founded by the world's leading 'iconic' two entrepreneurs Larry Page and Sergey Brin it was an innovation driven company. This is supported a letter written by Larry Page. ““*As Sergey and I wrote in the original founders letter*

⁸⁶ Alphabet (2018) *Alphabet Announces Fourth Quarter and Fiscal Year 2017 Results*. Available from:

https://abc.xyz/investor/pdf/2017Q4_alphabet_earnings_release.pdf

*11 years ago, 'Google is not a conventional company. We do not intend to become one.' Our company is operating well today, but we think we can make it cleaner and more accountable. So we are creating a new company, called Alphabet. I am really excited to be running Alphabet as CEO with help from my capable partner, Sergey, as President. For Sergey and me this is a very exciting new chapter in the life of Google—the birth of Alphabet. We liked the name Alphabet because it means a collection of letters that represent language, one of humanity's most important innovations, and is the core of how we index with Google search! We also like that it means **alpha-bet** (Alpha is investment return above benchmark), which we strive for! I should add that we are not intending for this to be a big consumer brand with related products—the whole point is that Alphabet companies should have independence and develop their own brands. What is Alphabet? Alphabet is mostly a collection of companies. The largest of which, of course, is Google. This newer Google is a bit slimmed down, with the companies that are pretty far afield of our main internet products contained in Alphabet instead. What do we mean by far afield? Good examples are our health efforts: Life Sciences (that works on the glucose-sensing contact lens), and Calico (focused on longevity). Sergey and I are seriously in the business of starting new things. Alphabet will also include our X lab, which incubates new efforts like Wing, our drone delivery effort. We are also stoked about growing our investment arms, Ventures and Capital, as part of this new structure”⁸⁷ (Larry Page cited in Alphabet Inc., 2018). Today Alphabet Inc. owns several innovation driven subsidiaries such as CapitalG, Chronicle, DeepMind, Google, Google Fiber, GV, Jigsaw and many others (Courtesy of Google Inc., 2018). ©2017 Google LLC, used with permission. Google and the Google logo are registered trademarks of Google LLC.*

2.3.3 Google Inc.

Google Inc. is a Mountain View, California, United States of America headquartered founded by Larry Page and Sergey Brin in 1998. According to Google Inc. (2018) the Google story begins in 1995 at Stanford University. Larry Page was considering Stanford for grad school and

⁸⁷ Alphabet (2018) *Alphabet Announces Fourth Quarter and Fiscal Year 2017 Results*. Available from: https://abc.xyz/investor/pdf/2017Q4_alphabet_earnings_release.pdf p1-11. (Courtesy of Google Inc.). ©2017 Google LLC, used with permission.

Sergey Brin, a student there, was assigned to show him around. By some accounts, they disagreed about nearly everything during that first meeting, but by the following year they struck a partnership. Working from their dorm rooms, they built a search engine that used links to determine the importance of individual pages on the World Wide Web. They called this search engine Backrub. Soon after, Backrub was renamed Google (pew). The name was a play on the mathematical expression for the number 1 followed by 100 zeros and aptly reflected Larry and Sergey's mission "to organize the world's information and make it universally accessible and useful." Over the next few years, Google caught the attention of not only the academic community, but Silicon Valley investors as well". In August 1998, Sun co-founder Andy Bechtolsheim wrote Larry and Sergey a check for \$100,000, and Google Inc. was officially born. With this investment, the newly incorporated team made the upgrade from the dorms to their first office: a garage in suburban Menlo Park, California, owned by Susan Wojcicki (*employee #16 and now CEO of YouTube*)⁸⁸ (Google Inc., 2018 courtesy of Google Inc.). ©2017 Google LLC, used with permission. Google and the Google logo are registered trademarks of Google LLC. Today Google Inc. is one of the innovation focused global organizations in the world and this is supported by the letter written by Larry Page. ⁸⁹“*As Sergey and I wrote in the original founders letter 11 years ago, We did a lot of things that seemed crazy at the time. Many of those crazy things now have over a billion users, like Google Maps, YouTube, Chrome, and Android. And we haven't stopped there. We are still trying to do things other people think are crazy but we are super excited about. We've long believed that over time companies tend to get comfortable doing the same thing, just making incremental changes. But in the technology industry, where revolutionary ideas drive the next big growth areas, you need to be a bit uncomfortable to stay relevant. Google itself is also making all sorts of new products, and I know Sundar will always be focused on innovation—continuing to stretch boundaries. I know he deeply cares that we can continue to make big strides on our core mission to organize the world's information. Recent launches like Google Photos and Google Now using machine learning are amazing progress.*

⁸⁸ Google Inc. (2018) *Our Story*. Available from: <https://www.google.com/about/our-story/> (Courtesy of Google Inc.). ©2017 Google LLC, used with permission.

⁸⁹ Larry Page (2018) *G is for Google*. Available from: <https://abc.xyz/> [Accessed 2018, 14 June] (Courtesy of Google Inc.). ©2017 Google LLC, used with permission.

Google also has some services that are run with their own identity, like YouTube. Susan is doing a great job as CEO, running a strong brand and driving incredible growth”” (Larry Page, 2018). Furthermore, according to Google Inc. (2018) today, with more than 60,000 employees in 50 different countries, Google makes hundreds of products used by billions of people across the globe, from YouTube and Android to Smartbox and, of course, Google Search (Google Inc., 2018) (*Courtesy of Google Inc.*). ©2017 Google LLC, used with permission. Google and the Google logo are registered trademarks of Google LLC.

2.3.4 Lürssen Yachts

One of the world’s leading innovation centered organization is Lürssen Yachts headquartered in Bremen, Germany which was founded by Friedrich Lürssen on June 27, 1875. In innovation driven culture and mindset has been handed down for several decades in Lürssen Yachts and even to this day the essence of Lürssen’s unique quality and innovative spirit is still alive. The co-owners of Lürssen Yachts are Peter Lürssen (*who is also the current CEO*) and Friedrich Lürssen and the company has sales revenue of around EURO€8.299 billion. During the year 1997 Lürssen Yachts built an astonishing 97-meter megayacht LIMITLESS, designed by the highly regarded designer Jon Bannenberg was handed over to her owner⁹⁰ (Lürssen, 2018, www.lurssen.com/en/about/history/). Remarkably, during the year 2015 Lürssen delivered the world’s longest yacht, AZZAM, at 180.65 meters. She not only sets a record length and speed exceeding 30 knots, but also for her building time of less than three years. In addition during the year 2016 Lürssen Yachts built the world’s biggest yacht called DILBAR, the largest motor yacht ever in terms of gross tonnage, leaves Lürssen shipyards. At 156 meters and loaded with highly sophisticated technology, she is one of the most complex and challenging yachts ever built. The 15, 917-ton vessel features luxury entertainment and recreation spaces never seen before on a yacht. The impressive project was completed in just 52 months (Lürssen, 2018, www.lurssen.com/en/about/history/). Remarkably, out of the 11 largest yachts sold during the year 2017 two of them were built by Lürssen Yachts. One of them is called Northern Star which has a length of 75metres (246ft) which was first listed for sale in December 2012 by her owner at an asking price of €129 million, but was later listed for €83 million by the owner. It features a

⁹⁰ Lürssen (2018) *Lürssen: Leading Innovation Since 1875*. Available from:

<https://www.lurssen.com/en/about/history/>

'country house' style interior. Northern Star can accommodate 12 guests in six staterooms. She also has room for up to 22 crew members so that your everyday needs can be taken care of while on board. The yacht's astonishing amenities include a gym, helipad, tender garage, swimming platform and Jacuzzi⁹¹ (Yachts Harbour cited in Businessinsider, 2017, www.businessinsider.com). The second largest yacht out of the 11 largest yachts sold during 2017 was the Solandge built by Lürssen Yachts with a length size of 88.5 metres (290ft) which was first listed for sale in August 2015 at an asking price of €179 million, the yacht later went through two price reductions and a central agency change. At the moment of sale the asking price for Solandge was €155,000,000. The superyacht can sleep up to 12 guests in 7 staterooms, including a panoramic master deck featuring 180 degree windows, a private dressing room, his and hers bathrooms and a private deck with a spa pool. Performance wise the yacht reaches a top speed of 18 knots and comfortably cruises at 14 knots (Yachts Harbour cited in Businessinsider, 2017, www.businessinsider.com).

2.3.5 Qantas (*The Spirit of Australia*)

Another good example of an organization operating in the global airline industry that has a tremendous record of being innovation driven is leading airliner Qantas '*the Spirit of Australia*'. Qantas Airways was founded in the Queensland in 1920. Qantas has grown to be Australia's largest domestic and international airline. Registered originally as the *Queensland and Northern Territory Aerial Services Limited* (QANTAS)⁹² (Qantas, 2018). "The Qantas Group is built on innovation. Our founders were big picture thinkers who had a vision for aviation to change Australia – and ever since then, we've always looked ahead to the next big breakthrough. Now, through our second AVRO Accelerator, we're giving entrepreneurs the chance to work with Qantas Group business units to develop, incubate and scale their businesses"⁹³ (Qantas, 2018). Today innovation is what makes global organizations such as Qantas thrive and continue to offer their customers excellent services and initiate programs that help them to form innovation driven

⁹¹ Businessinsider.com (2017) *The 11 Largest Luxury Yachts Sold in 2017*. Available from: www.businessinsider.com/largest-luxury-yachts-sold-in-2017-2017-12

⁹² Qantas (2018) *Our Company*. Available from: <https://www.qantas.com/travel/airlines/company/global/en>

⁹³ Qantas (2018) *Scaling the Next Generation of Global Businesses*. Available from: <https://avroaccelerator.qantas.com/>

partnerships with other startup enterprises and other well established businesses around the world.⁹⁴ According to Coyne (2017) national airline Qantas has launched an accelerator program aimed at uncovering innovative ideas that can improve travel experience. The 'Avro' accelerator program - named after Qantas' first aircraft, the Avro 504k - will give ten start-ups the opportunity to work with Qantas and big-name tech vendors for 12 weeks. It will give start-ups access to some of the airline's operational data, technology platforms, and "anonymised" customer insights, as well as industry partners. Each has offered [perks](#) - like hosting and service credits and discounts - to participants. Qantas has also signed up a host of [industry mentors](#) to the program. Qantas said there is potential for further funding from the airline and its partners down the track. It has broken up the program into five themes: a "seamless" travel experience; servicing customers beyond the air; simplifying platforms and systems; streamlining processes for efficiency; and the next "breakthrough business" (Coyne, 2017, www.itnews.com.au).⁹⁵ In addition during the year 2009 Qantas opened the Qantas Centre of Service Excellence located 10 minutes from Sydney airport and 12 minutes from Sydney CBD also known throughout Qantas as the home of the eXceptional brand-aligned end-to-end customer experience training program. The Centre of Service Excellence has primarily become the hub for innovation, recruitment, induction, learning and development programs, as well as social events (Qantas, 2018). The importance of innovation will be covered in the next section.

According to Imagination (2016) Einstein famously said that *"we cannot solve the problem with the same thinking we used when we created them"*. So simple conventional linear planning and problem solving processes using the same thinking that created some of these undesirable problems in the first place aren't not going to result in the visionary, creative ideas and innovative solutions required to solve them⁹⁶ (Imagination.com.au, 2016). Innovation nowadays has become the norm and definite way of doing things in this modern dayglobal

⁹⁴ Coyne, A. (2017) *Qantas Asks Start-Ups to Help It Innovate*. Available from:

<https://www.itnews.com.au/news/qantas-asks-start-ups-to-help-it-innovate-455371>

⁹⁵ Qantas (2018) *Qantas Centre of Service Excellence*. Available from:

<https://www.qantas.com/travel/airlines/excellence/global/en>

⁹⁶ Imagination.com.au (2016) *8 Reasons Why Innovation is Important to Businesses Today*. Available from:

<http://www.imagination.com.au/innovation-blog/8-reasons-innovation-important-businesses-today/>

business environment. ⁹⁷Innovation is of the most effective ways that helps organizations to gain a competitive advantage and this is supported by an article published by Michael. Porter (1990) The Competitive Advantage of Nations. *Harvard Business Review*, March-April. According to Michael Porter (1990) companies achieve competitive advantage through acts of innovation. Innovation is very critical to every small business nowadays and this will be covered in the following section.

2.4 Importance of innovation to a business

Innovation in its broadest sense, includes both new technologies and coming up with more efficient and effective new ways of doing things. Organizations perceive innovation as a new basis for competing or finding better means for competing in old ways. A nation's competitiveness depends on the capacity of its industry to innovate and upgrade. Companies gain advantage against the world's best competitors because of pressure and challenge. Sweden's long-standing concern for handicapped people has spawned an increasingly competitive industry focused on special needs. Denmark's environmentalism has led to success for companies in water-pollution control equipment and windmills. Ultimately, the only way to sustain a competitive advantage is to *upgrade it*—to move to more sophisticated types (Michael Porter, 1990. *The Competitive Advantage of Nations. Harvard Business Review*, March-April.). “Entrepreneurship is becoming a global movement and entrepreneurship is growing especially in emerging markets, where China and India are leading the pack and Africa is predicted to be the next hot spot. Innovation is an enabler of entrepreneurship as well as a way of empowering and enabling people to take control of their lives and manifest their own destiny and economic prosperity”⁹⁸ (Imagination.com.au, 2016). There are several reasons why innovation is important to a business and these are depicted in Figure 2.3 below.

⁹⁷ Michael. Porter (1990) The Competitive Advantage of Nations. *Harvard Business Review*, March-April.

⁹⁸ Imagination.com.au (2016) *8 Reasons Why Innovation is Important to Businesses Today*. Available from: <http://www.imagination.com.au/innovation-blog/8-reasons-innovation-important-businesses-today/>

Figure 2.3 Five reasons why innovation is important to a business



Source: Modified: (Imagination.com.au, 2017, Imagination.com, 2016, www.imagination.com.au; Amazon.com Inc., 2018)

2.4.1 It helps the business to out-compete its competitors

Innovation prospers when it is carefully planned and implemented in the appropriate manner to easily enable the business to offer something new to its customers to fulfill an untapped gap in the market or act as a solution to an already existing problem. Value addition in a profitable and sustainable manner is the main focus of any innovative process in a business⁹⁹ (Imagination.com.au, 2017, www.imagination.com.au). In addition, as previously mentioned earlier *innovation* refers to a process that clearly introduces, translates and

⁹⁹ Imagination.com (2017) *Innovate Eco-systems*. Available from: <http://www.imagination.com.au/tag/innovative-eco-systems/>

implements something new in the form of an idea, device, system or method to create value for the organization. Notably some of the leading innovators found around the world use this innovation strategy and the various benefits that are enjoyed by small businesses that successfully improve already existing products or ideas include the following: instant brand recognition, increased customer loyalty levels, enhanced market shares and goodwill.

2.4.2 It helps to stimulate consistent growth of the business

It has since been discovered by leading researchers in the field of entrepreneurship that innovation helps to stimulate growth in a small business. Innovation leads to the introduction of the following: (1) new products/services, (2) value adding cutting edge technologies, (3) enhanced positive word-of-mouth advertising, (4) increased sales revenue and profit income to use to finance new operational facilities in the country or in foreign markets and invest in various transformative research and development programs of the business, hiring of highly talented employees to boost the intellectual capital base of the business. A highly innovation driven business can easily establish new markets and develop sustainable long term relationships due to the fact that innovation enables a business to gain a competitive advantage it can use to penetrate new markets at an accelerated rate than its rivals. A good example of a business that has successfully managed to stimulate growth through innovation is online retail giant Amazon.com.

¹⁰⁰According to Amazon.com (2018) Amazon ranks #1 on The Harris Poll's Corporate Reputation survey, #2 on Fortune's World's Most Admired Companies, and #2 on LinkedIn's U.S. most desirable companies list (Amazon.com Inc., 2018). Furthermore during the year 2018 Amazon.com Inc. expanded its Vancouver, Canada Tech Hub, adding 3000 high-tech jobs.

¹⁰¹According to Amazon.com Inc. (2018) eventually Amazon expects to employ 5000 people in Vancouver, Amazon currently employs more than 1,000 researchers and engineers in the city, primarily creating new products and services for the company's international retail businesses and Amazon Web Services (AWS) (Amazon.com Inc., 2018). *“Used with permission from*

¹⁰⁰ Amazon.com Inc. (2018) *Job Creation & Investment*. Available from: <https://www.aboutamazon.com/job-creation-and-investment>

¹⁰¹ Amazon.com Inc. (2018) *Amazon Expands Vancouver Tech Hub Adding 3000 High-Tech Jobs*. Available from: <https://blog.aboutamazon.com/job-creation-and-investment/in-photos-amazon-expands-vancouver-tech-hub-adding-3-000-high-tech-jobs>

Microsoft". Furthermore, according to Amazon.com Inc. (2018) since 2012, Amazon has invested more than \$100 billion in the U.S., added \$45 billion to U.S. GDP, and added 125 U.S.-based jobs a day - or one job every ten minutes (Amazon.com Inc., 2018). Therefore, transformative innovative practices lead to impactful growth of the business.

2.4.3 It strengthens the employer brand power of the business

Transformative innovation practices in a business lead to growth due to increased sales revenue and profit income. Higher profit income enables the business to acquire new technology that helps to boost its transformation processes efficiency and quality thereby leading to high quality products/services being produced by the business in the market. Generally talented job seekers look for employment in businesses that have a history of successful innovations and that also possess a good employer brand status in the labour market as a result of selling high quality products/services and earning high profit margins. Talented job seekers when they see that the business is innovation oriented they apply for jobs in the business. Therefore, one of the most important aspects about a business being innovation orientated is that it helps to strengthen its employer brand status in the labour market. Innovation gives businesses an edge in the job market as a conducive workplace that provides career development and growth opportunities for employees to be part of various transformative innovation goals. A good example of an organization that has a powerful employer brand in the global labour market is Seattle Washington, United States of America headquartered Amazon.com Inc. ¹⁰²According to Amazon.com Inc. (2018) Amazon provides employees with highly-competitive pay, benefits, a group RRSP plan, and company stock. Amazon's customer fulfillment associates can also take advantage of its innovative Career Choice program, which pays 95 per cent of the cost of tuition to pursue continuing education courses in-demand fields, regardless of whether the skills are relevant to a career at Amazon. To date, more than 16,000 Amazonians have used the job-retraining program globally (Amazon.com Inc., 2018).

¹⁰² Amazon.com Inc. (2018) *Amazon Announces Further Expansion in Oklahoma with Tulsa Fulfillment Center*. Available from: <http://phx.corporate-ir.net/phoenix.zhtml?c=176060&p=irol-newsArticle&ID=2353923>

2.4.4 It enables the business to quickly respond to change

Change is now inevitable for any business (*both large/small*) and this is mainly attributed by the rapid technological developments happening in the global business environment. In addition the socio-demographic patterns of consumer markets are now highly dynamic due to the changing buying behavior of the young generation of customers in particular those below the age of 34 on products such as fashion, technology devices, methods of communication (*they now highly prefer social media*), education, food, transport, entertainment and so on. Thus, all the above highlighted factors have put immense pressure on businesses to explore and adopt innovation driven strategies. Innovation helps businesses to be highly flexible and be able to quickly respond to change. For instance, nowadays automobile manufacturers are now installing reverse cameras on almost all their automobile models available in the market to promote the safety of their customers when parking or reversing their vehicles including the safety of children (*in particular crawling infants who may be playing behind an already parked automobile*). Innovation enables the business to improve its current range of products/services to solve unfulfilled needs in the market for instance the installing of reverse cameras in automobiles over the past years by automobile manufacturing companies has significantly filled a gap that existed in the automobile sector. A good example of an organization that managed to quickly respond to change as a result of its innovation driven culture is Seattle, Washington, United States of America headquartered online retail giant Amazon.com Inc.¹⁰³. During the year 2007 it launched its Amazon Kindle device that allows readers to read, purchase, download publications such as e-books, newspapers, journals, magazines and so on. Book readers before the Amazon kindle was launched they had to physically carry their printed hard copies to any destination they wanted to use them and this was a burden for people in academia or researchers who often use 10-15 books a day for their various research activities. Today Amazon Kindle users can carry their light-weight devices anywhere without a problem and they can also now store and download more than 20 books in their Kindle devices. According to Karlinsky (2017) cited in Amazon.com Inc. (2018) *from those early weekend tests, the form of the Kindle was finalized. Later that year, in November, Bezos announced the e-reader at a media event in New York City. The e-reader*

¹⁰³ Karlinsky, N. (2017) *Inside Story of How Kindle Was Born*. Available from: <https://blog.aboutamazon.com/devices/the-inside-story-of-how-the-kindle-was-born>

forever changed the way books are read and published, but in the years leading up to the launch, developers didn't know if all their work would pay off. "There's a saying at Amazon that you have to be an optimist to be an entrepreneur," said Kessel. "It was a classic startup and you get all the ups and downs of the startup life." Kessel said the team was determined to keep the Kindle a single-purpose device – something where you could lose yourself in a book, rather than a multipurpose piece of hardware that might create distractions. They were also focused on making it easy for customers by ensuring they could access new books without connecting a cable to a computer for download. That dedication, which led to a built-in cellular data connection and, eventually, the ability to sync your books across Kindle devices and app, was no small feat. "We said books needed to download in less than 60 seconds, but it definitely didn't work that way at first," said Kessel. Patience was something the team was forced to learn. "Originally I told Jeff (Bezos) it would take us about 18 months to build the Kindle and we could do it with a couple handfuls of folks. It took us three-and-a-half years and a lot more than a couple of handfuls of folks." (Steve Kessel cited in Karlinsky, 2017, <https://blog.aboutamazon.com/>). According to Imagination.com.au (2017) the increasing availability and accessibility to free and low cost online education is encouraging and enabling almost anybody with a desire for learning and a hunger for knowledge to become subject matter experts in their fields. Innovative entrepreneurs and lean start-ups are proliferating via the Internet of Things, always connected mobile devices, cloud computing and via the social media. Especially by the development of software applications aimed at improving the quality of people's minds and lives everywhere (Imagination.com.au, 2017).

2.4.5 It helps to extend product lifecycles and customer satisfaction

Highly innovative centered businesses tend to gain the favour of customers since they often provide them with the new right products/services that: (1) add value and (2) also help them to fulfill their unmet needs. "Increasing consumer expectations and choices are impacting organizations to become increasingly customer centric through innovative change. By using human centered design to improve the users (*our*) experience provides increased value and new ways to create and invent products and services as well as to execute plans in ways that people

value and cherish”¹⁰⁴ (Imagination.com.au, 2018). When a business improves already existing products to fulfill customers unmet needs it automatically gains customer loyalty and satisfaction while simultaneously extending its product life cycle of its currently available range of products/services. A good example of product/life cycle extension is the innovation of several USA based email communication high-tech companies to become: (1) Internet search engines, (2) cloud technology services, (3) offer social media networks and (4) online advertising platforms. There are several traits that innovative people often possess and these will be further discussed in the following section.

2.5 Traits of innovative and creative people

As highlighted earlier-on in this chapter that innovative people are generally creative in terms of generating new ideas, adding value and providing solutions to existing problems. There are many traits or characteristics that are associated with creative people. The eight common traits of innovative and creative people are depicted in Figure 2.4 below.

¹⁰⁴ Imagination.com.au (2016) *8 Reasons Why Innovation is Important to Businesses Today*. Available from: <http://www.imagination.com.au/innovation-blog/8-reasons-innovation-important-businesses-today/>

Figure 2.4 The eight common traits of innovative & creative people



Source: Modified: (Patel, 2018, www.entrepreneur.com/; Chamorro-Premuzic, T., 2013; Amazon.com Inc., 2018).

2.5.1 They continuously learn everyday

¹⁰⁵“Creative people know that you can’t maintain your leading edge while waiting for inspiration to strike. Creativity requires fuel, and that fuel includes gaining knowledge through reading and studying new things, as well as by being open to new experiences. Innovative people thrive on [traveling](#). ” (Patel, 2018, www.entrepreneur.com/).

2.5.2 They are naturally curious and eager to get answers

“Highly innovative people are naturally curious, you question, the more your imagination is stimulated to consider other possibilities. This is why creative people are constantly investigating and examining things, including their own products and the quality of their own services” (Patel, 2018, www.entrepreneur.com/).

2.5.3 They have an inspirational unique vision

The fact that innovation is aimed at creating something new or that adds value and or solves a currently existing problem makes innovative and creative people to have an inspirational unique vision of creating something that helps to fulfill an unmet need.

2.5.4 They have an opportunistic mindset

In general innovative and creative people have an opportunity seeking mindset that makes them to focus on identifying unfulfilled needs in the market. The epicenter of innovation is opportunities and for a person to be called an innovator they must first have the ability to identify opportunities in the market and carefully think of something new while simultaneously adding value to the extent that it greatly benefits the customers. Innovative and creative people tend to be highly attentive of their surroundings. Furthermore, innovative people search for highly complex challenging tasks and they search for different things in life¹⁰⁶ (Chamorro-Premuzic,

¹⁰⁵ Patel, D. (2018) *11 Proven Habits of Highly Innovative People*. Available from:

<https://www.entrepreneur.com/article/313733>

¹⁰⁶ Chamorro-Premuzic, T. (2013) The Five Characteristics of Successful Innovators. *Harvard Business Review*, October Issue.

2013. The Five Characteristics of Successful Innovators. *Harvard Business Review, October Issue*).

2.5.5 They have strong perseverance

Passion for their work is one attribute associated with creative people including high levels of professionalism and they generally do not easily give up on their set goals in life. Creativity is about generating new ideas and not everyday can they successfully generate them. In certain instances or certain days their creative thinking may take a longer time period than other days to generate a completely unique and new idea. Thus strong perseverance and patience is one of the traits highly successful innovators commonly share. Innovators have to be consistently patient, energetic and they must persevere instead of giving up on the idea generation process as a whole so that they may execute the opportunities they identify of unfulfilled needs of customers in the marketplace (Chamorro-Premuzic, 2013. The Five Characteristics of Successful Innovators. *Harvard Business Review, October Issue*).

2.5.6 They usually have formal education or training

In general there is a common misconception that the greatest innovators in the world do not have formal education or most of them are school dropout geniuses. However, this is untrue and the facts seem to suggest that the majority of successful innovators are indeed well trained experts in their career fields¹⁰⁷ (Chamorro-Premuzic, 2013). An untrained innovator is most likely to find it difficult to differentiate between relevant and irrelevant generated ideas or more simply put between noise and signals. This fact is supported by studies done in the entrepreneurship field that highlight that a formal education and training in entrepreneurship helps innovators to be the best innovators in terms of producing relevant and value adding original ideas^{108 109}(Chamorro-

¹⁰⁷ Chamorro-Premuzic, T. (2013) The Five Characteristics of Successful Innovators. *Harvard Business Review, October Issue*.

¹⁰⁸ Martin, Bruce C. & McNally, Jeffrey J. & Kay, Michael J., 2013. "Examining the formation of human capital in entrepreneurship: A meta-analysis of entrepreneurship education outcomes," *Journal of Business Venturing*, Elsevier, vol. 28(2), pages 211-224.

Premuzic, 2013. The Five Characteristics of Successful Innovators. *Harvard Business Review*, October Issue).

2.5.7 They strongly value team work or networking and they have high execution intelligence

Connectivity means being connected to technology devices or an information communication platform such as the Internet while on the other hand networking can also refer to being connected to various personal/business contacts (*such as friends, employees, customers, suppliers, social media contacts and so on*). A creative entrepreneur is fully knowledgeable of the fact that in order for him/her to generate useful ideas they must work as a team in the business than by themselves and they often view partnerships as an opportunity to perform better rather than seeing it as a complication. The world's leading innovators or entrepreneurs have a high execution intelligence to implement their newly generated brilliant idea into something new and life changing to customers or the business.

2.5.8 They ensure that every idea they generate contributes to the business's success

The ultimate goal of innovation in any business is to add value to the business in terms of increased market share, enhanced brand recognition status, increased customer loyalty, higher sales revenue and so on. A good example is the growing number of innovators who are starting to produce excellent business ideas and inventions at the heart of voice technology seem to be significantly contributing to their organization's success through investing in voice technologies. ¹¹⁰“Every day, people around the world are making Alexa smarter by building with voice to make customers' lives easier, helping them solve real problems, and even entertaining them” (Amazon.com Inc., 2018). ¹¹¹According to Amazon.com Inc. (2018) the same might be said for

¹⁰⁹ Ideas (2013) *Journal of Business Venturing*. Available from:

<https://ideas.repec.org/a/eee/jbvent/v28y2013i2p211-224.html>

¹¹⁰ Amazon.com (2018) *9 Women Shaping the Future of Voice With Alexa*. Available from:

<https://blog.aboutamazon.com/amazon-ai/9-women-shaping-the-future-of-voice-with-alexa>

¹¹¹ Amazon.com Inc. (2018) *10 Alexa Skills You've Got to Try*. Available from:

<https://blog.aboutamazon.com/devices/10-alexa-skills-youve-got-to-try>

our Echo devices. We love Alexa for playing music, setting alarms and timers, or creating shopping lists. But did you know that app developers, just like those who have created apps for your mobile phone, have now created more than 30,000 Alexa skills? Or that Alexa scientists and engineers are working on machine-learning techniques that will make it easier for you to discover these great skills? (Amazon.com Inc. 2018). There are several tips that businesses can adopt to promote innovation and these will be further discussed in the following section.

2.6 Tips for promoting innovation & creativity in a business

Poor leadership styles, lack of freedom, poor remuneration and a bad image in the market often lead to the creation of an uncondusive environment for innovation and creativity. Innovation flourishes in businesses where the owner-managers provide adequate support towards innovation driven operational practices. It is important for entrepreneurs to be fully knowledgeable of the fact that the fundamental principle of any business innovation practice is that any new idea that is strongly considered to be important, life changing, impactive and or highly innovative must somehow first provide a solution to a problem that already exists in a result-orientated and cost-friendly way. Therefore, one of the most effective ways of promoting an innovation driven culture in a business is through recognizing and appreciating employees who are good-to-great innovators.

Consistent idea generation is key to the success of any business that is innovation centered and well known for innovative ideas in the market. The owner-managers of a small business tend to play a vital role in fostering an innovation culture amongst employees. There are many ways that a small business can use to adopt an innovation-culture in order to promote innovation and creativity in its day-to-day operational activities. Some of the common ways of promoting innovation and creativity in a business are depicted in Figure 2.5 below.

Figure 2.5 Six common ways of promoting innovation & creativity



2.6.1 Applaud every new idea and clearly state ‘there is no foolish idea’

It is important that the entrepreneurs in the organization create an environment that is very receptive to new idea generation by appreciating and congratulating every employee who generates a good idea despite the fact that it is an irrelevant or relevant idea. Entrepreneurs and management must consistently ensure that they strongly emphasize to entrepreneurs that there is no idea that is considered to be foolish and they must freely speak about the ideas that come in their minds.

2.6.2 Identify and write down a list of all the unfulfilled needs in the market

It is critical for the firm to write down on a piece of paper a clear list of all the known unfulfilled needs of customers in the market and when this process is completed the generation of new ideas that may help to solve the previously listed problems (*that is unfulfilled needs of customers in the market*) must commence. Entrepreneurs and management of the firm must consistently see the unfulfilled needs in the market as opportunities for the firm to develop new markets and sales revenue.

2.6.3 Innovation training programs must be designed and adopted

Nowadays many businesses have become innovation centered and they have realized the benefits of idea generation to their success and survival. It is critical that entrepreneurs and management of the business devise in-depth innovation focused training programs they offer to their employees to develop a culture and spirit of innovation driven practices in the business. Researchers have since discovered that top innovators are generally individuals who have a formal education and training in terms of producing relevant and value adding original ideas¹¹²¹¹³¹¹⁴(Chamorro-Premuzic, 2013. The Five Characteristics of Successful Innovators. *Harvard Business Review*, October Issue).

2.6.4 Hiring highly talented employees

A business that has a high intellectual capital base employs highly skilled, experienced, qualified employees. Entrepreneurs who aim to create a conducive workplace that helps to consistently generate innovative ideas must ensure that they create a good employer brand status through offering attractive compensation plans, balanced work/life working schedules, career growth opportunities and so on. Talented job applicants are attracted to businesses that have a good employer brand and that offer them excellent career and training opportunities.

2.6.5 Offering a free and open working environment

Generally high creativity and freedom at the workplace are interrelated thus businesses that offer employees autonomy to work freely at their own pace tend to have a consistent generation of excellent business ideas. Idea generation is greatly hindered by a workplace that is considered to

¹¹² Chamorro-Premuzic, T. (2013) The Five Characteristics of Successful Innovators. *Harvard Business Review*, October Issue.

¹¹³ Martin, Bruce C. & McNally, Jeffrey J. & Kay, Michael J., 2013. "[Examining the formation of human capital in entrepreneurship: A meta-analysis of entrepreneurship education outcomes](#)," *Journal of Business Venturing*, Elsevier, vol. 28(2), pages 211-224.

¹¹⁴ Ideas (2013) *Journal of Business Venturing*. Available from: <https://ideas.repec.org/a/eee/jbvent/v28y2013i2p211-224.html>

be a strict and high work pressure environment. A relaxed and free working environment is the best environment to generate excellent business ideas. For example, most of the highly successful Silicon Valley, California, United States of America high-tech giant firms often have snooker tables, chess boards, video games, gyms, swimming pools and tennis courts at their headquarters premises to help employees who feel that they need to relax and refresh their mind to visit these above mentioned facilities and then later on return to the workplace and produce excellent business ideas.

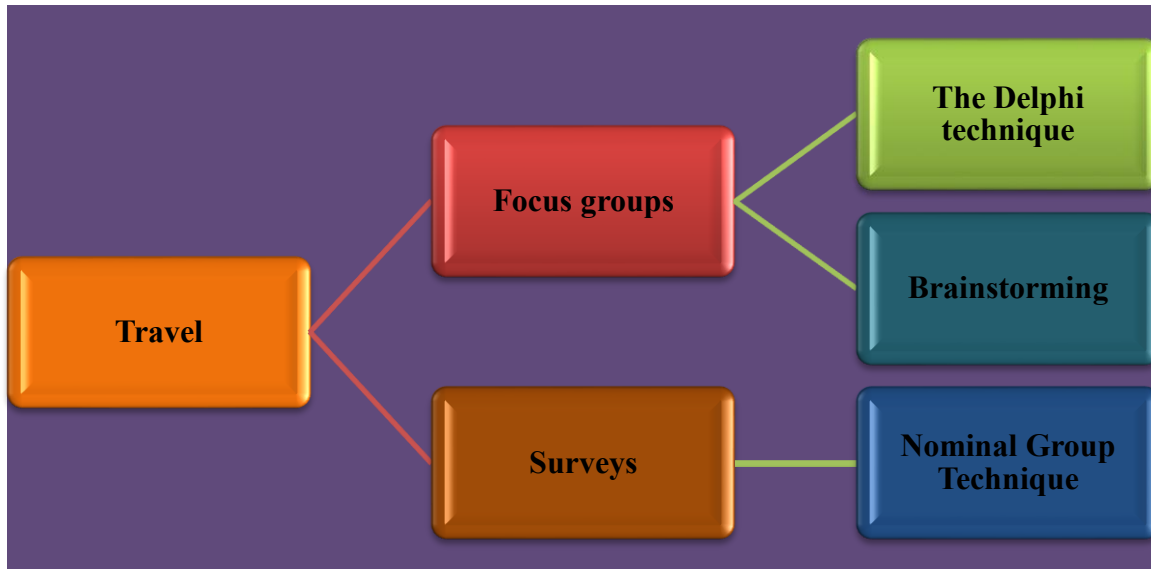
2.6.6 Invest in consistent market research

Businesses that invest adequate funds in their market research activities consistently generate excellent business ideas since it helps them to remain up-to-date with the consistently changing consumer buying behavior trends, everchanging demographic patterns and technological advancements. Therefore, market research helps to identify existing gaps in the marketplace and this can help the business to develop new products or services that can fulfill these existing gaps in the market. There are five common idea generating techniques and these will be further discussed in the following section.

2.7 Five common idea generating techniques

The perpetual life of any type of business is fueled by new idea generation, growth, change and an inspired shared vision. There are several idea generating techniques that can be adopted by small businesses today and these are depicted in Figure 2.6 below.

Figure 2.6 Six idea generating techniques



Source: Modified: (Weinstein, 2018; Association for Qualitative Research, 2018; RAND Corporation, 2020; Sample, 1984)

2.7.1 Travel

As they say, ‘*the writings of a person’s book of life experiences or opportunities can easily be filled-in through travel*’. In essence entrepreneurs who consistently travel within their city, country and foreign countries are more likely to be exposed to numerous unique new ideas and opportunities in general. ¹¹⁵“Traveling opens your eyes to a plethora of potential business ideas” (Weinstein, 2018, www.entrepreneur.com).

2.7.2 Focus groups

“*Focus group* is a term often applied to a group discussion carried out for market research purposes. Participants unknown to each other are brought together, in a particular neutral location, for the specific purpose of discussing an issue, or responding to ideas or materials of interest to the client of the research. The term "focus group" originated in the USA. It is useful to retain a distinction between this and the term more widely used in the UK, “group

¹¹⁵ Weinstein, B. (2004) *10 Greta Ways to Generate Business Ideas*. Available from: <https://www.entrepreneur.com/article/74184>

discussion”¹¹⁶ (Association for Qualitative Research, 2018, www.aqr.org.uk/). For example, a focus group can consist of cancer patients thus they share a common interest of being diagnosed with the same illness. Therefore, a focus group is one way businesses can successfully generate creative and life changing ideas that help to solve a problem in society.

2.7.3 Surveys

One of the effective ways businesses can use to generate new ideas is surveys. In general surveys collect information from research participants through asking them questions that are associated with the research’s main subject topic. Research participants can be customers, community members, industry professionals, government officials, suppliers, employees and so on. There are various methods that can be implemented by a small business and these include the following: (1) telephone surveys, (2) social media surveys (*social network platforms and Internet video conference calling*), (3) interviews (*structured or unstructured interviews that are done face-to-face*), (4) online surveys that are done via the Internet using email and the business’s website, (5) mail surveys (*these involve the posting of questionnaires to the targeted research participants via the post office and usually the firm provides return envelopes and stamps to offer convenience and ensure that feedback is provided*), (6) questionnaire surveys (*generally a questionnaire can be made up of both ‘open ended’ and ‘closed ended’ questions*), (7) paid surveys (*these are surveys where research participants are paid for contributing towards the research*), (8) mobile surveys (*Mobile surveys use short message service/‘SMS’ texts to communicate with research participants and the entrepreneur can also receive both written ‘texts’ and verbal ‘mobile phone call’ feedback as well*). It can be summarized that the feedback that is provided by the research participants helps to generate new ideas since some of the answers to the questions that are asked during the survey can actually be the solution of the problem at hand the firm is searching for.

¹¹⁶ Association for Qualitative Research (2018) *Focus Group*. Available from: <https://www.aqr.org.uk/glossary/focus-group>

2.7.4 The Delphi technique

““RAND developed the Delphi method in the 1950s, originally to forecast the impact of technology on warfare. The method entails a group of experts who anonymously reply to questionnaires and subsequently receive feedback in the form of a statistical representation of the “group response”, after which the process repeats itself. The goal is to reduce the range of responses and arrive at something closer to expert consensus. The Delphi Method has been widely adopted and is still in use today””¹¹⁷ (RAND Corporation, Santa Monica, CA, 2020, www.rand.org). Good business, product or service ideas are some of the positive outcomes of the Delphi technique.

2.7.5 Brainstorming

Today the term ‘brainstorming’ has become the generic term for sessions that are held with the main aim of producing innovative new ideas and this term was developed by [Alex Osborn](#) an advertising executive during the 1950s. Alex Osborn set a few standard rules that must be adhered to during the brainstorming sessions (*that is when people gather to generate ideas*) and these were: “Toss out as many ideas as possible. Don’t worry if they’re too crazy. Build on the ideas people generate. Don’t criticize initially”¹¹⁸ ¹¹⁹(Markman, 2017. *Your Team Is Brainstorming All Wrong. Harvard Business Review, May Issue*). The brainstorming technique is the most popular idea generation technique. According to the Government of Western Australia Department of Primary Industries and Regional Development (2017) sometimes it can be difficult to start thinking about how to go about achieving a goal or solving a problem. Brainstorming is a quick way to generate lots of ideas and possibilities. One of the strengths of this tool is that it stimulates creative, unconstrained thinking. This can help us think about new

¹¹⁷ RAND Corporation, Santa Monica, CA (2020) *Delphi Method*. Available from: <https://www.rand.org/topics/delphi-method.html> [Accessed February 09, 2020] “*Rerprinted with permission*”.

¹¹⁸ Markman, 2017. *Your Team Is Brainstorming All Wrong. Harvard Business Review, May Issue*

¹¹⁹ Osborn, A.F. (1979) *Applied Imagination: Principles and Procedures of Creative Thinking*. Charles Scribner's Sons. 3rd Edition. ISBN-10: 0684162563. Available from: <https://www.amazon.com/Applied-Imagination-Principles-Procedures-Creative/dp/0684162563/>

and different ways of doing things. Brainstorming can be used in groups or by individuals. Business teams can use it to share and build on each other's ideas. *Brainstorming in a group*. For effective group brainstorming someone needs to set up and lead the session. This person encourages people to participate and helps them to follow the rules¹²⁰. The rules of brainstorming are:

- stay focused on the goal
- come up with as many ideas as you can
- any idea is acceptable
- there is no criticism of people's ideas or comparing of ideas
- build on other people's thinking and combine ideas
- one person speaks at a time
- comments need to be quick and to the point.

Preparing for the brainstorming session

- Define the goal or problem you will focus on.
- Choose the people to be involved. It is good to have a mix of people, for example, those with practical experience, specialists and creative thinkers. Involving people who have different perspectives makes the brainstorming more productive.
- Set up a comfortable environment where people can sit and see each other and a whiteboard or flipchart.

¹²⁰ Government of Western Australia Department of Primary Industries and Regional Development (2017) *Improvement Tools: Brainstorming*. Available from: <https://www.agric.wa.gov.au/improvement-tools-brainstorming-0> Copyright © Western Australian Agriculture Authority, 2013–2018 [Accessed 2020, 27 February]

- Make sure everyone has a pen and paper.
- Include someone who can accurately, neatly and quickly write the thinking on the flip chart using marker pens¹²¹.

Running the brainstorming session

- 1) Explain the purpose of the session. Make sure people understand the goal.
- 2) Ask everyone to take five minutes to work on their own and write down all the ideas they have for achieving the goal.
- 3) Each person in turn reads out one idea. These are written on the flipchart. Keep going from person to person until all of the initial ideas have been recorded.
- 4) While this is happening, people listen to what others are saying. Encourage them to build on ideas. This could mean combining two ideas to come up with a new one.
- 5) When all the initial ideas have been recorded, see if any more ideas have been stimulated. Give people time to think because it can take a while for more ideas to start to flow.
- 6) When the extra ideas have been recorded review the full list. Make sure everyone understands all the ideas. This is about checking that people understand. It is not about discussing or judging the ideas.
- 7) Once people understand the ideas, similar ones can be grouped as long as everyone agrees.
- 8) After the brainstorming session the ideas can be assessed and prioritised in relation to their impact on the goal.

¹²¹ Government of Western Australia Department of Primary Industries and Regional Development (2017) *Improvement Tools: Brainstorming*. Available from: <https://www.agric.wa.gov.au/improvement-tools-brainstorming-0> Copyright © Western Australian Agriculture Authority, 2013–2018 [Accessed 2020, 27 February] ©Government of Western Australia & © Commonwealth of Australia 2020.

Tools to use with brainstorming

Use the [SMARTT goal tool](#) to clarify the goal you will be focusing on during the brainstorming. The [Impact and influence tool](#), [Eight criteria technique](#) and [gross margin analysis](#) can help to assess and prioritise the ideas. [Inverse thinking](#) is a type of brainstorming where you think about how not to achieve a goal. This then informs how you could achieve it. Tools like Inverse thinking, free writing, word association and mind maps can be used to stimulate thinking in personal brainstorming (Government of Western Australia Department of Primary Industries and Regional Development, 2017, <https://www.agric.wa.gov.au/>).

2.7.6 Nominal Group Technique (NGT)

One of the many idea generation techniques used by businesses nowadays to generate ideas is the Nominal Group Technique (NGT).¹²² According to a journal paper published in the *Journal of Extension Vol 22(2)* titled: *Nominal Group Technique: An Alternative to Brainstorming* by Sample, J. (1984) a possible alternative to brain storming is NGT. This technique was originally developed by Delbecq and VandeVen¹²³ and has been applied to adult education program planning by Vedros¹²⁴. This technique is a structured variation of small group discussion methods. The process prevents the domination of discussion by a single person, encourages the more passive group members to participate, and results in a set of prioritized solutions or recommendations. The steps to follow in NGT are:

¹²² Sample, J. (1984) Nominal Group Technique: An Alternative to Brainstorming. *Journal of Extension Vol 22(2)*. Copyright © by Extension Journal, Inc. ISSN 1077-5315. Journal Editorial Office, joe-ed@joe.org

¹²³ Delbecq, A. L. and VandeVen, A. H. (1971) "A Group Process Model for Problem Identification and Program Planning," *Journal Of Applied Behavioral Science VII* (July/August, 1971), 466 -91

¹²⁴ Vedros, K. R. (1979) "*The Nominal Group Technique is a Participatory, Planning Method In Adult Education*". (Ph.D. dissertation, Florida State University, Tallahassee, 1979)

1. Divide the people present into small groups of 5 or 6 members, preferably seated around a table.
2. State an open-ended question ("What are some of the ways we could encourage participants to car pool?").
3. Have each Person spend several minutes in silence individually brainstorming all the possible ideas and jotting these ideas down.
4. Have the groups, collect the ideas by sharing them roundrobin fashion (one response per person each time), while all are recorded in key term, on a flipchart. No criticism is allowed, but clarification in response to questions is encouraged.
5. Have each person evaluate the ideas and individually and anonymously vote for the best ones (for example, the best idea gets Points, next best 4 Points, etc).
6. Share votes within the group and tabulate. A group report is prepared, showing the ideas receiving the most points.
7. Allow time for brief group presentations on their solutions.

NGT is no exception. Some of the obvious advantages are that voting is anonymous, there are opportunities for equal participation of group members and distractions (communication "noise") inherent in other group methods are minimized (Sample, 1984). The theory of disruptive innovation will be covered in the following section.

2.8 Disruptive innovation

Numerous organizations around the world have successfully enhanced their businesses through implementing disruptive innovation.¹²⁵¹²⁶ According to Christensen, Raynor and McDonald

¹²⁵ Christensen, C.M, Raynor, M.E. and McDonald, R., 2015. What Is Disruptive Innovation. *Harvard Business Review*, December Issue

¹²⁶ Bower, J. L. and Christensen, C.M. (1995) Disruptive Technologies: Catching the Wave. *Business Review*, January-February Issue.

(2015) What Is Disruptive Innovation. *Harvard Business Review*, December Issue, the theory of disruptive innovation, [introduced in these pages in 1995](#), has proved to be a powerful way of thinking about innovation-driven growth. Many leaders of small, entrepreneurial companies praise it as their guiding star; so do many executives at large, well-established organizations. First, a quick recap of the idea: “Disruption” describes a process whereby a smaller company with fewer resources is able to successfully challenge established incumbent businesses. Specifically, as incumbents focus on improving their products and services for their most demanding (*and usually most profitable*) customers, they exceed the needs of some segments and ignore the needs of others. Entrants that prove disruptive begin by successfully targeting those overlooked segments, gaining a foothold by delivering more-suitable functionality—frequently at a lower price. Incumbents, chasing higher profitability in more-demanding segments, tend not to respond vigorously. Entrants then move upmarket, delivering the performance that incumbents’ mainstream customers require, while preserving the advantages that drove their early success. When mainstream customers start adopting the entrants’ offerings in volume, disruption has occurred. Disruptive innovations originate in low-end or new-market footholds. Disruptive innovations are made possible because they get started in two types of markets that incumbents overlook. *Low-end footholds* exist because incumbents typically try to provide their most profitable and demanding customers with ever-improving products and services, and they pay less attention to less-demanding customers. In fact, incumbents’ offerings often overshoot the performance requirements of the latter. This opens the door to a disrupter focused (at first) on providing those low-end customers with a “good enough” product. In the case of *new-market footholds*, disrupters create a market where none existed. Put simply, they find a way to turn nonconsumers into consumers. Disruption theory differentiates disruptive innovations from what are called “sustaining innovations.” The latter make good products better in the eyes of an incumbent’s existing customers: the fifth blade in a razor, the clearer TV picture, better mobile phone reception. These improvements can be incremental advances or major breakthroughs, but they all enable firms to sell more products to their most profitable customers. Disruptive innovations, on the other hand, are initially considered inferior by most of an incumbent’s customers. Typically, customers are not willing to switch to the new offering merely because it is

less expensive. Instead, they wait until its quality rises enough to satisfy them¹²⁷ (Christensen, C.M, Raynor, M.E. and McDonald, R., 2015. What Is Disruptive Innovation. *Harvard Business Review, December Issue*). A clear discussion of how business enterprise merges with agility will be covered in the following section.

2.9 The way in which a business enterprise merges with agility

“*Business agility* is the ability of a business to realize and sustain its full potential both in terms of its profits and its people, regardless of internal or external environment changes. We define business agility as an emergent property demonstrated by organizations who have four essential capabilities:

- Deliver Fast and Responsively (*Delivery Agility*)
- Innovate and Disrupt (*Product Innovation*)
- Adapt Organization and Culture (*Organizational Adaptability*)
- Lead through Complexity (*Leadership Effectiveness*)

Business agility enables organizations to innovate and deliver more effectively, thus turning market disruption into competitive advantage, while thriving in complex environments. An organization that has attained business agility is able to adapt their structures to rapidly deliver products or services, innovate beyond market changes, and grow leaders that can effectively support all of this across even large and complex businesses. *Examples of Business Agility mindsets in the real world*. Finding Agile in the real world is easy for most: go to any software company and ask to see their development team – chances are, they have converged on an Agile hybrid working process. It is becoming just as easy to find evidence of business agility in the real world. It becomes palpable first in the growing number of voices calling to overhaul, reimagine and evolve the rest of the business so it too can benefit from Agile mindsets. When businesses have integrated agility into their everyday work, they are able to look to the future, to build a

¹²⁷ Christensen, C.M, Raynor, M.E. and McDonald, R., 2015. What Is Disruptive Innovation. *Harvard Business Review, December Issue*.

strong capability of sensing and responding to change, and to drive disruption – to become disruptors before they can be disrupted. This takes concerted efforts from leadership and supporting functions, like HR, portfolio and budgeting and more”¹²⁸ (Accenture-Solutions IQ, 2020, www.solutionsiq.com). *Business enterprise agility* is when a business system has a reactive capability to any form of change through adjusting its initial stable configuration.¹²⁹¹³⁰¹³¹¹³²(Leybourn, 2013; Wieland and Wallenburg, 2012 cited in Wikipedia, 2018 cited in Imagination.com.au, 2017, www.imagination.com.au) (Wikipedia, 2018. This article uses material from the Wikipedia article **Business Agility**, https://en.wikipedia.org/wiki/Business_agility which is released under the Creative Commons Attribution-ShareAlike 3.0 Unported License (view authors).¹³³ According to Imagination.com.au (2017) innovation results as a *COLLISION* between different perspectives and to break habitual thought patterns and result in an explosion of creativity that leads to innovative ideas and solutions! The key collision being between “necessity” because necessity is the mother of all invention and innovation and highest “possibility” thought patterns. This creates the “why” for being innovative and the power of this intrinsic motivation can then be defined as the passionate purpose for innovation. Without a clear, compelling and courageous “why” and passionate purpose for innovation, people will seldom leave their comfort zones to be, think and do things differently, which is what innovation requires to be successful and sustainable (Imagination.com.au, 2017, www.imagination.com.au). ““Agility merges with

¹²⁸ Accenture-Solutions IQ (2019) *What is Business Agility*. Available from:

<https://www.solutionsiq.com/resource/blog-post/what-is-business-agility/>

¹²⁹ Imagination.com (2017) *Innovate Eco-systems*. Available from:

<http://www.imagination.com.au/tag/innovative-eco-systems/>

¹³⁰ Wikipedia, 2018. This article uses material from the Wikipedia article **Business Agility**,

https://en.wikipedia.org/wiki/Business_agility which is released under the Creative Commons Attribution-ShareAlike 3.0 Unported License (view authors)

¹³¹ Leybourn, Evan (2013) *Directing the Agile Organisation: A Lean Approach to Business Management*. IT Governance Publishing. ISBN 978-1-849-28491-2

¹³² Wieland, A. and Wallenburg, C.M. (2012) Dealing with supply chain risks: Linking risk management practices and strategies to performance. *International Journal of Physical Distribution & Logistics Management*, 42(10)

¹³³ Imagination.com.au (2016) *8 Reasons Why Innovation is Important to Businesses Today*. Available from:

<http://www.imagination.com.au/innovation-blog/8-reasons-innovation-important-businesses-today/>

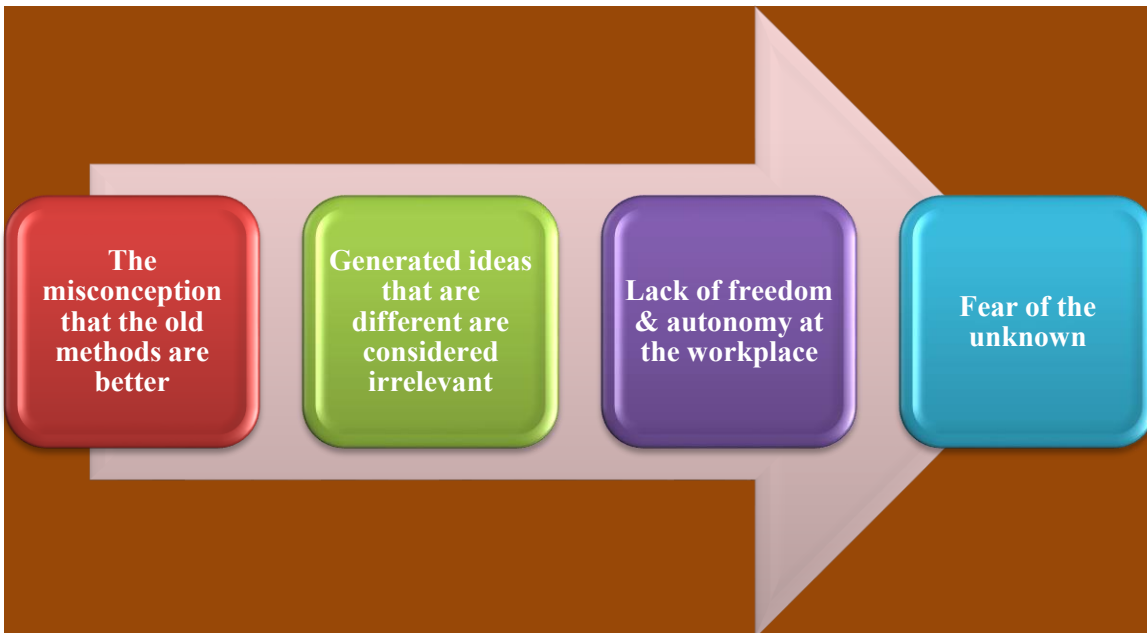
innovation when we apply the collision “both” as a way of intentionally shifting our way of being, thinking and doing “and” taking a strategic, systemic and end to end approach to discovering, designing and delivering the change or innovation strategy. Where people;

- Quickly embrace, respond, adapt to, and safely deal effectively with change,
- Self regulate their complacency and unconscious resistances to change.
- Feel confident and empowered to take smart and courageous risks.
- Permit, encourage and enable people to rock the ‘business as usual’ boat and safely disrupt their comfort zones.
- Collaborate and connect, are curious and inquisitive and generatively see, respond to and solve problems.
- Create an energetic environment that cultivates their purposefulness, creativity and wellness”” (Imagination.com.au, 2017, www.imagination.com.au). There are various causes of idea generation failure in small businesses and this will be covered in the next section.

2.10 Causes of idea generation failure in small businesses

Interestingly, the smaller the size of a business the more appetite it has for growth and one way to easily grow a business is through being innovation centered. It is now inevitable for a business to prosper without adopting transformative innovation practices and culture. Researchers have identified numerous reasons why small businesses fail to generate ideas and one of the main reason is the ‘lack of capital’ which also causes a ripple effect of making the business fail to afford to hire talented employees who can to help boost the intellectual capital and the innovative ideas of the business. In addition idea generation fails in most small businesses as a result of various reasons and some of these reasons are depicted in Figure 2.7 below.

Figure 2.7 Reasons why idea generation fails in small businesses



2.10.1 The misconception that the old successful methods are better

Surprisingly, there are still some businesses that strongly believe that old habits are better than learning new habits therefore such businesses often believe that a system or process that succeeded 10 or 20 years ago will continue to work for the next 20 or more years. This misconception is wrong due to the rapidly changing modern day global business environment which now requires businesses to be highly innovative and creative to keep up with the consistently changing trends or patterns in the market to avoid operating at a loss or closing down operations.

2.10.2 Generated ideas that are different are considered irrelevant

In some businesses during the idea generating sessions new ideas that seem to be out of the ordinary are considered to be irrelevant and a complete waste of time for the group to properly analyse. Therefore in the process of eliminating these different new ideas the business automatically loses its innovativeness approach and it fails to generate new value adding ideas.

2.10.3 Lack of freedom & autonomy

As identified earlier on in this chapter that creative people prefer to work for businesses that offer them freedom and autonomy. A workplace that places more emphasis on strict controls and regular monitoring of employees is more likely to have a reduced number of new ideas than a workplace that offers freedom and autonomy.

2.10.4 Fear of the unknown

Change involves the transformation or a shift of the way things are done in a business so that much more efficient and effective methods can be adopted to easily attain improvement. In some of the small businesses entrepreneurs fear the unknown that is they do not want to take bold steps to accept new ideas and execute them to fulfill the identified opportunities. Entrepreneurs who fear the unknown are often resistant to change and therefore during idea generation sessions they tend to dictate the ideas they think are suitable for their business in most instances they opt to choose old ways of doing things. This is one of the causes of idea generation techniques in small businesses. The strategies that a business can use to develop a competitive advantage will be discussed in the following section.

2.11 How to create a competitive advantage

Globalization is both the new ‘trouble maker’ (*it has led to the creation of new competition*) and ‘play maker’ (*it has led to the creation of new foreign markets*) for most of the businesses across the world. Strategic management has become a necessary tool to use to develop effective competitive advantages for small businesses nowadays.¹³⁴¹³⁵ “*What is a Competitive Advantage?*” A competitive advantage is an attribute that enables a company to outperform its competitors. This allows a company to achieve superior **margins** compared to its competition and

¹³⁴ Corporate Finance Institute (2020) *What is a Competitive Advantage?* Available from: <https://corporatefinanceinstitute.com/resources/knowledge/strategy/competitive-advantage/> [Available from: October 02, 2020]

¹³⁵ Corporate Finance Institute (2020) *Operating Margin*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/accounting/operating-margin/> [Available from: October 02, 2020]

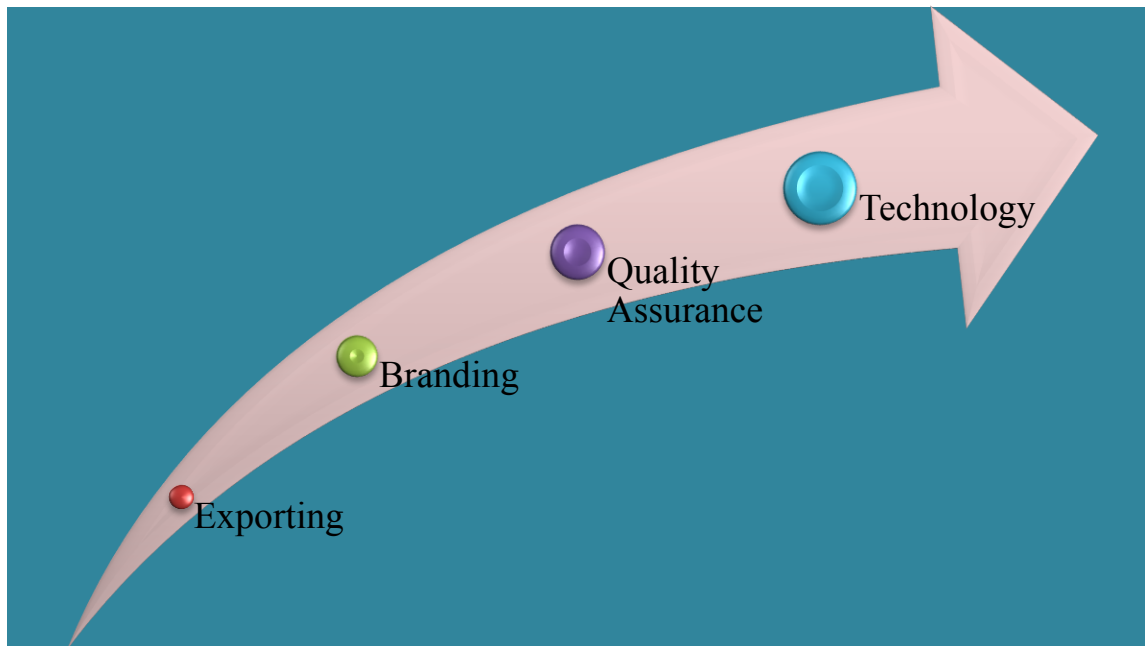
generates value for the company and its shareholders. A competitive advantage must be difficult, if not impossible, to duplicate. If it is easily copied or imitated, it is not considered a competitive advantage. *Examples of Competitive Advantage*

1. Access to natural resources that are restricted from competitors
2. Highly skilled labor
3. A unique geographic location
4. Access to new or proprietary technology
5. Ability to manufacture products at the lowest cost
6. Brand image recognition¹³⁶¹³⁷ (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>). The additional ways a small business can gain a competitive advantage are depicted in Figure 2.8 below and then later on discussed in detail.

¹³⁶ Corporate Finance Institute (2020) *What is Value Added*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/finance/what-is-value-added/> [Available from: October 02, 2020]

¹³⁷ Corporate Finance Institute (2020) *Intangible Assets*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/accounting/intangible-assets/> [Available from: October 02, 2020]

Figure 2.8 Four additional ways of gaining a competitive advantage



Source: Modified: (Michael. E. Porter, 1985; European Commission, 2018; Ferrell and Hirt, 2002:330; Government of Canada Innovation, Science and Economic Development Canada, 2016).

2.11.1 Technology

A competitive advantage can even be a technology the business can provide as a benefit to its customers. For example, a micro-finance company located in the magnificent city of Toronto in Canada (*North America*) can use biometric security technology in its banking halls which can be a unique technology it possesses over its competitors who still use manual security clearing systems that are susceptible to frequent human errors. ¹³⁸“Information technology is permeating the value chain at every point, transforming the way value activities are performed and the nature of the linkages among them. It also is affecting the competitive scope and reshaping the way products meet buyer needs. These basic effects explain why information technology has acquired

¹³⁸ Michael. E. Porter, 1985. How Information Gives You Competitive Advantage. *Harvard Business Review*, July Issue.

strategic significance and is different from the many other technologies businesses use. Every value activity creates and uses information of some kind. A service activity uses information about service requests to schedule calls and order parts, and generates information on product failures that a company can use to revise product designs and manufacturing methods” (Michael. E. Porter, 1985. How Information Gives You Competitive Advantage. *Harvard Business Review*, July Issue).

2.11.2 Quality assurance

Small businesses can gain a competitive advantage through quality management. *Quality assurance* is a process that is used by organizations or trading blocs (such as the European Commission) to enforce quality control standards by applying the planned, systematic quality activities and working to improve the processes that are used in producing goods or services¹³⁹ (European Commission, 2018). In addition quality assurance is one definite way an organization or trading bloc can use to reduce the number of errors or defects commonly found in manufactured goods or services. Quality is one of the ways organizations can use to gain a profitable competitive advantage for a much longer time period. “*Quality*, from a technical point of view, is a concept associated to different fields and requirements that products must meet according to specifications and comply with consumers expectations” (European Commission, 2011:15). It is important to note that there are two categories of quality and these include: (1) *product quality* varies due to the fact that it is based on the customers needs or wants and it encompasses aspects such as product design, features, durability, performance and so on (2) *process quality* aims to produce products/services that have minimal defects or faults (Davis *et al.*, 2000:34).¹⁴⁰“*Quality control* involves the formal and systematic use of testing to measure the achievements of specified standards and recommendations; the measurement and enforcement of defined levels of standards” (European Commission, 2018). A small business can make itself reliable and different in the market by adopting and implementing expert approved and

¹³⁹ European Commission (2018) *Quality Assurance*. Available from:

http://ec.europa.eu/ipg/quality_control/index_en.htm

¹⁴⁰ European Commission (2018) *Agricultural Quality Standards in European Union (EU) How they Fit into a Broader Framework*. Available from:

<https://pdfs.semanticscholar.org/presentation/8377/5471d8e34a9be4356215bfd90992f6620370.pdf> p15.

accredited quality standards from international quality standard organizations. ¹⁴¹“International Standards mean that consumers can have confidence that their products are safe, reliable and of good quality. ISO's standards on road safety, toy safety and secure medical packaging are just a few of those that help make the world a safer place” (International Organization for Standardization, 2018).

Nowadays one of the easiest ways a small business can acquire quality assurance and confidence of its customers is through being accredited by international quality standards organizations such as the Geneva, Switzerland-based International Organization for Standardization (*ISO*). According to ISO (2018) the ISO story began in 1946 when delegates from 25 countries met at the Institute of Civil Engineers in London and decided to create a new international organization ‘to facilitate the international coordination and unification of industrial standards’. On 23 February 1947 the new organization, ISO, officially began operations. Because 'International Organization for Standardization' would have different acronyms in different languages (IOS in English, OIN in French for *Organisation internationale de normalisation*), our founders decided to give it the short form ISO. ISO is derived from the Greek isos, meaning equal. Whatever the country, whatever the language, we are always ISO. ISO has published 22205 [International Standards](#) and related documents, covering almost every industry, from technology, to food safety, to agriculture and healthcare. ISO International Standards impact everyone, everywhere. ISO is an independent, non-governmental international organization with a membership of 161 [national standards bodies](#). Today we have [members](#) from 161 countries and 780 [technical committees and subcommittees](#) to take care of standards development. More than 135 people work full time for ISO’s Central Secretariat in Geneva, Switzerland (International Organization for Standardization, 2018). Additional benefits that can be enjoyed by ISO Accredited small businesses are many. “Through its members, it brings together experts to share knowledge and develop voluntary, consensus-based, market relevant International Standards that support innovation and provide solutions to global challenges. International Standards make things work. They give world-class specifications for products, services and systems, to ensure quality, safety and efficiency. They are instrumental in facilitating international trade” (International

¹⁴¹ International Organization of Standardization (2018) *About ISO*. Available from: <https://www.iso.org/about-us.html>

Organization for Standardization, 2018). ISO currently offers numerous advantages to its small-medium-enterprises (*SMEs*) to achieve higher quality standards which later lead to increased customer loyalty, brand value and sales. ¹⁴²“According to ISO (2018) International Standards help businesses of any size and sector to reduce costs, increase productivity and access new markets. For small to medium sized enterprises (*SMEs*), standards can help to:

- Build customer confidence that your products are safe and reliable
- Meet regulation requirements, at a lower cost
- Reduce costs across all aspects of your business
- Gain market access across the world” (International Organization for Standardization, 2018).

Quality assurance is one way small businesses can succeed in the global marketplace against large corporations as they can offer high quality products and avoid business failure through achieving a competitive edge over rivals. Another example of the importance of quality assurance is that in countries such as the United Kingdom and the European Union Member States businesses that export their wood packaging products there must ensure that they comply to the International Standards For Phytosanitary Measures No. 15 (*ISPM 15*). ¹⁴³According to the United Kingdom Forestry Commission (2017:7) wood packaging material entering the EU from all countries with the exception of Switzerland, whether or not actually in use in the transport of objects of all kinds, must be ISPM15 compliant. Wood packaging material which is subject to these measures include packing cases, boxes, cases, crates, drums and similar packings, pallets, box pallets and other load boards, and pallet collars. The exception is associated controlled

¹⁴² International Organization of Standardization (2018) *ISO and SMEs*. Available from: <https://www.iso.org/iso-and-smes.html>

¹⁴³ United Kingdom Government Forestry Commission (2017) *Importing Wood, Wood Products and Bark Requirements for Landing Controlled Material into Great Britain from Non-EU Countries*. Available from: [https://www.forestry.gov.uk/pdf/FCPH001.pdf/\\$FILE/FCPH001.pdf](https://www.forestry.gov.uk/pdf/FCPH001.pdf/$FILE/FCPH001.pdf) [Accessed 2018, 19 July] p7-32. © United Kingdom Government Forestry Commission, 2017. This information is licensed under the Open Government Licence v3.0. To view this licence, visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/> OGL v3.0

dunnage such as bearers, stickers and spacers consigned with regulated packs of wood (see Table A1.20 for details). Associated controlled dunnage means wood which supports a consignment of wood of a genus or species specified in tables A1.1–A1.8 and A1.14 in Appendix 1 and which: a. is constructed from wood of the same type and quality as the wood in the consignment; and b. meets the same EU phytosanitary requirements as the wood in the consignment (United Kingdom Government Forestry Commission, 2017:7).

2.11.3 Branding

Another way small businesses can obtain a competitive advantage is through branding. *Branding* is whereby the products/services of the business are given names and properly identified so that they differ from competitors products in the market place¹⁴⁴ (Ferrell and Hirt, 2002:330). Examples of some of the leading brand names include: Microsoft, LinkedIn, Twitter, Google and so on. *“Used with permission from Microsoft”. [Entrepreneurship & Business Innovation: A North America, Europe, Africa, Oceania & Asia 21st Century Perspective 1st Edition] is an independent [publication] and is neither affiliated with, nor authorized, sponsored, or approved by, Microsoft Corporation. “TWITTER, TWEET, RETWEET and the Twitter logo are trademarks of Twitter, Inc. or its affiliates.” ©2017 Google LLC, used with permission. Google and the Google logo are registered trademarks of Google LLC.* Brand names can be both written and verbally communicated to customers as they include words. In general brand names that are well known for their high quality, durability, consistent innovations, ultimate performance, flexibility, robustness, classic style and so on tend to gain a competitive advantage and high profit margins for the business (Ferrell and Hirt, 2002:330). The value of a brand now plays a significant role in determining the overall networth of a business and its brand(s) in terms of: its positioning in the market place, demand or sales revenue, capability to develop customer loyalty, appeal, elegance and so on. It can therefore be concluded that branding is one definite way a firm can use to achieve a profitable competitive advantage.

¹⁴⁴ Ferrell, O.C. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p20 - 428.

2.11.4 Exporting

One of the simpler ways small businesses can use to achieve a competitive advantage is the exporting of goods/services to foreign markets. Many businesses establish new markets when they begin to supply foreign companies with their products/services and by doing so they begin to contribute to the international trade statistics of their home country (Ferrell and Hirt, 2002:96). “In 2013, Canada exported goods totalling \$420 billion, of which \$106 billion (25.2 percent) was exported by SMEs. In 2014, 73,000 SMEs (11.8 percent) exported goods and services” (Government of Canada Innovation, Science and Economic Development Canada, 2016:vii. “*Reproduced with the permission of the Minister of Industry, 2018*”)¹⁴⁵. During time periods of economic recessions small businesses often generate low sales revenue and those that export into foreign markets tend to offset their domestic losses with their export markets foreign currency sales revenues therefore exporting businesses have a competitive advantage over non-exporting businesses.

2.12 Conclusion

Innovation is now the key to success and small businesses that adapt an innovation driven culture continuously improve their products or services. Creativity is usually generated by people who have a great sense of imagination. The most popular idea generating techniques that are used by firms nowadays are brainstorming, focus groups and surveys. Ineffective business leadership can stiffen idea generation processes of small businesses since employees need to be guided and continuously inspired by their management to produce brilliant ideas. In a nutshell globalization has intensified the need for small businesses to differentiate themselves in the marketplace. Exporting, technology, market niching and branding are strategies entrepreneurs can use to develop competitive advantages.

¹⁴⁵ Government of Canada Innovation, Science and Economic Development Canada (2016) *Key Small Business Statistics*. Available from: [https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf/\\$file/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf](https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf/$file/KSBS-PSRPE_June-Juin_2016_eng-V2.pdf) “Reproduced with the permission of the Minister of Industry, 2018”).

2.13 Discussion questions

1. Define innovation and creativity? Explain the strategies an organization can use to encourage idea generation?
2. Describe five idea generating techniques? Explain the tips businesses can follow to achieve good idea generation?
3. Explain why small businesses fail in idea generation?
4. Define a competitive advantage and explain in detail the different ways small businesses can gain a competitive advantage?
5. Describe the importance of exporting and branding giving relevant examples?

Chapter 3: Forms of business ownership & the legal foundations of business law

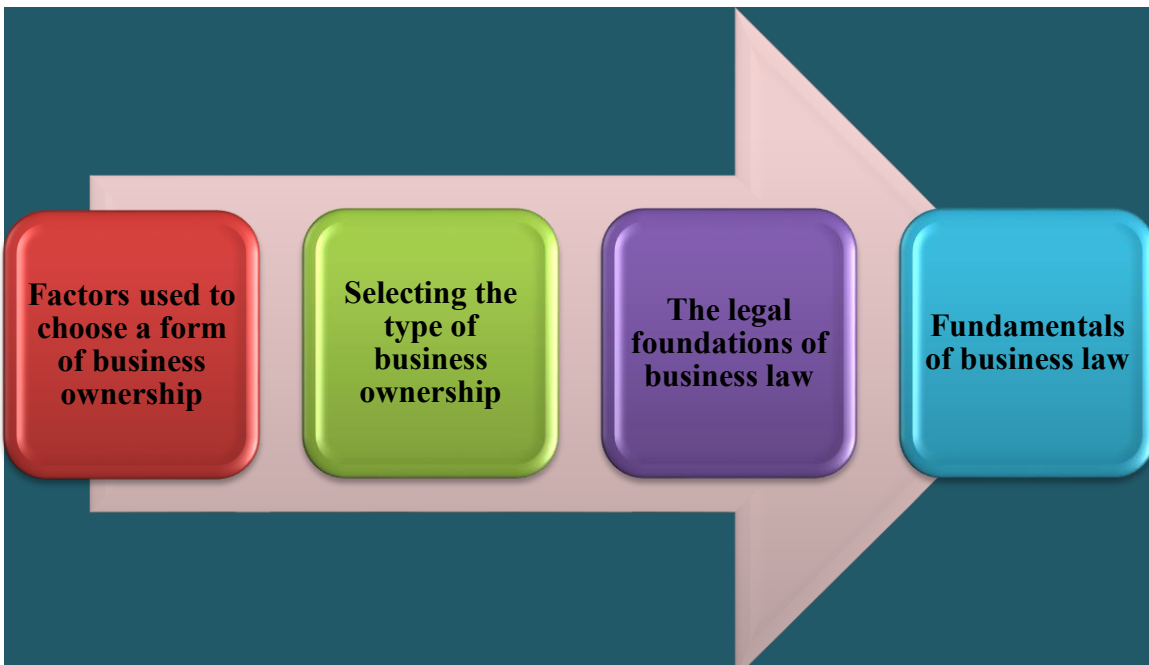
After studying this chapter you should be able to:

- Describe the legal factors that are used to choose a form of business ownership.
- Outline the advantages and disadvantages of each form of business ownership.
- Describe when entrepreneurs should select a type of business ownership.
- Identify the legal foundations of business law.
- Outline the two classifications of law.
- Explain the fundamentals of business law.

3.1 Introduction

Every single day thousands of new businesses are being established across the world and they all share one thing in common “their contribution to the global economy’s Gross Domestic Product”. One of the many important decisions that entrepreneurs must make when they are still preparing to start their proposed new business venture is ‘choosing the type of business ownership’. The decision to choose a specific type of business ownership can either benefit the new business and or negatively affect it in the future. Generally various aspects must be taken into consideration by the entrepreneur before making that critical decision and such decisions are influenced by the following aspects: the cost of registering the business, tax rates for each type of business ownership, the size of the intended business operation, the financial capital that is available and the ownership structure of each type of business ownership. Generally when entrepreneurs are starting their new businesses they should ensure that they choose the appropriate form of ownership that meets both their short or long term specific business needs. Every entrepreneur has his or her personal goals when starting a business and they are various factors that influence their decision to choose a type of business ownership. Furthermore, it is critical for entrepreneurs to understand the elements of each type of business ownership, their distinctive advantages and disadvantages. The sub-components of choosing a form of business ownership and the legal foundations of business law that will be covered in this chapter are depicted in Figure 3.1 below.

Figure 3.1 Four sub-components of choosing a form of business ownership and the legal foundations of business law

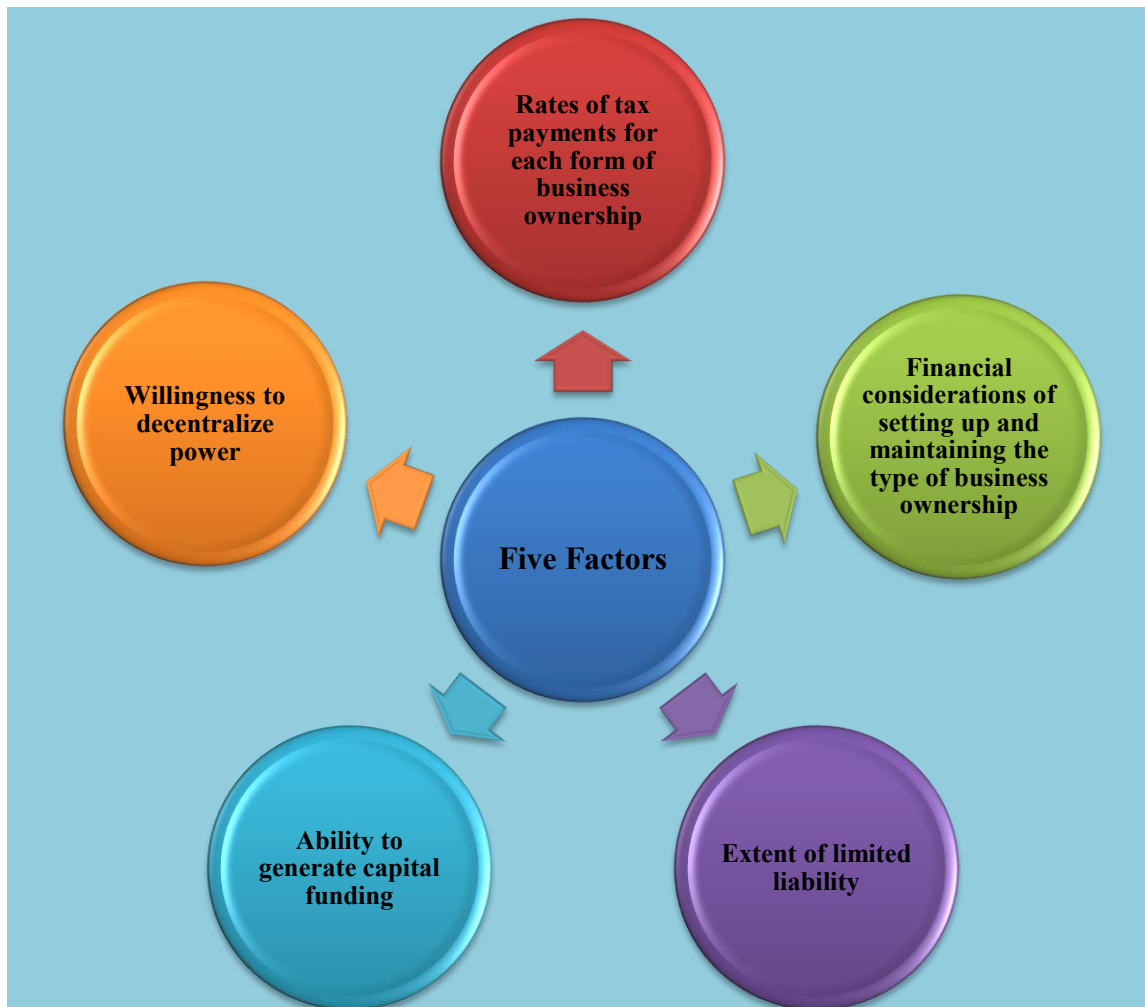


There are various factors that entrepreneurs need to consider when they are choosing a type of business ownership and these will be covered in the following section.

3.2 Factors used to choose a form of business ownership

People generally start their business for different reasons thus every entrepreneur has his or her personal goals they aim to achieve when starting a business. There are various factors that influence their decision to choose a type of business. The factors that influence business ownership are many and these are depicted in Figure 3.2 below.

Figure 3.2 Five factors used to choose legal forms of business ownership



Source: Modified: (Ferrell and Hirt, 2000:113-128)

3.2.1 Rates of tax payments for each form of business ownership

In general corporations are charged higher tax rates than other forms of business ownerships such as sole proprietorships and partnerships. This factor is one of the main reasons why entrepreneurs make a decision to use a certain form of business ownership¹⁴⁶ (Ferrell and Hirt, 2000:113).

¹⁴⁶ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p13-288.

3.2.2 Financial considerations of setting up and maintaining the selected type of business ownership

It is usually cheaper to start a sole proprietorship or partnership business. But it is more expensive to start a private or public company as they need the owners to pay more registration fees, legal costs for advice and many other costs (Ferrell and Hirt, 2000:113). Public companies generally incur higher operational costs due to their large size and they are also required by law to find independent auditors and accountants to prepare and publish their yearly financial statements. They are also required to submit reports about their shares and bonds to the stock exchange commission and government authorities in the country they trade their shares (Ferrell and Hirt, 2000:127).

3.2.3 Extent of limited liability

In most instances entrepreneurs tend to prefer forms of business ownership that offer them personal limited liability to protect their personal assets in the event of the business incurring excessive financial losses which later on makes the business fail to pay its day-to-day operational costs/debts¹⁴⁷(Ferrell and Hirt, 2000:125). Naturally entrepreneurs take calculated risks thus before starting a business they assess the extent of limited liability of each type of business ownership.

3.2.4 Ability to generate capital funding

Entrepreneurs should evaluate the minimum financial capital requirements needed by each form of business ownership. In general types of business ownerships such as partnerships and corporations have an increased capability of raising more financial capital due to the fact that they have more than one investor as compared to sole proprietorship businesses that only have one source of capital usually the business owner.

¹⁴⁷ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p13-288.

3.2.5 Willingness to decentralize power

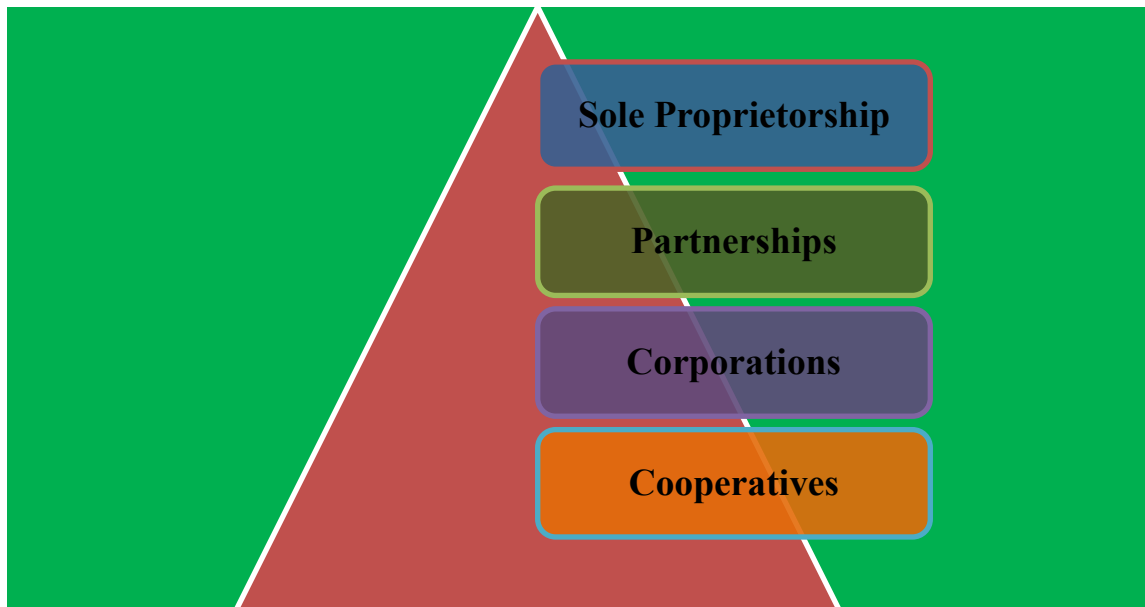
In general sole proprietorships and partnerships naturally have centralized structures of power in the sense that the business owners have enormous decision making and delegating powers in their day-to-day business activities. Entrepreneurs should ensure that they select a form of business ownership that enables them to decentralize their powers. The process of selecting the type of business ownership to use when starting a new business will be discussed in the following section.

3.3 Selecting the appropriate type of business ownership

One of the most critical ingredient that leads to the success of a small business is the choosing of the right type of business ownership by the entrepreneur when preparing to launch their new business. This is due to the fact that each type of business ownership an entrepreneur chooses often helps to determine the following: (1) the various sources of capital the business will have at its disposal, (2) the management expertise it will need, (3) its decision-making effectiveness and so on. It is however important for entrepreneurs to be fully knowledgeable of the fact that each type of business ownership can be changed overtime as the business experiences growth in its operational activities. The different forms of business ownership include: sole proprietorships, partnerships, close corporations, private limited companies and corporations¹⁴⁸ (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”). All these types of business ownerships have their advantages and disadvantages, legal requirements, size and personal qualities. The forms of business ownership will be discussed in detail and they are depicted in Figure 3.3 below.

¹⁴⁸ Government of Canada (2018) *Sole Proprietorship, Partnership, Corporation or Co-operative*. Available from: <https://canadabusiness.ca/starting/before-starting-your-business/corporation-partnership-or-sole-proprietorship/> “*Reproduced with the permission of the Minister of Industry, 2018*”.

Figure 3.3 Four types of business ownership



Source: Modified: (Government of Canada, 2018; Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>; Upcounsel, 2020, www.upcounsel.com/).

3.3.1 Sole proprietorships

“With this type of business organization, you are the sole owner, and fully responsible for all debts and obligations related to your business. All profits are yours to keep. Because you are personally liable, a creditor can make a claim against your personal assets as well as your business assets in order to satisfy any debts”¹⁴⁹ (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”). The sole proprietorship is the most commonly used type of business ownership because it is easy and costs less to launch.

3.3.1.1 Advantages of sole proprietorships

Sole proprietorship businesses due to their size and one owner they have many advantages. According to the Government of Canada (2018) **Advantages:**

¹⁴⁹ Government of Canada (2018) *Sole Proprietorship, Partnership, Corporation or Co-operative*. Available from: <https://canadabusiness.ca/starting/before-starting-your-business/corporation-partnership-or-sole-proprietorship/> “*Reproduced with the permission of the Minister of Industry, 2018*”.

- Easy and inexpensive to register,
- Regulatory burden is generally light,
- You have direct control of decision making,
- Minimal working capital required for start-ups,
- Some tax advantages if your business is not doing well (for example, deducting your losses from your personal income, and a lower tax bracket when profits are low),
- All profits go to you directly¹⁵⁰ (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.3.1.2 Disadvantages of a sole proprietorship

The disadvantages of sole proprietorships are many. According to the Government of Canada (2018) **Disadvantages:**

- Unlimited liability (if you have business debts, claims can be made against your personal assets to pay them off)
- Income is taxable at your personal rate and, if your business is profitable, this could put you in a higher tax bracket
- Lack of continuity for your business if you are unavailable
- Can be difficult to raise capital on your own (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.3.2 Partnerships

Entrepreneurs who lack the necessary management skills, adequate capital, industry experience, personal assets to use as collateral to access loans and fear the risk of losing their invested capital should find a business partner or partners to help them complement their weaknesses mentioned above. “A partnership is a non-incorporated business that is created between two or more people.

¹⁵⁰ Government of Canada (2018) *Sole Proprietorship, Partnership, Corporation or Co-operative*. Available from: <https://canadabusiness.ca/starting/before-starting-your-business/corporation-partnership-or-sole-proprietorship/> “*Reproduced with the permission of the Minister of Industry, 2018*”.

In a partnership, your financial resources are combined with those of your business partner(s), and put into the business. You and your partner(s) would then share in the profits of the business according to any legal agreement you have drawn up. In a **general partnership**, each partner is jointly liable for the debts of the partnership. In a **limited partnership**, a person can contribute to the business without being involved in its operations. A **limited liability partnership** is usually only available to a group of professionals, such as lawyers, accountants or doctors. When establishing a partnership, you should have a partnership agreement in place. This is important because it establishes the terms of the partnership and can help you avoid disputes later on. Hiring a lawyer or other legal professionals to help you draw up a partnership agreement will save you time and protect your interests”¹⁵¹ (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.3.2.3 Advantages of partnerships

The advantages of partnerships are many. According to the Government of Canada (2018)

Advantages:

- Fairly easy and inexpensive to form a partnership
- Start-up costs are shared equally with you and your partner(s)
- Equal share in the management, profits and assets
- Tax advantage — if income from the partnership is low or loses money (you and your partner(s) include your shares of the partnership in your individual tax returns) (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.3.2.4 Disadvantages of partnerships

Partnerships like any other small business have disadvantages. According to the Government of Canada (2018) **Disadvantages:**

¹⁵¹ Government of Canada (2018) *Sole Proprietorship, Partnership, Corporation or Co-operative*. Available from: <https://canadabusiness.ca/starting/before-starting-your-business/corporation-partnership-or-sole-proprietorship/> “*Reproduced with the permission of the Minister of Industry, 2018*”.

- There is no legal difference between you and your business
- Unlimited liability (if you have business debts, personal assets can be used to pay off the debt)
- Can be difficult to find a suitable partner
- Possible development of conflict between you and your partner(s)
- You are held financially responsible for business decisions made by your partner(s); for example, contracts that are broken¹⁵² (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.3.3 Corporations

Large corporations dominate the global business environment nowadays. ¹⁵³“*What is a Corporation? A corporation is a legal entity created by individuals, stockholders, or shareholders, with the purpose of operating for profit. The creation involves a legal process called incorporation where legal documents containing the primary purpose of the business, name and location, and the number of shares and types of stock issued, are drafted. The process of incorporation gives the business entity a distinct feature that protects its owners from being personally liable in the event of a lawsuit or legal claim. A corporation can be created by issuing ownership shares and operating a business for profit, or by not issuing shares but with a membership structure instead and operating as a non-profit business*” (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com/resources/knowledge/finance/what-is-corporation-overview/>). According to the Government of Canada (2018) another type of business structure is a corporation. Incorporation can be done at the federal or provincial/territorial level. When you incorporate your business, it is considered to be a legal entity that is separate from its shareholders. As a shareholder of a corporation, you will not be personally liable for the debts, obligations or acts of the corporation. It is always wise to seek legal advice before incorporating

¹⁵² Government of Canada (2018) *Sole Proprietorship, Partnership, Corporation or Co-operative*. Available from: <https://canadabusiness.ca/starting/before-starting-your-business/corporation-partnership-or-sole-proprietorship/> “*Reproduced with the permission of the Minister of Industry, 2018*”.

¹⁵³ Corporate Finance Institute (2020) *What is a Corporation*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/finance/what-is-corporation-overview/>

(Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”). Corporations can draft legally binding contracts with other corporations or individuals and it can be sued or sue in court as a separate legal entity. There are six types of corporations namely; private corporation, public corporation, subsidiary corporation, holding company, quasi-public corporation and non-profit corporation (Upcounsel, 2020, www.upcounsel.com/; Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>; Ferrell and Hirt, 2000:122). These will be discussed in detail as follows:

3.3.3.1 Private corporation

¹⁵⁴“The *private corporation* definition is a type of corporation in which stock shares are only offered to specific individuals such as employees or investors. While private corporations are quite similar to public corporations, they do have unique benefits and drawbacks. Understanding this business entity can help you determine if it's the right choice for your company. *Private Corporation Overview*. Like a public corporation, a private corporation issues stock and has shareholders. However, it does not issue an initial public offering (IPO) and shares are not traded on public exchanges. Instead, the private corporation is held only by a small investor group and is organized for the profit of these individuals. Private corporations must satisfy the same legal requirements as public corporations” (Upcounsel, 2020, <https://www.upcounsel.com/private-corporation-definition>). Furthermore, according to Upcounsel (2020) *Four main types of private companies* include:

- Sole proprietorships, in which the company is owned by just one person
- Limited liability companies (LLCs), which can have one or more owners known as members
- S corporations
- C corporations

Each has to follow specific guidelines about members, shareholders, and finances and taxes. All companies in the U.S. are initially privately held. They range in scope and size from small family

¹⁵⁴ Upcounsel (2020) *Private Corporation Definition: Everything You Need to Know*. Available from: <https://www.upcounsel.com/private-corporation-definition>

businesses to large corporations. However, most large corporations eventually decide to go public so it's easier to raise working capital. Private companies must rely on certain types of equity funding and bank loans but are not subject to proxy wars and hostile takeovers that may affect public corporations. They tend to be more stable because their share prices do not vary with the investment market. In many cases, private company stock is held only by the company's owners, their family members, and employees and their family members. Outside investors may be limited to those who meet certain requirements, such as an income level (Upounsel, 2020, <https://www.upounsel.com/private-corporation-definition>). Some of the largest private companies in the world are located in countries such as Nigeria, South Africa, Brazil, Argentina, India, the People's Republic of China, Mexico, Germany, Denmark, Australia, France, the United Kingdom, Sweden, Canada, Switzerland, The Netherlands and the United States of America. Generally private companies do not have a legal obligation to declare their financial statements to the registrar of companies or security stock exchange control authorities as required for public companies in most of the countries around the world (Ferrell and Hirt, 2000:119).

3.3.3.2 Public corporation

¹⁵⁵ ““*What's a public corporations definition?* A public corporation is a legal entity that is separate and distinct from its owners. Public corporations enjoy most of the responsibilities and rights that an individual possesses. For example, a corporation has the right to loan and borrow money, enter into contracts, sue and be sued, own assets, hire employees, and pay taxes. A public corporation is often referred to as a "legal person.”” (Upounsel, 2020, <https://www.upounsel.com/public-corporations-definition>). Notably, *public corporations* also sell or trade their shares/stock on the stock exchange in order for the general public to buy or sell them. There are many commonly known public corporations as a result of their good performance and powerful corporate brands.

¹⁵⁵ Upounsel (2020) *What is Public Corporations Definition?* Available from: <https://www.upounsel.com/public-corporations-definition>

3.3.3.3 Subsidiary corporations

¹⁵⁶“*What is a Subsidiary?* A subsidiary (sub) is a business entity or corporation that is fully owned or partially controlled by another company, termed as the parent, or holding, company. Ownership is determined by the percentage of shares held by the parent company, and that ownership stake must at least be 51%. *What are the Attributes of a Subsidiary?* A subsidiary operates as a separate and distinct corporation from its parent company. This benefits the company for the purposes of taxation, regulation, and liability. The sub can sue and be sued separately from its parent. Its obligations are also typically its own and are not usually a liability of the parent company. *Advantages.* #1 *Tax benefits* - A parent company can substantially reduce tax liability through deductions allowed by the state. For parent companies with multiple subsidiaries, the income liability from gains made by one sub can often be offset by losses in another. #2 *Risk reduction* - The parent-subsidary framework mitigates risk because it creates a separation of legal entities. Losses incurred by a subsidiary do not readily transfer to the parent. In case of bankruptcy, however, the subsidiary’s obligations may be assigned to the parent if it can be proven that the parent and subsidiary are legally or effectively one and the same” (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>).

3.3.3.4 A holding company

¹⁵⁷According to Upcounsel (2020) *What is a holding company?* A holding company is defined as an LLC, parent corporation or limited partnership that has enough voting share in a separate company to manage its operations. Holding company are in place for the sole aim of operating a separate company. The company being controlled could be a corporation, LLC, etc. The aim of a holding company is not to produce services or goods, but to hold and bring value to an investment. Holding companies can exist for such endeavors as owning:

- Real Estate
- Patents

¹⁵⁶ Corporate Finance Institute (2020) *What is a Subsidiary?* Available from:

<https://corporatefinanceinstitute.com/resources/knowledge/finance/subsidiary-definition/>

¹⁵⁷ Upcounsel (2020) *What is a Holding Company Everything You Need to Know?*. Available from:

<https://www.upcounsel.com/what-is-a-holding-company>

- Trademarks
- Stocks
- Miscellaneous assets
- Copyrights

A business that is fully owned by a holding company is called a wholly owned subsidiary. In essence, the company holds the assets and nothing more. *Benefit of a Holdings Company*. A core benefit of holdings is that the holding is safeguarded from losses. For example, if a company enters bankruptcy, other companies under the umbrella of the main holding company is protected from creditor claims (Upounsel, 2020, <https://www.upcounsel.com/what-is-a-holding-company>). Therefore, the various corporations' the holding company owns shares in have their own separate legal entities, they even have other shareholders and may not be entirely owned by the holding company or vice versa.

3.3.3.5 Quasi-public corporations

Typical examples of quasi-public corporations include the following: national postal office services, electricity power utility companies, water companies, cleaning services (*refuse and sewerage*) companies and so on. ¹⁵⁸“A *quasi public corporation*, sometimes referred to as a public service corporation, is a private corporation that is backed by a government agency that has a public requirement to provide certain services. Most quasi public corporations begin as government agencies, but thereafter branch off on their own, becoming a separate entity. Such corporations, while quasi public, can still offer shares to the public and have investors involved to help gain capital for the business. Such entities have greater flexibility and fewer restrictions than ordinary private corporations because of the public policy purpose” (Upounsel, 2020, <https://www.upcounsel.com/quasi-public-corporation>).

3.3.3.6 Non-profit corporations

Generally non-profit corporations are established to offer humanitarian assistance to the general population of a country or different countries across the world. On the other hand other non-

¹⁵⁸ Upounsel (2020) *Quasi Public Corporation*. Available from: <https://www.upcounsel.com/quasi-public-corporation>

profit corporations specifically provide environmental protection and science development support without targeting profitability goals. They are usually owned or founded by world governing bodies, national governments, large organizations, individuals with different specializations (*doctors, social workers, scientists, engineers, entrepreneurs and so on*) and civil society for a nation. Individual entrepreneurs with non-profit corporations that have gained worldwide recognition for their enormous contribution to global societal development and the welfare of people for example the Bill & Melinda Gates Foundation and the Carlos Slim Foundation (Carlos Slim Foundation, Carso Institute for Health and Telmex Foundation)¹⁵⁹ (Carlos Slim, 2015, <http://www.carlosslim.com>). “On June, 2010 the Carlos Slim Foundation, the Bill & Melinda Gates Foundation, the government of Spain and the IDB, launched the Mesoamerica Health 2015 Initiative. The aim of this Initiative is to reduce the gap in health equality faced by the poorest 20% of the population living in Central America and Southern Mexico” (Copa TELMEX cited in Carlos Slim, 2015, <http://www.carlosslim.com>). “Used with permission from Microsoft”. [*Entrepreneurship & Business Innovation: A North America, Europe, Africa, Oceania & Asia 21st Century Perspective 1st Edition*] is an independent [publication] and is neither affiliated with, nor authorized, sponsored, or approved by, Microsoft Corporation. “TWITTER, TWEET, RETWEET and the Twitter logo are trademarks of Twitter, Inc. or its affiliates.” The aims of non-profit organizations significantly differ and they vary depending on each sector they provide their services. Non-profit organizations access their funding from private family foundations, world bodies, conglomerates, companies, private individuals, national governments, trust foundations, religious organizations, sports associations, football clubs, and many other sources.

3.3.3.7 Advantages of corporations

The advantages of corporations are many due to their large size and ability to hire experienced management. According to the Government of Canada (2018) **Advantages:**

- Limited liability
- Ownership is transferable
- Continuous existence
- Separate legal entity

¹⁵⁹ Carlos Slim (2015) *Biography*. Available from: www.carlosslim.com/biografia_ing.html

- Easier to raise capital than it might be with other business structures
- Possible tax advantage as taxes may be lower for an incorporated business¹⁶⁰ (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.3.3.8 Disadvantages of corporations

Corporations have many disadvantages. According to the Government of Canada (2018)

Disadvantages:

- A corporation is closely regulated
- More expensive to set up a corporation than other business forms
- Extensive corporate records required, including documentation filed annually with the government
- Possible conflict between shareholders and directors
- You may be required to prove residency or citizenship of directors (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.3.4 Cooperatives

“A co-operative is owned and controlled by an association of members. It can be set up as a for-profit or as a not-for-profit organization. This is the least common form of business, but can be appropriate in situations where a group of individuals or businesses decide to pool their resources and provide access to common needs, such as the delivery of products or services, the sale of products or services, employment, and more.” (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”). In many developing and developed countries’ rural areas are usually agriculture-based. Cooperatives are very popular in rural areas of many countries. A typical good example of a successful cooperative type of business ownership is the

¹⁶⁰ Government of Canada (2018) *Sole Proprietorship, Partnership, Corporation or Co-operative*. Available from: <https://canadabusiness.ca/starting/before-starting-your-business/corporation-partnership-or-sole-proprietorship/> [Accessed 2018, 22 June] “*Reproduced with the permission of the Minister of Industry, 2018*”.

Kaira District Co-operative Milk Producers Union Limited which was established in 1946 in a small town called Anand in the State of Gujarat which is situated in Western parts of India¹⁶¹ (Amul, 2017). During its first days of operation the Kaira District Co-operative Milk Producers Union Limited procured 247 litres of milk on the first day and from only two villages in Gujarat. But today the cooperative is well known across India for its unique “Amul Model” (Amul, 2017). *According to Amul (2017) the Amul Model of dairy development is a three-tiered structure with the dairy cooperative societies at the village level federated under a milk union at the district level and a federation of member unions at the state level. The model encompasses the following: establishment of a direct linkage between milk producers and consumers by eliminating middlemen, milk producers (farmers) control procurement, processing and marketing; and professional management (Amul, 2017). India has become one of the leading producers of dairy milk in the world as a result of the Amul Model with over 16 million milk producers delivering their milk in 1,60,000 dairy cooperative societies around the country (Amul, 2017). A total of 220 District Co-operative Unions process the milk while 28 State Marketing Federations have a mandate to safeguard the welfare interests of the milk producers and their villages across India (Amul, 2017).* A research study was conducted by Prasad, R. & Satsangi, R. (2013) titled: ‘A Case Study of Amul Co-operative in India in Relation to Organizational Design & Operational Efficiency’ published in the *International Journal of Scientific & Engineering Research, Volume 4(1)*.¹⁶² According to Prasad & Satsangi (2013) it is popular belief that co-operatives are a failure, but the Amul co-operative structure is a grand success. Amul has an appropriate blend of policy makers, technology and a support system to the milk producers without disturbing their agro-economic system and ploughing back the profits, by prudent use of men, materials and machines (Prasad & Satsangi, 2013).

¹⁶¹ Amul (2017) *Amul Model: Birth of Amul*. Available from: <http://www.amul.com/m/about-us>

¹⁶² Prasad, R. & Satsangi, R. (2013) A Case Study of Amul Co-operative in India in Relation to Organizational Design & Operational Efficiency published in the *International Journal of Scientific & Engineering Research, 4(1)*, p2-4.

3.3.4.1 Advantages of cooperatives

Even though their aim is not to make profits cooperatives still enjoy enormous advantages.

According to the Government of Canada (2018) **Advantages:**

- Owned and controlled by its members
- Democratic control (one member, one vote)
- Limited liability
- Profit distribution (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.3.4.2 Disadvantages of cooperatives

The disadvantages of cooperatives are many. According to the Government of Canada (2018)

Disadvantages:

- Longer decision-making process
- Participation of all members is required in order to succeed
- Possible conflict between members
- Extensive record keeping
- Less incentive to invest additional capital (Government of Canada, 2018. “*Reproduced with the permission of the Minister of Industry, 2018*”).

3.4 The legal foundations of business law

Nowadays it has become the norm to hear about businesses that are experiencing legal problems. The lack of knowledge in business law by entrepreneurs often results in them running a business recklessly, failing to fulfill the terms of most business contracts, engaging in unfair competition practices or fraud and many other legal problems. In general entrepreneurs are strongly encouraged to have some form of basic knowledge and understanding of business law so that they can make well informed decisions. The principles of law are often similar worldwide while laws themselves are very different in each and every country since countries are sovereign States (Beckman and Butte, 2018). Businesses that take part in international trade (*exporting, importing, franchising and foreign direct investment*) should be knowledgeable about

international law. According to Beckman and Butte (2018) *international law* consists of the rules and principles of general application dealing with the conduct of States and of international organizations in their international relations with one another and with private individuals, minority groups and transnational companies (Beckman and Butte, 2018).

Legislation plays a critical role in every society especially the business sector since it helps compel businesses to operate with integrity, ethically and fairly. The aim of this chapter is to educate entrepreneurs about the legal foundations of business law issues that can help them run their businesses effectively. It is important for every business to have a legal attorney to consult about any legal issues that may arise in their day-to-day operational activities.

3.4.1 Sources of laws

“Under *Sources of Law* we explained that some countries will apply greater weight to certain sources of law than others, and that some will put more emphasis on judicial decisions than others. There are two main types of legal system in the world, with most countries adopting features from one or other into their own legal systems, Common Law and Civil law”¹⁶³ (World Bank, 2016, <https://ppp.worldbank.org/>).

3.4.1.1 Common Law System

According to the World Bank (2016) countries following a common law system are typically those that were former British colonies or protectorates, including the United States. Features of a common law system include:

- There is not always a written constitution or codified laws;
- Judicial decisions are binding – decisions of the highest court can generally only be overturned by that same court or through legislation;
- Extensive freedom of contract - few provisions are implied into the contract by law (although provisions seeking to protect private consumers may be implied);

¹⁶³ World Bank (2016) *Key Features of Common Law or Civil Law Systems*. Available from: <https://ppp.worldbank.org/public-private-partnership/legislation-regulation/framework-assessment/legal-systems/common-vs-civil-law>

- Generally, everything is permitted that is not expressly prohibited by law (World Bank, 2016, <https://ppp.worldbank.org/>).

“A common law system is less prescriptive than a civil law system. A government may therefore wish to enshrine protections of its citizens in specific legislation related to the infrastructure program being contemplated. For example, it may wish to prohibit the service provider from cutting off the water or electricity supply of bad payers or may require that documents related to the transaction be disclosed under a freedom of information act. There may also be legal requirements to imply into a contract in equal bargaining provisions where one party is in a much stronger bargaining position than the other. There are few provisions implied into a contract under the common law system – it is therefore important to set out ALL the terms governing the relationship between the parties to a contract in the contract itself. This will often result in a contract being longer than one in a civil law country” (World Bank, 2016, <https://ppp.worldbank.org/>).

3.4.1.2 Civil Law System

¹⁶⁴“Countries following a civil law system are typically those that were former French, Dutch, German, Spanish or Portuguese colonies or protectorates, including much of Central and South America. Most of the Central and Eastern European and East Asian countries also follow a civil law structure. The civil law system is a codified system of law. It takes its origins from Roman law. Features of a civil law system include:

- There is generally a written constitution based on specific codes (e.g., civil code, codes covering corporate law, administrative law, tax law and constitutional law) enshrining basic rights and duties; administrative law is however usually less codified and administrative court judges tend to behave more like common law judges;
- Only legislative enactments are considered binding for all. There is little scope for judge-made law in civil, criminal and commercial courts, although in practice judges tend to follow previous

¹⁶⁴ World Bank (2016) *Key Features of Common Law or Civil Law Systems*. Available from: <https://ppp.worldbank.org/public-private-partnership/legislation-regulation/framework-assessment/legal-systems/common-vs-civil-law>

judicial decisions; constitutional and administrative courts can nullify laws and regulations and their decisions in such cases are binding for all.

- In some civil law systems, e.g., Germany, writings of legal scholars have significant influence on the courts;
- Courts specific to the underlying codes – there are therefore usually separate constitutional court, administrative court and civil court systems that opine on consistency of legislation and administrative acts with and interpret that specific code;
- Less freedom of contract - many provisions are implied into a contract by law and parties cannot contract out of certain provisions (World Bank, 2016, <https://ppp.worldbank.org/>).

According to the World Bank (2016) a civil law system is generally more prescriptive than a common law system. However, a government will still need to consider whether specific legislation is required to either limit the scope of a certain restriction to allow a successful infrastructure project, or may require specific legislation for a sector. There are a number of provisions implied into a contract under the civil law system – less importance is generally placed on setting out ALL the terms governing the relationship between the parties to a contract in the contract itself as inadequacies or ambiguities can be remedied or resolved by operation of law. This will often result in a contract being shorter than one in a common law country. It is also important to note in the area of infrastructure that certain forms of infrastructure projects are referred to by well-defined legal concepts in civil law jurisdictions. *Concessions* and *Affermage* have a definite technical meaning and structure to them that may not be understood or applied in a common law country. Care should be taken, therefore, in applying these terms loosely. This is further considered under *Agreements*¹⁶⁵ (World Bank, 2016, <https://ppp.worldbank.org/>).

3.4.1.3 Summary of Differences between Civil law and Common law legal systems

According to the World Bank (2016) Set out below are a few key differences between common law and civil law jurisdictions.

¹⁶⁵ World Bank (2016) *Key Features of Common Law or Civil Law Systems*. Available from: <https://ppp.worldbank.org/public-private-partnership/legislation-regulation/framework-assessment/legal-systems/common-vs-civil-law>

Table 3.1 Summary of Differences Between Civil law and Common Law Legal Systems

Feature	Common Law	Civil Law
Written constitution	Not Always	Always
Judicial decisions	Binding	Not binding on 3rd parties; however, administrative and constitutional court decisions on laws and regulations binding on all
Writing of legal scholars	Little influence	Significant influence in some civil law jurisdictions
Freedom of contract	Extensive – only a few provisions implied by law into contractual relationship	More limited – a number of provisions implied by law into contractual relationship
Court system applicable to PPP projects	In most cases contractual relationship is subject to private law and courts that deal with these issues	Most PPP arrangements (e.g. concessions) are seen as relating to a public service and subject to public administrative law administered by administrative courts

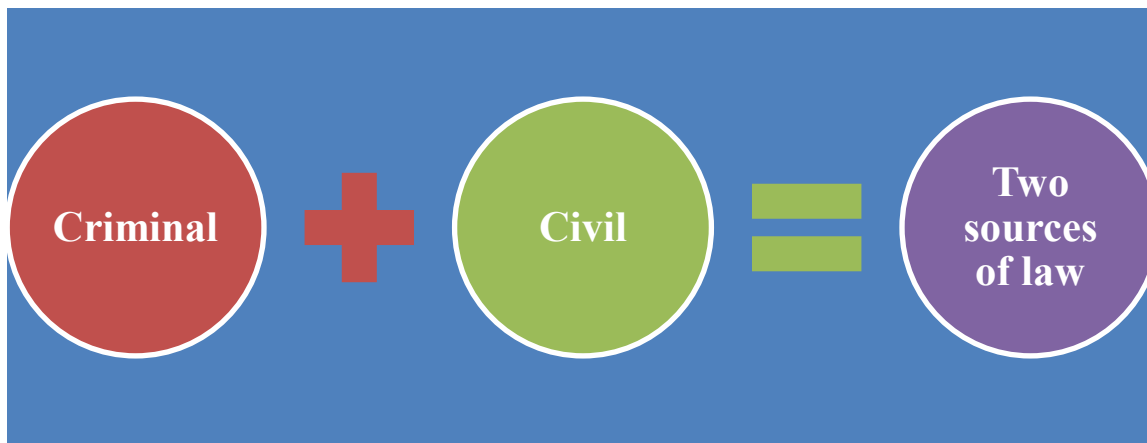
World Bank (2016, <https://ppp.worldbank.org/>)

The following section will cover aspects relating to the classification of laws.

3.4.2 Classification of laws

In most countries laws are classified and this will be depicted by Figure 3.4 below.

Figure 3.4 The two sources of law



Source: Modified: (US Legal, 2018; Ferrell and Hirt, 2000; Law Central Alberta, 2020, <https://www.lawcentralalberta.ca/>).

As pointed-out by Figure 3.4 there are two sources of law and these include:

3.4.2.1 Criminal law

“*Criminal law* is the body of rules and statutes defining the offences against the community at large”¹⁶⁶ (US Legal, 2018).

3.4.2.2 Civil law

Civil law is a component of the law that is basically not classified as criminal since it is only associated with certain legal issues that do not lead to imprisonment but fines for instance workplace disputes, defamation and so on (Ferrell and Hirt, 2000:30). “*Civil law* refers to either: any type of law except criminal (such as family law, personal injury actions, employment law, and wills & estates)”¹⁶⁷ (Law Central Alberta, 2020, <https://www.lawcentralalberta.ca/en/civil-law>). Generally the constitution of a country is superior to all laws that govern it thus the laws must support and uplift the fundamental rights clearly stipulated by the constitution (Ferrell and Hirt, 2000:30). It is important for entrepreneurs to understand the fundamentals of business law.

3.4.3 Fundamentals of business law

The laws that govern the way businesses should operate are many. Entrepreneurs should familiarize themselves with the fundamentals of business law in order to avoid violating the criminal or civil law. The laws entrepreneurs should be knowledgeable about include the following:

3.4.3.1 The law of fraud and deceit/torts

“*Fraud* is generally defined in the law as an intentional misrepresentation of material existing fact made by one person to another with knowledge of its falsity and for the purpose of inducing the other person to act, and upon which the other person relies with resulting injury or damage. Fraud may also be made by an omission or purposeful failure to state material facts, which

¹⁶⁶ US Legal (2018) *Criminal Law and Legal Definition*. Available from: <https://definitions.uslegal.com/c/criminal-law/>

¹⁶⁷ Law Central Alberta (2020) *Civil Law*. Available from: <https://www.lawcentralalberta.ca/en/civil-law>

nondisclosure makes other statements misleading. To constitute fraud, a misrepresentation or omission must also relate to an 'existing fact', not a promise to do something in the future, unless the person who made the promise did so without any present intent to perform it or with a positive intent not to perform it. Promises to do something in the future or a mere expression of opinion cannot be the basis of a claim of fraud unless the person stating the opinion has exclusive or superior knowledge of existing facts which are inconsistent with such opinion. The false statement or omission must be material, meaning that it was significant to the decision to be made” (US Legal, 2016). According to US Legal (2016) *deceit* is the intentional act of misleading a person of ordinary prudence by giving false impression. If a person knowingly or recklessly misrepresents a fact to another he is said to deceive the other. Tortious liability can be imposed on a person who falsely represents a fact with the intention to make another person detrimentally rely and act upon it. The four elements of the tort of deceit are:

- False representation of a fact.
- Representation made with the knowledge that it is false.
- Intention to make the plaintiff to act upon the belief that the fact is true.
- Proof of damage sustained by the plaintiff upon acting on the false information.
- Deception may involve dissimulation, distraction, camouflage, concealment, propaganda, or sleight of hand.

In most tort court cases the injured persons are usually awarded some financial compensation (also called compensatory damages) for their loss that is if their claim is considered to be justifiable by the court (US Legal, 2016).

3.4.3.2 Product liability

According to US Legal (2016) *products liability* refers to the liability of any or all parties along the chain of manufacture of any product for damage caused by that product. This includes the manufacturer of component parts, an assembling manufacturer, the wholesaler, and the retail store owner¹⁶⁸ (US Legal, 2016). Contracts are important in businesses as they help to ensure

¹⁶⁸ US Legal (2016) *Product Liability*. Available from: <https://definitions.uslegal.com/p/product-liability/>

that individuals or organizations comply to the terms of an agreement and this will be covered in the next section.

3.4.3.3 Function of the law of contracts

Generally people acquire rights and obligations on a daily basis despite the fact that they may be aware of it or unaware at all. For example, when we visit our local supermarket or hardware to purchase items we acquire contractual obligations.

3.4.3.4 The definition of a contract

According to US Legal (2016) *a contract* is an agreement between two parties that creates an obligation to do or refrain from doing a particular thing. The purpose of a contract is to establish the terms of the agreement by which the parties have fixed their rights and duties. Courts must enforce valid contracts, unless one party has legal grounds to bar enforcement. Consumers and commercial entities both depend on the enforceability of contracts when conducting business relations. When consumers or commercial entities enter a contract to buy goods or services at a particular price, in a particular amount, or of a particular quality, they expect the seller to deliver goods and services that conform to the contract. Manufacturers, wholesalers, and retailers similarly expect that their goods and services will be bought in accordance with the terms of the contract. A legal action for breach of contract arises when at least one party's performance does not live up to the terms of the contract and causes the other party to suffer economic damage or other types of measurable injury. The injury may include any loss suffered by the plaintiff in having to buy replacement goods or services at a higher price or of a lower quality from someone else in the market. It may also include the costs and expenses incurred by the plaintiff in having to locate replacement goods or services in the first place. Contract disputes may be governed by the common law, statutory law, or both (US Legal, 2016).

3.4.3.5 Elements of a contract

¹⁶⁹According to LawTeacher.net (2013) for an agreement to serve and to be recognized as a valid and binding contract, it must meet the following requirements:

- *Consensus*: the parties' intent in their minds must match (or at least appear to match) on all material aspects of their agreement;
- *Capacity*: the parties must have the necessary legal capacity to contract;
- *Formalities*: where in exceptional cases, require that the agreement should be in a certain format (for example, in writing and signed), these formalities must be respected.
- *Legality*: the agreement must be lawful - in other words it cannot be prohibited by law or common law;
- *Possibility*: the undertaken commitments must be performed when the agreement is entered, and
- *Security*: the agreement must have definite or determinate content, so that the commitments can be enforced (LawTeacher. November 2013. *The Law Of Contract In South Africa*. [online]. Available from: <https://www.lawteacher.net/free-law-essays/contract-law/the-law-of-contract-in-south-africa-contract-law-essay.php?vref=1> [Accessed 12 July 2018]. It is important for entrepreneurs to be fully knowledgeable about the law of property and this will be discussed in the next section.

3.4.3.7 Law of property

““*Property law* is the law that in the common law legal system governs the various forms of ownership in real property and in personal property. Property is anything that is owned by a person or entity. Property is divided into two types: "real property," which is any interest in land, real estate, growing plants or the improvements on it, and "personal property" (sometimes called

¹⁶⁹ LawTeacher. November 2013. *The Law Of Contract In South Africa*. [online]. Available from: <https://www.lawteacher.net/free-law-essays/contract-law/the-law-of-contract-in-south-africa-contract-law-essay.php?vref=1> [Accessed 12 July 2018].

"personalty"), which is everything else""¹⁷⁰ (US Legal, 2016). Property law differs in most countries even though some of the elements are similar and it is also quite broad. The *law of property* is broad thus it is comprised of intellectual, real and personal property¹⁷¹ (Ferrell and Hirt, 2000:41). "*Intellectual property* is a property right that can be protected under federal and state law, including copyrightable works, ideas, discoveries, and inventions. The term intellectual property relates to intangible property such as patents, trademarks, copyrights, and trade secrets. Thus, in today's legal marketplace most registered patent attorneys hold themselves out as intellectual property law attorneys, as opposed to merely a patent attorney. A *patent* is the right to exclude others from making, using or selling the invention throughout the United States of America. In short, others may not make, use or sell the patented invention without the authorization of the patent owner. A patent then, is a limited monopoly granted by the government for the term period of the patent. After the patent expires, anyone may make, use or sell the invention" (US Legal, 2016).

¹⁷²According to FreeAdvice.com (2018) *real property* is generally defined as land and things permanently attached to the land. Things that are permanently attached to the land include homes, garages, and buildings, often referred to as "improvements". Substances that are beneath the land, such as gas, oil, minerals, are also considered permanently attached. Items that can be attached to the land but are not necessarily permanent, such as mobile homes and tool sheds, are not considered real property. Property is generally divided into real property and personal property. Real property includes things like your home and the land on which it lies, while personal property includes moveable goods. Your car, clothes, and most of your personal possessions are personal property. There are special legal requirements controlling the ownership of real property. Under the Statute of Frauds, all contracts for the sale of real property must be in writing. If a contract regarding real property is not in writing, it will not be enforced in a court of

¹⁷⁰ US Legal (2016) *Property Law*. Available from: <https://definitions.uslegal.com/p/property-law/>

¹⁷¹ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p13-288.

¹⁷² FreeAdvice.com (2018) *Real Property*. Available from: Available from: https://real-estate-law.freeadvice.com/real-estate-law/real-estate-law/real_property.htm

law. Real property is not covered under the Uniform Commercial Code, or UCC, which refers only to consumer goods. This means UCC warranties and regulations do not apply to the purchase or sale of real property. Generally, states set the rules governing real property within its borders. To understand the application of real property laws in your state, consult a local attorney with experience in this area of law (FreeAdvice.com, 2018, www.freeadvice.com/). “Intangible and tangible property. Personal property is broken down into [tangible property](#) and intangible property. *Tangible personal property* has physical substance and can be touched, held, and felt. Examples of tangible personal property are numerous, just a few examples are furniture, vehicles, baseball cards, cars, comic books, jewelry, and [art](#). *Intangible personal property* includes assets such as bank accounts, stocks, bonds, insurance policies, and retirement benefit accounts¹⁷³ (Gordon Fischer Law Firm, 2020, <https://www.gordonfischerlawfirm.com/tangible-intangible-property/>). *Intangible property* refers to property that exists on paper only and cannot be physically touched such as the reputation of the business and registered intellectual property (*such as trademark*) (Ferrell and Hirt, 2000:41). The law of agency will always apply to a business’s operational activities and this will be covered in the next section.

3.4.3.8 The law of agency

¹⁷⁴According to US Legal (2016) *agency* law is concerned with any "principal"-“agent” relationship; a relationship in which one person has legal authority to act for another. The relationships generally associated with agency law include guardian-ward, executor or administrator-decedent, and employer-employee. Agency is an agreement, express, or implied, by which one of the parties, called the principal, entrusts to the other, called the agent, the management of some business; to be transacted in his name, or on his account, and by which the agent assumes to do the business and to render an account of it. As a general rule, whatever a man may do by himself, except by virtue of a delegated authority, he may do by an agent. When the agency is express, it is created either by deed, or in writing not by deed, or verbally without writing. When the agency is not express, it may be inferred from the relation of the parties and the nature of the employment without any proof of any express appointment. The agency must be

¹⁷³ Gordon Fischer Law Firm (2020) *Two Broad Classifications*. Available from:

<https://www.gordonfischerlawfirm.com/tangible-intangible-property/>

¹⁷⁴ US Legal (2016) *Agency Law and Legal Definition*. Available from: <https://definitions.uslegal.com/a/agency/>

given ahead of time, or subsequently adopted; and in the latter case there must be an act of recognition, or an acquiescence in the act of the agent, from which a recognition may be fairly implied (US Legal, 2016). The agency agreement can be in writing or a verbal agreement. Even companies seek the services of recruitment agencies to act on their behalf to recruit and train new employees. The following section will cover aspects related to the law of bankruptcy.

3.4.3.9 The law of bankruptcy

Small businesses need to borrow financial capital to finance their business operations and expansion plans. In certain instances small businesses end up over-borrowing from lenders and financial institutions. While on the other hand some of them end up failing to generate adequate financial income to use to repay the borrowed monies which results in them filing for bankruptcy.¹⁷⁵ According to the Government of Australia Department of Industry, Innovation & Science (2018) when your business runs into financial trouble, take the time to seek advice and support as soon as possible, to understand what options are available. Bankruptcy or liquidation should be a last resort. If your business is struggling with debt, it may feel like bankruptcy or closing your business is the only option. Before you do anything, seek advice from a professional. They can suggest different ways of repaying your debt that don't involve bankruptcy or closing your business. Bankruptcy and liquidation are ways of dealing with debt that can't be repaid. Bankruptcy only applies to individuals (not companies). When you become bankrupt, you are declared by law to be unable to pay your debts. It will get rid of most of your debts and debt collectors will stop contacting you. Bankruptcy lasts for 3 years and can affect your financial future, so it should be considered as a last resort. Liquidation only applies to companies. When a company can't pay its debts and goes into liquidation, it stops operating. Company assets are sold in an attempt to pay off the debts. There are two ways to become bankrupt: (1) you can volunteer to become bankrupt, (2) your debtors (*people or businesses you owe money to*) can apply for you to be made bankrupt. Becoming bankrupt means a registered trustee will take control of most of your finances and try to pay off your debts. They may sell

¹⁷⁵ Australian Government Department of Innovation, Industry, Science and Research (2011) *Key Statistics*

Australian Small Business. Available from:

<https://static.treasury.gov.au/uploads/sites/1/2017/06/SmallBusinessPublication.rtf> © Commonwealth of Australia 2018.

your assets (*even though you can keep some types of assets, like personal belongings*) and take any income you earn over a certain limit. Bankruptcy usually lasts for three years. During this time, you'll be restricted to what you can do. For example, you may be restricted from running a company, or working in certain trades and professions¹⁷⁶ (Government of Australia Department of Industry, Innovation & Science, 2018). The conclusion of this chapter will be covered in the following section.

3.4.4 Conclusion

It can therefore be concluded that selecting the right type of business ownership is critical when starting a new business. Entrepreneurs should also ensure that they comply with all legal aspects that are needed when registering their form of business ownership. There are various factors that influence the selection of a type of business ownership such as rates of tax payments, financial costs of setting up the business, limited liability and many others. In general entrepreneurs are strongly encouraged to have some basic knowledge and understanding of business law so that they can make well informed decisions. Generally people acquire rights and obligations on a daily basis despite the fact that they may be aware of it or unaware at all. The *law of property* is broad thus it is comprised of intellectual, real and personal property.

3.4.5 Discussion questions

1. Explain in detail the legal aspects that are prerequisite that entrepreneurs need to know before they register their business? Select one type of business ownership that has the most legal requirements?
2. Outline and explain the types of business ownership an entrepreneur can use to start a business giving relevant examples? Describe the advantages and disadvantages of each form of business ownership?

¹⁷⁶ Australian Government Department of Innovation, Industry, Science and Research (2011) *Key Statistics Australian Small Business*. Available from:

<https://static.treasury.gov.au/uploads/sites/1/2017/06/SmallBusinessPublication.rtf> © Commonwealth of Australia 2018.

3. Describe the benefits of having business law knowledge when you are a business owner and provide relevant examples? Define business law and its importance to an entrepreneur or manager. Describe the two sources of law?
4. Define a contract and the different devices used in written contracts? Describe the requirements needed to fulfill a contract or elements of a contract?
5. Discuss the law of bankruptcy and law agency?

Chapter 4: Feasibility analysis & writing a business plan

After studying this chapter you should be able to:

- Define what is a feasibility analysis and its importance to an entrepreneur.
- Describe the difference between a feasibility study and a business plan.
- Outline the components of a feasibility analysis and the reasons why feasibility studies fail.
- Define a business plan and the advantages/disadvantages of writing a business plan.
- Describe the readers and elements of a business plan.
- Common business plan mistakes made by entrepreneurs.

4.1 Introduction

Historically many startups have failed due to one simple mistake made by their founders '*failing to carry-out a feasibility study and drafting a business plan as these are the two critical ingredients needed to achieve business success*'. "A good business plan guides you through each stage of starting and managing your business. You'll use your business plan as a roadmap for how to structure, run, and grow your new business. It's a way to think through the key elements of your business. Business plans can help you get funding or bring on new business partners. Investors want to feel confident they'll see a return on their investment. Your business plan is the tool you'll use to convince people that working with you — or investing in your company — is a smart choice"¹⁷⁷ (U.S. Small Business Administration, 2020, www.sba.gov). It is critical for entrepreneurs to understand that the ultimate secret to every business's success is first checking if their idea will be viable or not in the market before registering their business. A *feasibility study* is defined as a formally drafted document that depicts the findings of the 'research and indepth assessment' of the proposed business venture as it clearly helps to highlight if the proposed business venture makes good business sense or not in terms of its cost effectiveness and ability to generate sustainable

¹⁷⁷ U.S. Small Business Administration (2020) *Write Your Business Plan*. Available from: <https://www.sba.gov/business-guide/plan-your-business/write-your-business-plan> [Accessed October 02, 2020]

profit income. ¹⁷⁸According to Hofstrand and Holz-Clause (2009:1) the feasibility study focuses on helping answer the essential question of “*should we proceed with the proposed project idea?*” All activities of the study are directed towards helping answer this question. Feasibility studies can be used in many ways but primarily focus on proposed business ventures. Farmers and others with a business idea should conduct a feasibility study to determine the viability of their idea before proceeding with the development of a business. Determining early that a business idea will not work saves time, money and heartache later. A feasible business venture is one where the business will generate adequate cash-flow and profits, withstand the risks it will encounter, remain viable in the long-term and meet the goals of the founders. The venture can be either a start-up business, the purchase of an existing business, an expansion of current business operations or a new enterprise for an existing business (Hofstrand and Holz-Clause, 2009:1). The immense pressure of fulfilling the requirements needed for an entrepreneur to register a business can be overburdening to many entrepreneurs and most of the entrepreneurs due to the need to meet set deadlines they end up rushing through the process steps of preparing to start a business in particular omitting to conduct a feasibility study. Some of the common reasons why entrepreneurs often neglect feasibility studies are many. According to Hofstrand and Holz-Clause (2009:2) reasons given for not doing a feasibility analysis include: (1) *‘We know it’s feasible. An existing business is already doing it’*. (2) *‘Why do another feasibility study when one was done just a few years ago?’* (3) *‘Feasibility studies are just a way for consultants to make money’*. The reasons given above should not dissuade you from conducting a meaningful and accurate feasibility study. Once decisions have been made about proceeding with a proposed business, they are often very difficult to change. You may need to live with these decisions for a long time (Hofstrand and Holz-Clause, 2009:2). The overall sub-components of a feasibility analysis and a business plan that will be covered in this chapter are depicted in Figure 4.1 below.

¹⁷⁸ Hofstrand, D. and Holz-Clause, M. (2015) *What is a Feasibility Study*. Available from; <https://www.extension.iastate.edu/agdm/wholefarm/html/c5-65.html>

Figure 4.1 Ten sub-components of a feasibility analysis and a business plan

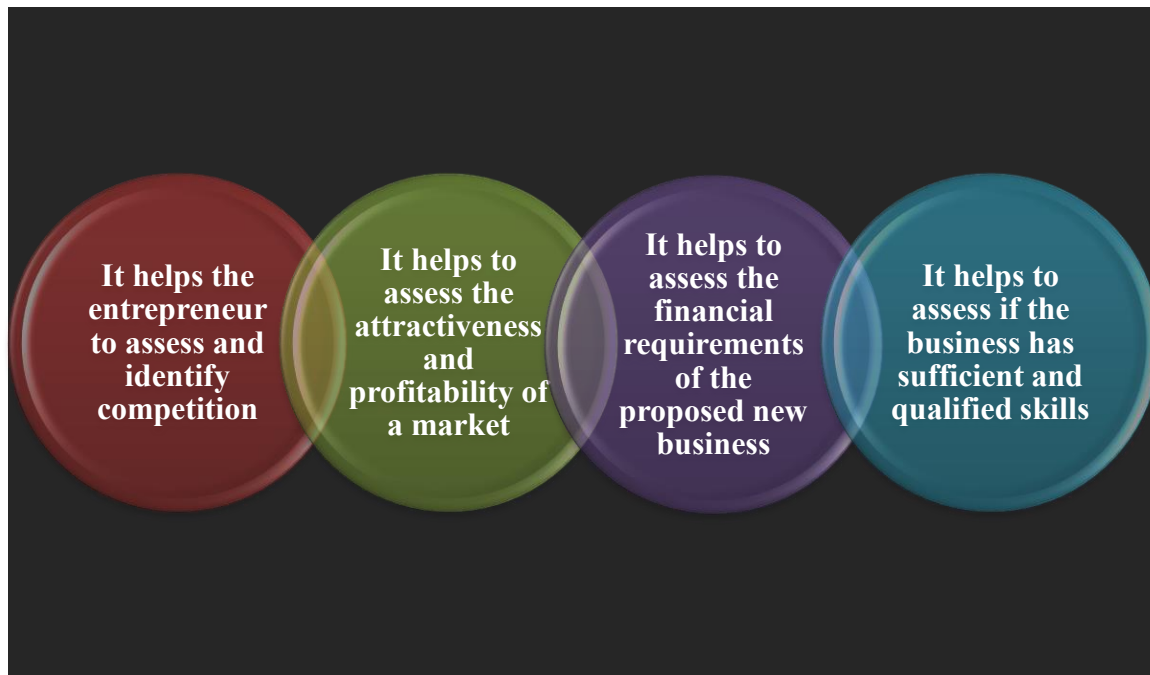


Feasibility studies are important in general and they will be covered in detail in the next section.

4.2 Importance of conducting a feasibility study

The burden of ‘uncertainty’ is one aspect that is constant in the operational life of both large and small businesses. The main aim of a feasibility study is to assess, analyse and confirm the commercial, technical and economic basis of the proposed new business venture. The four common reasons why feasibility studies are important are depicted in Figure 4.2 below.

Figure 4.2 Four reasons why a feasibility study is important



4.2.1 It helps the entrepreneur to assess and identify competition

Two critical tools are generally available for use by entrepreneurs to identify their competitors their proposed new business venture and these tools are a business plan and a feasibility study. In addition a feasibility study will enable entrepreneurs to foresee any potential threats from their competitors in advance and be able to form counter competitive strategies that will help increase the long term profitability and survival of the proposed new business venture. A feasibility study is one document that helps entrepreneurs to list all their competitors activities and core competencies. Thus a feasibility study will enable an entrepreneur to identify what they can do better or perform poorly and this automatically empowers the entrepreneur to establish sustainable competitive advantage strategies for the proposed new business venture.

4.2.2 It helps to assess the attractiveness and profitability of a market

It is critical for entrepreneurs of new businesses to first ensure that they assess the attractiveness of a market before launching their new business and one definite way of doing so is through conducting a 'feasibility study'. A feasibility study and a business plan play a significant role in assisting the new business in identifying its target market (*customers/consumers*). In addition

through conducting market research the proposed new business's *customers/consumers* preferences in terms of what kind of products/services they need, why and how to reach them with marketing communication strategies can easily be determined by both the feasibility study and business plan tools. A feasibility study and a business plan will help to answer these above mentioned questions for the entrepreneur.

4.2.3 It helps to assess the financial requirements of the proposed new business

The ultimate goal of every single business (*except registered non-profit making organizations*) is to make a profit. A feasibility analysis is a key that is used to open the gates of sustainable profitability by entrepreneurs through designing an effective business model. Generally feasibility studies help the entrepreneur to properly outline the foreseeable operational costs of the proposed new business and the initial costs of starting the proposed new venture. It is at this stage of preparing to start a business where entrepreneurs often save their money since the results of the feasibility study often indicate if a business idea will succeed or not thus if the results are negative the entrepreneur does not have to inject their scarce financial resources into an unviable business venture.

4.2.4 It helps to assess if the business has sufficient and qualified skills

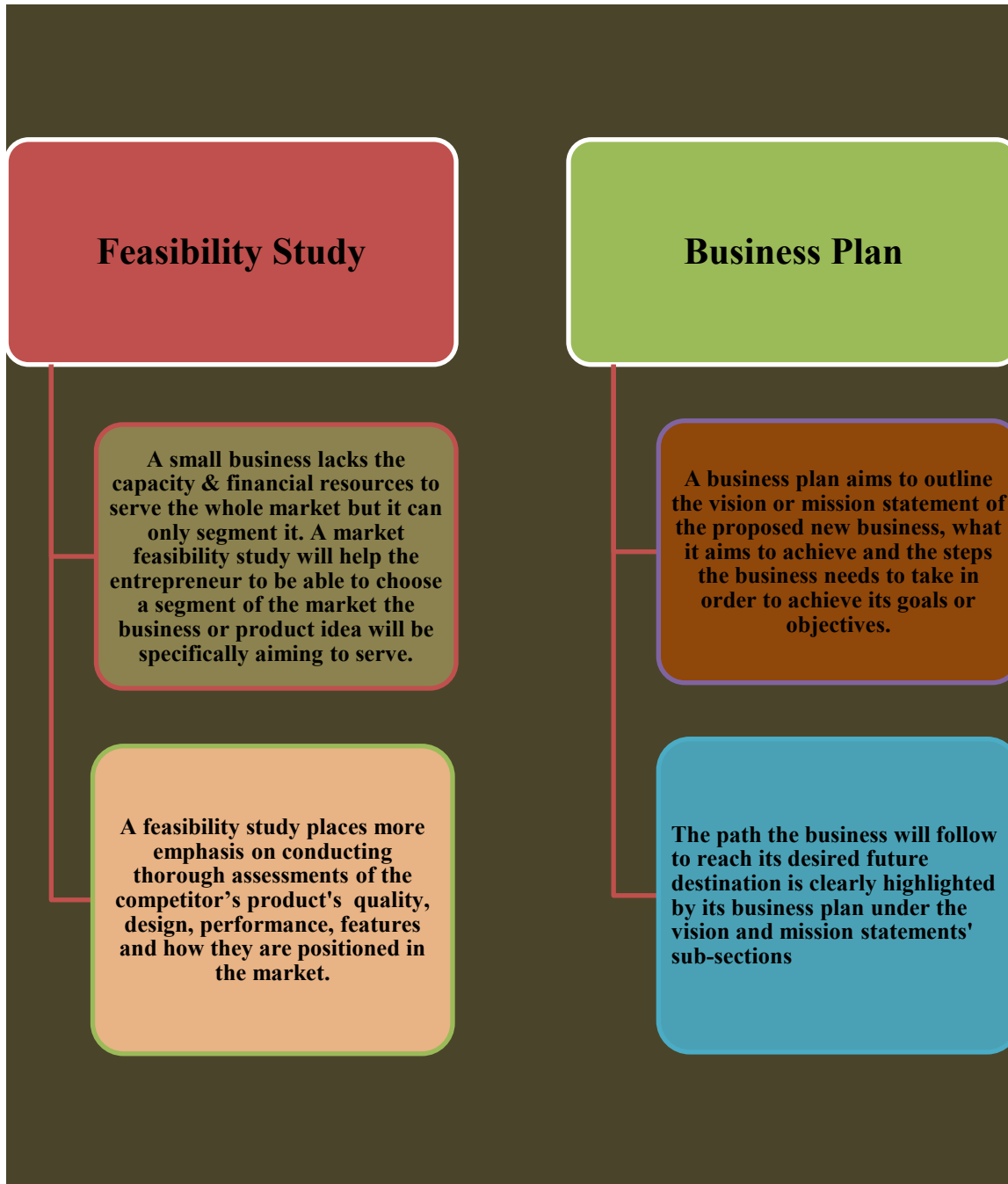
A feasibility study plays a vital role in helping entrepreneurs to assess if they have the adequate management skills and human resources needed to successfully run their proposed new business venture. In addition the feasibility analysis will also help to highlight the type of organizational structure the new business venture will need in order to have the adequate management structures that help to provide effective communication channels. It is important to highlight the the difference between a feasibility study and a business plan and this will be covered in the next section.

4.3 Difference between a feasibility study and a business plan

Most entrepreneurs often fall for the misconception that “*if I draft a business plan I have also conducted a feasibility study*” unfortunately this is a misinformed way of thinking and or a misguided way of starting a new business venture. As pointed out in ‘Chapter 1’ one of the traits of highly successful entrepreneurs is that they take calculated risk thus conducting a feasibility

study and a business plan entrepreneurs will basically be taking calculated risks in deciding to start their proposed business ventures. In addition it is important to highlight the fact that a business plan and a feasibility study are two different projects despite the fact that similarities exist in certain instances and they aim to achieve the same goals of securing the establishment of a highly profitable business venture. The difference between a business plan and a feasibility study are depicted in Figure 4.3 below.

Figure 4.3 Main differences between a feasibility study and a business plan

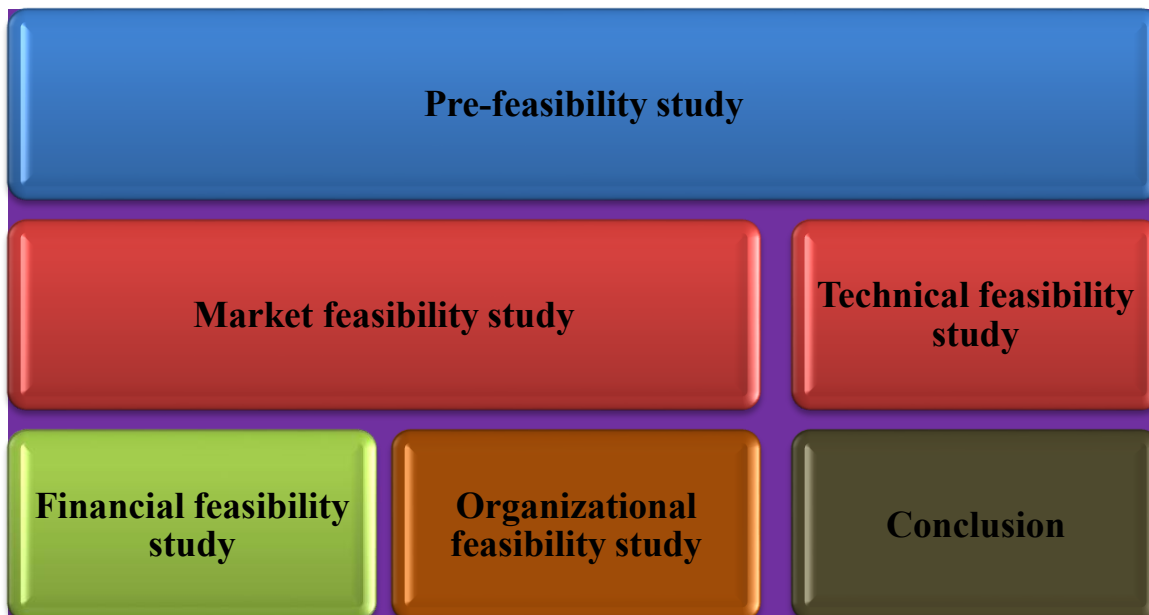


The feasibility study is made up of numerous components and these will be discussed in detail in the following section.

4.4 Components of a feasibility analysis

¹⁷⁹According to Hofstrand and Holz-Clause (2009:2) a feasibility study is usually conducted after producers have discussed a series of business ideas or scenarios. The feasibility study helps to “frame” and “flesh-out” specific business scenarios so they can be studied in-depth (Hofstrand and Holz-Clause, 2009:2). There are various models or concepts of drafting a feasibility analysis that have been developed by leading academics, researchers and authors for the past years. In this textbook six components of a feasibility study were identified and these are depicted in Figure 4.4 below.

Figure 4.4 Six components of a feasibility analysis



Source: Modified: (Hofstrand and Holz-Clause, 2009:2; Wolfe, 2018)

4.4.1 Pre-feasibility study

According to Hofstrand and Holz-Clause (2009:2) a *pre-feasibility* study may be conducted first to help sort out relevant scenarios. Before proceeding with a full-blown feasibility study, you may want to do some pre-feasibility analysis of your own. If you find-out early-on that the proposed business idea is not feasible, it will save you time and money. If the findings lead you

¹⁷⁹ Hofstrand, D. and Holz-Clause, M. (2015) *What is a Feasibility Study*. Available from; <https://www.extension.iastate.edu/agdm/wholefarm/html/c5-65.html>

to proceed with the feasibility study, your work may have resolved some basic issues (Hofstrand and Holz-Clause, 2009:2). In this part of the feasibility study that is where the overall description or overview of the proposed new business venture is found that is its mission, processes, systems, products/services and so on.

4.4.2 Market feasibility

A *market feasibility* study is an evaluation of the attractiveness and profit potential of the target market of the proposed product or service (Abou-Moghli and Al-Abdallah, 2012:95).¹⁸⁰ “*Market feasibility*

- Type of industry
- Prevailing market
- Future market growth
- Competitors and potential customers
- Projection of sales” (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>). According to Hofstrand and Holz-Clause (2009:2) also, a market assessment may be conducted that will help to determine the viability of a proposed product in the marketplace. The market assessment will help to identify opportunities in a market or market segment. If no opportunities are found, there may be no reason to proceed with a feasibility study. If opportunities are found, the market assessment can give focus and direction to the construction of business scenarios to investigate in the feasibility study. A market assessment will provide much of the information for the marketing feasibility section of the feasibility study (Hofstrand and Holz-Clause, 2009:2). The entrepreneur in this part should focus on trying to better understand the profile information of their customers (*population, age, sex, social status, race, gender, beliefs, lifestyles, product*

¹⁸⁰ Corporate Finance Institute (2020) *What is a Feasibility*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/other/feasibility-study/> [Accessed October 02, 2020]

preferences and buying behavior patterns) and the levels of competition in the marketplace. A market feasibility study will help the business analyze the following key areas namely: determining the cost-volume relationship, profit potential of the sector the new business will be launched, determining the right time to introduce the new product idea and choosing a target market (Abou-Moghli and Al-Abdallah, 2012:96). These will be discussed in-depth as follows:

- *Determining the right time to introduce new product ideas* – it is important for the business to assess and select the appropriate time to introduce its new product into the market. Some products are seasonal for instance launching an ice cream during winter season is a fatal bad decision. This is due to the fact that fewer customers buy cold products during the winter season than during the summer season when the weather is hot therefore making customers consume more cold products such as ice creams.
- *Choosing a target market* – it is critical for small businesses to choose specific target markets to serve with their products/services so that they may be able to succeed in customizing their integrated marketing communication messages and produce the products or services according to the needs of customers.

4.4.3 Technical feasibility

“Technical feasibility

Technical: Hardware and software

Existing or new technology

Manpower

Transportation”¹⁸¹ (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>).

¹⁸¹ Corporate Finance Institute (2020) *What is a Feasibility*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/other/feasibility-study/> [Accessed October 02, 2020]

4.4.4 Financial feasibility

“Financial feasibility

- Initial investment
- Resources to procure capital: Banks, investors, venture capitalists
- Return on investment” (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>). In this part of the feasibility study the entrepreneur assesses the financial requirements of the proposed new business or product idea looking at aspects that include the following: operational costs, the break even analysis, business formation costs and so on. These include the following:
 - *Operating expenses budget* - a financial feasibility study helps to forecast the operating expenses a firm will definitely incur and the possible actual amounts it will pay for them. These costs include the following: salaries and wages, rent, interest on loans, advertising costs, depreciation of fixed assets costs, repairs of the machinery or buildings, water and electricity charges, refreshment costs, transport costs, bad debts, postage costs, mobile phone/Internet connection and telephone charges, stationery costs, travel costs, legal fees, tax deductions, operating licence fees and many others.
 - *Break even analysis* - the breakeven point is whereby the business makes neither a profit nor a loss since the total sales revenue equals the total operating costs of the business. It is important for the entrepreneur to be able to know the minimum sales target to surpass in order to avoid making a loss. Breakeven point is reached when the total sales revenue meets with the total operating costs¹⁸² (Davis, Aquilano and Chase, 2003:187).
 - *Formation costs* – these include costs such as feasibility study project costs, business plan writing costs that is if business consultants are used to draft the document, market research costs for gathering customer data, legal fees incurred when seeking advice to select the type of

¹⁸² Davis, M., Aquilano, N. and Chase, R. (2003 *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-288.

business ownership, market testing (*include focus groups or questionnaires*), stationery and printing costs and other new product research development costs.

4.4.5 Organizational feasibility

“Organizational feasibility

- The organizational structure of the business
- Legal structure of the business or the specific project
- Management team’s competency, professional skills, and experience”¹⁸³ (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>).

4.4.6 Conclusion – It is very important for entrepreneurs to maintain a high level of integrity and ethics of research when drafting the conclusion section of the feasibility study. An unbiased mindset is required to draft the conclusion section of the feasibility study and it is important for the entrepreneur to report facts and figures that were highlighted by the study. There are several reasons why feasibility studies fail in general and these will be covered in the following section.

4.5 Reasons why feasibility studies fail

“A feasibility study should be considered a failure if: (1) the capital cost is higher than expected, (2) the operating cost is higher than expected, (3) the recovered grade is lower than expected, (4) sales revenue is lower than expected, (5) it takes longer to build and ramp up than expected, (6) initial performance cannot be sustained, though it may take several years for the failure to become evident”¹⁸⁴ (McCarthy, 2018, www.amcconsultants.com). Feasibility studies often fail due to a number of reasons. Some of the reasons why feasibility studies fail include the following:

¹⁸³ Corporate Finance Institute (2020) *What is a Feasibility*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/other/feasibility-study/> [Accessed October 02, 2020]

¹⁸⁴ McCarthy, P. (2018) *Why Feasibility Studies Fail*. Available from: www.amcconsultants.com/experience/why-feasibility-studies-fail/

- *Insufficient resources* – when there are insufficient resources in the business namely; time (setting unachievable deadline dates or skipping stages in implementing processes), inadequate budgets, lack of highly qualified human resources and so on (McCarthy, 2018, www.amcconsultants.com).

- *Human factor* – this is due to the following: (1) when top management of the business are possessed with the prescient CEO syndrome (*they become overwhelmed by their beliefs and fail to see facts objectively*), (2) the innate motivation by the owner-managers of the business to make a failed idea work despite the fact that the facts & figure disagree with their innate motivation, (3) a biased mindset (*some entrepreneurs only accept ideas that are in direct alignment with their beliefs*) and so on (McCarthy, 2018, www.amcconsultants.com). A business plan is one of the most important document every business must possess and this will be covered in the following section.

4.6 Business success is writing a business plan

The secret behind the success and prosperity of the world's highly successful organizations is that their founders did one thing right when they were launching their new business that is "*they drafted a detailed good business plan document*". Business plans help to form a strong foundation to build a new business. A *business plan* is defined as a carefully drafted document that provides a brief insightful summary of a proposed new business and it clearly depicts the steps the business will follow over a period of time to achieve its goals. In general a good business plan depicts the steps the business will follow by including the following sections: executive summary, mission statement, corporate strategy, organizational structure, competition analysis, financial analysis, management team, market analysis, production analysis and so on. A true entrepreneur does not comprise their business ethics, professionalism and planning in order to quickly rush through things. Surprisingly, some of the entrepreneurs tend to ignore the process of writing a business plan and a feasibility study in order to quickly rush to launch their new business based on their 'beliefs or inner feeling'. Later on after rushing to open their new businesses without writing a business plan and carryingout a feasibility analysis these entrepreneurs start to experience several challenges in their new business's operational activities. Only then that is when they decide to start: (1) carryingout market research, (2) drafting the main purpose or vision of their new business, (3) creating marketing strategies they should adopt, (4)

choosing their target market, (5) identifying their immediate competitors and so on. The advantages of business plans will be discussed in the following section.

4.7 Advantages of a business plan

A business plan has many advantages and these include the following:

- Business plans help the entrepreneur to thoroughly analyze and develop the business model which refers to how the business will make its money in order to be able to achieve its intended objectives.
- Writing a business plan enables the entrepreneurs to differentiate their proposed new business idea from other ideas or competitors especially when seeking funding from banks or searching for potential investors.
- A business plan clearly highlights to potential investors that the entrepreneur has a guaranteed market for the business by conducting market research and the business's products or services will be produced based on customers' needs and wants.
- Business plans that are clearly written often highlight the vision or mission statement of the proposed new business, what it aims to achieve and the steps the business needs to take to achieve its goals or objectives.
- Writing a business plan acts as a precaution to the entrepreneur to quickly identify any future problems the business may face and it also allows the entrepreneur to find solutions to solve some of these problems in advance before the new business is launched.
- One of the advantages of writing a business plan is to attract potential investors or lenders by clearly highlighting the products or services the business will sell, providing factual evidence gathered through carrying out market research that the new business has a guaranteed market, clearly highlighting the predicted net profits of the new business and so on.

Furthermore, it is important to strongly emphasise that there are endless benefits that can be enjoyed by businesses that draft good business plans. ¹⁸⁵According to Berry (2016) here are those top ten benefits:

(1) *See the whole business* - business planning that is done right connects the dots in your business so you get a better picture of the whole. Strategy is supposed to relate to tactics with strategic alignment. Does that show up in your plan? Do your sales connect to your sales and marketing expenses? Are your products right for your target market? Are you covering costs including long-term fixed costs, product development, and working capital needs as well? Take a step back and look at the larger picture.

(2) *Strategic Focus* - startups and small businesses need to focus on their special identities, their target markets, and their products or services tailored to match.

(3) *Set priorities* - you can't do everything. Business planning helps you to keep track of the right things, and the most important things. Allocate your time, effort, and resources strategically.

(4) *Manage change* - with good planning process you regularly review assumptions, track progress, and catch new developments so you can adjust. Plan vs. actual analysis is a dashboard, and adjusting the plan is steering.

(5) *Develop accountability* - good planning process sets expectations and tracks results. It's a tool for regular review of what's expected and what happened. Good work shows up. Disappointments show up too. A well-run monthly plan review with plan vs. actual included becomes an impromptu review of tasks and accomplishments.

(6) *Manage cash* - good business planning connects the dots in cash flow. Sometimes just watching profits is enough. But when sales on account, physical products, purchasing assets, or repaying debts are involved, cash flow takes planning and management. Profitable businesses suffer when slow-paying clients or too much inventory constipate cash flow. A plan helps you to see the problem and adjust to it.

¹⁸⁵ Berry, T. (2016) *10 Benefits of Business Planning for all Businesses*. Available from:

<https://www.sba.gov/blogs/10-benefits-business-planning-all-businesses>

(7) *Strategic alignment* - does your day-to-day work fit with your main business tactics? Do those tactics match your strategy? If so, you have strategic alignment. If not, the business planning will bring up the hidden mismatches. For example, if you run a gourmet restaurant that has a drive-through window, you're out of alignment.

(8) *Milestones* - good business planning sets milestones you can work towards. These are key goals you want to achieve, like reaching a defined sales level, hiring that sales manager, or opening the new location. We're human. We work better when we have visible goals we can work towards.

(9) *Metrics* - put your performance indicators and numbers to track into a business plan where you can see them monthly in the plan review meeting. Figure out the numbers that matter. Sales and expenses usually do, but there are also calls, trips, seminars, web traffic, conversion rates, returns, and so forth. Use your business planning to define and track the key metrics.

(10) *Realistic regular reminders to keep on track* - we all want to do everything for our customers, but sometimes we need to push back to maintain quality and strategic focus. It's hard, during the heat of the everyday routine, to remember the priorities and focus. The business planning process becomes a regular remind¹⁸⁶ (Berry, 2016, www.sba.gov/blogs/). There are several disadvantages of writing a business plan and these are covered in greater detail in the following section.

4.8 Disadvantages of business plans

Business plans are viewed by some entrepreneurs as problematic. The disadvantages of business plans include the following:

- *It creates a narrow channelled vision* - in certain instances a business plan provides an entrepreneur with a narrow channelled vision that makes them fail to take advantage or search for other opportunities/unfulfilled gaps in the market. A good example is that of an entrepreneur who starts a book shop store in the magnificent city of Sydney in Australia. The entrepreneur's

¹⁸⁶ Berry, T. (2016) *10 Benefits of Business Planning for all Businesses*. Available from:

<https://www.sba.gov/blogs/10-benefits-business-planning-all-businesses>

already drafted business plan's operational and marketing strategy sections may clearly outline that they must sell their books using in-store marketing strategies and mass media. Thus if the business plan does not mention the use of information, communication and technology (*ICT*) unified communications (*such as the Internet website advertising, social media platforms, email and so on*) the entrepreneur is more likely to ignore using these new marketing technologies in selling their books to their various targeted customers. In an economically developed and growing country such as Australia the number of Internet users keeps growing everyday as a result of e-Commerce and today it is one of the most preferred way of doing business (*online shopping and advertising*). Therefore, if the entrepreneur fails to adopt new ICT related marketing tools such as Internet advertising and social media advertising they will enjoy limited book sales revenue. A business plan that has a narrow channelled vision can enormously disadvantage an entrepreneur as highlighted by the example above.

- *A business plan can be biased* - the rules and ethics of business research may clearly state that integrity forms the basis of success in the field of entrepreneurship but when it comes to business planning most of the entrepreneurs become victims of bias. In some instances it is very difficult for an entrepreneur to view facts and figures in a fair and unbiased manner when they are envisioning a future course of their proposed new business. The entrepreneur's eagerness for success and strong beliefs may force them to alter results of business plans to successfully apply for business loans or attract investors. Therefore bias is one disadvantage of business plans.

- *It creates false hope or certainty* - One main disadvantage of a business plan is that it is simply a prediction that relies on facts and figures that are currently available in the present day. Today the business environment is rapidly changing and change has become the norm thus nothing is no longer certain or guaranteed. Business plans may lead to high inflexibility especially when there is an increased level of certainty during the business planning process as the business will fail to adapt to change.

- *Writing a business plan requires a literate business professional* - generally if an entrepreneur is not educated or cannot afford to hire a business management professional to draft their business plan there are certainly more likely to fail in developing one.

- *It is a time consuming and costly process* – this is due to the fact that the entrepreneur has to: (1) gather information about competitors, (2) conduct market research studies and (3) hire a business management expert to develop some of the parts of the plan such as the financial strategy or operational strategy. It is important to clearly know who your audience will be when writing business plans and this will be covered in the following section.

4.9 Readers of business plans

There are two types of readers of business plans namely: internal readers and external readers. These are depicted by Figure 4.5 below.

Figure 4.5 Four internal readers of business plans in a business



4.9.1 Internal readers

The internal readers are people who are directly involved with the organization's day-to-day business activities and they include the following:

4.9.1.1 Employees

An organization's employees who work in the various levels of the organizational structure often read business plans in order to understand the business's vision, mission, business strategy, direct or indirect competitors so that they can directly align their day-to-day work activities to the business strategy/purpose.

4.9.1.2 Management

Business plans also help the organization's management team to quickly read a summarized version of the business's mission, vision, set goals, strategies, strengths, weaknesses, competitive analysis, forecasted financial projections when the business is initially launched and afterwards so that they remain on track of achieving the set goals.

4.9.1.3 Board of directors

Board of directors often conduct more strategic thinking and planning for the business and one critical tool that helps them to succeed in doing so is a business plan. In general business plans help to provide board of directors with guidelines on the firm's mission statement, vision, strengths and weaknesses, direct and indirect competitors, projected financial earnings and so on.

4.9.1.4 Owners or shareholders

The owners or shareholders of the business read business plans to: (1) assess how the business will be able to provide them with their return on investments and its growth objectives, (2) to assess the performance of the business when it is launched and (3) to consistently remind themselves about the mission statement or vision of the business.

4.9.2 External readers

The external readers are people who are outside the business but have an interest in the business's day-to-day activities. These are depicted in Figure 4.6 below.

Figure 4.6 Six external readers of business plans in a business



4.9.2.1 Potential investors

Time is important and also scarce in the modern-day business world especially for business investors. A business plan is a short version or ‘quick to read’ prepared document that easily provides investors an opportunity to read a brief summarized overview of the proposed business’s mission statement, financial projections, market analysis, business strategies, weaknesses and strengths.

4.9.2.2 Customers

Nowadays it is quite common for customers to request a business plan document of any firm or business since it is a credible source of information they can easily read to find-out all the summarized information about the business in question. Therefore, customers read business plans to identify the competitive advantages of the business's products/service offerings, financial projections, management team, market analysis and so on.

4.9.2.3 Financial institutions or potential lenders

Financial institutions or potential lenders only rely on business plans and feasibility studies documents to determine the potential of profitability or success of a proposed new business venture. In general business plans help financial institutions to clearly evaluate a proposed new business's overall business strategy, operational strategies, financial projections and marketing plans it will use to ensure that it operates profitably.

4.9.2.4 Potential suppliers

Generally similar to financial institutions or potential lenders in most instances potential suppliers only rely on business plans and feasibility studies documents to determine the potential of profitability or success of a proposed new business venture. Thus potential suppliers of a business often read its business plan to assess if the new business can qualify to receive materials on credit terms and be able to repay them back based on the financial/market analysis sections of the document.

4.9.2.5 Intermediaries

When it comes to reading business plans most intermediaries place more emphasis on assessing the level of support that will be invested by the new business's in providing adequate marketing communication (*public relations, publicity, advertising and sales promotions*) budget allocations to the proposed new business's products/services on a regular basis in order to attract high customer traffic and sales revenue. Intermediaries such as wholesalers or retailers read business plans to assess if the proposed new business meets the criteria to receive shelf space in their outlets or not. They carefully analyze aspects such as the level of marketing support the new

business will provide to its new products in order to attract customers, quality standards of the products, distribution network plans and so on.

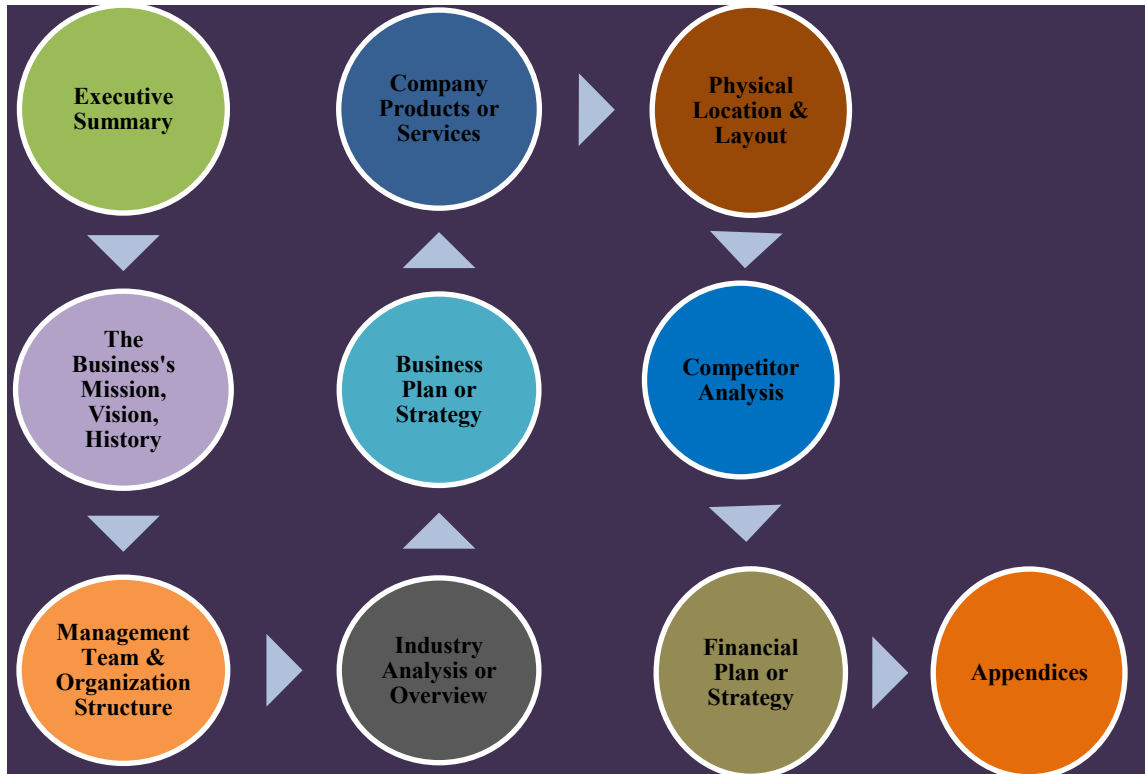
4.9.2.6 Potential mergers or strategic alliance partners

In general potential mergers or strategic alliance partners read business plans to see the new business's mission statement, vision, business strategy, financial projections, competitive advantages and so on. Business plans are different and this will be covered in the following section.

4.10 Business plan outline

In general business plans differ since people generate and develop different business ideas but there are some elements that are standard. These standard elements or parts have to be present in every business plan and these are depicted in Figure 4.7.

Figure 4.7 Ten Elements of a Business Plan



Source: Modified: (US Small Business Administration, 2020, <https://www.sba.gov>).

4.10.1 Executive summary - it is a brief insightful description about the overall business structures of the proposed new business venture that aims to present vital information or data that investors and lenders need to know about the new business. ¹⁸⁷“Briefly tell your reader what your company is and why it will be successful. Include your mission statement, your product or service, and basic information about your company’s leadership team, employees, and location. You should also include financial information and high-level growth plans if you plan to ask for financing” (US Small Business Administration, 2020, <https://www.sba.gov>). An executive summary should clearly highlight the following: (1) the business model, (2) the market research study results, (3) the direct and indirect competitors of the business, (4) the competitive advantages of the business over its competitors, (5) the operational strategies that will be implemented in order to maintain

¹⁸⁷ US Small Business Administration (SBA) (2020) *Writing Your Business Plan*. Available from; <https://www.sba.gov/business-guide/plan-your-business/write-your-business-plan>

quality management, (6) the projected profit figures excluding the detailed calculations as they will be highlighted in the financial analysis section of the plan.

4.10.2 The business’s vision, mission statement and history – a carefully drafted vision clearly highlights the desired future destination where the business wants to be. While on the other hand the mission statement clearly outlines the purpose of the business, long term goals, objectives and so on. In this section the history of the business is written only if the business plan is being drafted for an already existing business not for a new proposed business venture.

4.10.3 Management team and organization structure - business plans should highlight all the personal information of top management and owners of the proposed new business such as biographical details (*age, gender and so on*), work history and experience, educational qualifications and other recently acquired skills. “Tell your reader how your company will be structured and who will run it. Describe the [legal structure](#) of your business. State whether you have or intend to incorporate your business as a C or an S corporation, form a general or limited partnership, or if you're a sole proprietor or LLC. Use an organizational chart to lay out who's in charge of what in your company. Show how each person's unique experience will contribute to the success of your venture. Consider including resumes and CVs of key members of your team” (US Small Business Administration, 2020, <https://www.sba.gov>).

4.10.4 Industry analysis and overview – the industry analysis is a key section that must be included in a business plan since it helps to outline in detail if a sector is growing fast, moderately or slowly. Information about the average operating costs of small businesses in the sector must be provided and information about the current competitive strategies being implemented by direct or non-direct competitors.

4.10.5 Business plan or strategy - this is the most vital part of the business plan as it clearly outlines the strategies the business will use to out-compete its competitors in the market while maintaining its profitability. In this section the entrepreneur must clearly ensure that they include information about how the business will accomplish its set business goals and objectives including the creation of core competencies the business can use as leverage over its rivals in the market. This is the most pivotal part of the business plan due to the fact that the business strategy

is used to develop and direct all the other parts of the business plan namely; operational, marketing, competitive and financial strategies.

4.10.6 Company products or services - under this section of the business plan the entrepreneur should provide information about the different ranges of products or services the proposed business will be selling, product features, packaging/labelling, brand symbols, slogans and trademark registrations of the products. ¹⁸⁸“Describe what you sell or what service you offer. Explain how it benefits your customers and what the product lifecycle looks like. Share your plans for intellectual property, like copyright or patent filings. If you're doing [research and development](#) for your service or product, explain it in detail” (US Small Business Administration, 2020, <https://www.sba.gov>). Another key point is that the entrepreneur must also provide information on how the new business’s products/services will offer quality assurance to customers for instance by highlighting that it will apply for quality standards approval from accredited international quality standards bodies.

4.10.7 Physical location and layout - this section of the business plan clearly provides information about the physical location of the business for instance ‘in what way is it a strategic location or a high customer traffic site’. Additional information must be provided on how the proposed new business venture’s location will help to boost customer traffic, sales revenue, ability to offer convenience and accessibility.

4.10.8 Competitor analysis - the entrepreneur should clearly show that in-depth research has been done to gather information about the proposed new business’s: (1) direct and indirect competitors, (2) their competitive advantages, (3) marketing/operational strategies and (4) the competitor’s areas of weaknesses the new business can take advantage of in order to outmaneuver them in the marketplace.

4.10.9 Financial plan or strategy – in this section of the business plan information about the cash flow statements, income statements, the balance sheet and the financial ratios must all be provided to clearly outline the projected profit income the new business will generate over a certain period of time. This section must properly be prepared so that investors can easily read

¹⁸⁸ US Small Business Administration (SBA) (2020) *Writing Your Business Plan*. Available from; <https://www.sba.gov/business-guide/plan-your-business/write-your-business-plan>

the facts and figures that clearly identify how the new business will be able to provide them with a return on investment or good financial rewards. ¹⁸⁹“Supplement your funding request with financial projections. Your goal is to convince the reader that your business is stable and will be a financial success. If your business is already established, include income statements, balance sheets, and cash flow statements for the last three to five years. If you have other collateral you could put against a loan, make sure to list it now. Provide a prospective financial outlook for the next five years. Include forecasted income statements, balance sheets, cash flow statements, and capital expenditure budgets. For the first year, be even more specific and use quarterly — or even monthly — projections. Make sure to clearly explain your projections, and match them to your funding requests. This is a great place to use graphs and charts to tell the financial story of your business” (US Small Business Administration, 2020, <https://www.sba.gov>).

4.10.10 Appendices - this is the section of the business plan where all the supporting documents are attached. For instance, questionnaires, financial statements, market research results, industry economic statistics, interview schedules and so on (US Small Business Administration, 2020, <https://www.sba.gov>). “Use your appendix to provide supporting documents or other materials were specially requested. Common items to include are credit histories, resumes, product pictures, letters of reference, licenses, permits, or patents, legal documents, permits, and other contracts” (US Small Business Administration, 2020, <https://www.sba.gov>). The common business plan mistakes that are done by entrepreneurs are many and these will be discussed in the following section.

4.11 Common business plan mistakes made by entrepreneurs

Entrepreneurs in some instances make several mistakes in writing business plans. This is usually the case when expert advice is not sought and in the end it negatively affects their business's operations and profitability. The common mistakes that are made by entrepreneurs when writing a business plan are depicted in Figure 4.8 below.

¹⁸⁹ US Small Business Administration (SBA) (2020) *Writing Your Business Plan*. Available from; <https://www.sba.gov/business-guide/plan-your-business/write-your-business-plan>

Figure 4.8 Five common mistakes made by entrepreneurs when writing business plans



The five common business plan pitfalls made by entrepreneurs as depicted by Figure 4.7 above include:

- *Failure to identify key competitors and making too many grammatical errors* - every business despite its size has direct and indirect competitors. Direct competitors compete with the business in the targeted market and they are considered to be the business's key competitors. A business plan must clearly highlight its key competitor's strengths, weaknesses, marketing position and so on. Thus when this information is inappropriately written in the business plan the plan becomes a document mistakenly done. In addition another mistake that is made by entrepreneurs is failing to proof read their business plans before submitting them to readers as they will be having too many grammatical errors (*typographical or language errors*). The presence of too many grammatical errors in the business plan often makes the readers of the business plan to think that the entrepreneur is reckless, poorly organized, lacks commitment in their proposed business project and so on.

- *Failure to properly finish writing the document* – generally the main parts of a business plan include: the executive summary, company history, management team and organizational structure, market analysis, financial analysis, operational strategy, legal requirements,

competitor/industry analysis and so on. A business plan document that fails to cover the above mentioned sections is considered to be an unfinished plan.

- *Too much wishful thinking when writing business plans* - in general wishful thinking leads to enhanced innovation or creativity but when it comes to business plan writing some of the entrepreneurs apply it through making unachievable goals or objectives for their proposed new businesses. Goals, financial projections and objectives of a business must be specific and realistic when they are included in a business plan to attract investors or potential lenders.

- *Poor financial analysis* - the key part of every business plan is the ability to accurately predict the financial costs the new business will incur, sales revenue and assets it will own in the future for instance over a time period of up to 3 years. In some instances entrepreneurs either overstate or understate their costs, profits, total assets and sales units due to the lack of professional accounting skills.

- *Failure to include the legal requirements section of the business plan* - in certain instances entrepreneurs often fail to write the legal requirements section due to the lack of knowledge in law or assuming that it is an irrelevant section. Apparently legal requirements are key facts that attract investors who want to know if the proposed new business venture will break the law or adhere to it (*for instance registering the corporate entity of the business at the government's company registry offices, acquiring operating permits/licenses, tax registration, water and electricity connections and so on*).

4.12 Conclusion

Feasibility studies help to provide the entrepreneur with critical information about their proposed new business venture via testing if their business idea or product idea is feasible or not in the market and if they should proceed to implement the idea or completely abandon it. All the six areas of feasibility analysis need to be carefully conducted by the entrepreneur fairly and accurately to produce a realistic outcome. It can therefore be concluded that a business plan is a document that assists entrepreneurs to carefully cover all the overall business structures of their proposed new venture and be able to sell their business ideas to potential investors or lenders. Furthermore, business plans also help entrepreneurs to be able to identify their competitors,

study their products or services weaknesses and market strategies. There are various pitfalls that entrepreneurs make when writing-up their business plans and one of them is the writing of unrealistic financial projections to help the business plan attract investors or lenders.

4.13 Discussion questions

1. Explain the definition of a feasibility analysis?
2. Briefly outline the advantages of a feasibility analysis to the entrepreneur before they start a new business?
3. Describe the six feasibility analysis components?
4. Define a business plan? Explain the advantages and disadvantages of drafting a business plan giving relevant examples? Identify six readers of a business plan and how they benefit from reading the business plan?
5. Discuss the five common mistakes entrepreneurs often make when writing up business plans?

Chapter 5: Franchising

After studying this chapter you should be able to:

- Explain the reasons for the rapid interest in franchising globally. Define franchising and the seven types of franchising. Briefly explain the history of franchising where it is believed to have originated.
- Outline the motivations of franchisors and franchisees to decide to enter the field of entrepreneurship via franchising.
- Identify at least six types of franchising available to entrepreneurs to use to enter the field of entrepreneurship.
- Describe the benefits of franchising to franchisors and franchisees. Discuss the steps to follow when designing a franchise system.
- Describe the 10 guidelines to follow when buying a franchise. Identify the common mistakes franchisors and franchisees make in franchising.
- Describe the advantages and disadvantages of franchising.

5.1 Introduction

Today numerous powerful global brands and franchise systems from the continents of Africa (*in the Southern, Western, Eastern & North Africa regions*), Asia (*People's Republic of China, Singapore, India, Japan, South Korea, Thailand and many other nations*), Europe (*Eastern & Western Europe*), North America (*United States of America, Canada & Mexico*) and South America (*Brazil, Argentina, Chile, Peru, & many other countries*) have now dominated the global marketplace. Therefore, this has created a fascinating buzz about franchising in the field of entrepreneurship and commerce. ¹⁹⁰According to the International Franchise Association (2018) (1) in the USA, there are more than 3,000 different franchise business companies that are already existing in various parts of the country, (2) there are around 300 different business categories in which franchise business is being offered, (3) more than 825,000 franchise business ideas can be found for entrepreneurs to invest in and start a business, (4) the franchise business

¹⁹⁰ International Franchise Association (2018) *Franchising Deep Impact*. Available from:

<https://www.franchise.org/stats-franchising%E2%80%99S-deep-impact>

contributes \$2.1 trillion to the US economy, (5) the sector supports around 18 million workers in the country, (6) one out of every 12 companies has a franchise business model for the entrepreneurs to invest in, (7) fast Food Franchise business is the most popular franchise business in the US (International Franchise Association, 2018). It is important to note that the global statistics about franchising growth rates are limited and not regularly updated in most countries around the world. In Europe there are quite a number of distinguished franchise brands and some of the many countries that have growing franchise sectors are depicted in Figure 5.1 below which is based on the European Franchise Federation (2012) European Franchise Report – Country Report.

Figure 5.1 European Franchise Report – Country Reports Statistics



Source: European Franchise Federation (2018)

Nowadays franchising is now a lucrative type of business ownership and a way to grow the business quickly both nationally or internationally. ¹⁹¹Franchising nowadays has been adopted in several industries and the most popular industries include: food and restaurant franchises, business opportunities, cleaning and maintenance, low investment franchises, automotive franchises, business services franchises, home service franchises, retail franchises, vending franchises and senior care franchises (Franchise Brokers Association, 2015). The sub-components of franchising that will be covered in this chapter are depicted in Figure 5.2 below.

¹⁹¹ Franchise Brokers Association (2015) *Top 10 Most Popular Franchise Industries*. Available from: <https://www.franchiseba.com/blog/top-10-most-popular-franchise-industries/>

Figure 5.2 Twelve sub-components of franchising



There are various definitions of franchising nowadays thus the meaning of the term ‘franchising’ will be discussed in the next section.

5.2 Franchising defined and its history

It is important to highlight the fact that franchising is not a business entity rather it is a method of conducting business that can be used by entrepreneurs and generally the gist behind franchising is that it is a marketing concept that provides an innovative way a business can use to distribute

products/services. ¹⁹²According to the Franchise Council of Australia (2018) *franchising* is a business relationship in which the franchisor (*the owner of the business providing the product or service*) assigns to independent people (*the franchisees*) the right to market and distribute the franchisor's goods or service, and to use the business name for a fixed period of time. The International Franchise Association defines franchising as a "*continuing relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organising training, merchandising and management in return for a consideration from the franchisee*". "Franchising" is used to describe a number of business models, the most commonly identified of which is "business format franchising" (Franchise Council of Australia, 2018).¹⁹³According to the European Franchise Federation (2018) European Code of Ethics for Franchising. The Code states: "*Franchising* is a system of marketing goods and/or services and/or technology, which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the Franchisor and its individual Franchisees, whereby the Franchisor grants its individual Franchisee the right, and imposes the obligation, to conduct a business in accordance with the Franchisor's concept. The right entitles and compels the individual Franchisee, in exchange for a direct or indirect financial consideration, to use the Franchisor's trade name, and/or trade mark and /or service mark, know-how, business and technical methods, procedural system, and other industrial and /or intellectual property rights, supported by continuing provision of commercial and technical assistance, within the framework and for the term of a written franchise agreement, concluded between parties for this purpose (European Franchise Federation, 2018).

Franchising is one of the most popular and fascinating subject in the field of entrepreneurship today with a history that began over a century ago despite the fact that the origins of franchising are arguable or vary based on different research studies across the world. Some researchers have indicated that it originated in ancient Rome or the People's Republic of China (*thousands of years ago*), Germany (*1800s*), United States of America (*1800s*), England (*1900s*) and so on.

¹⁹² Franchise Council of Australia (2018) *What is Franchising*. Available from: <https://www.franchise.org.au/what-is-franchising.html>

¹⁹³ European Franchise Federation (2018) *Franchising Definition Description*. Available from: <http://www.eff-franchise.com/101/franchising-definition-description.html>

¹⁹⁴According to the European Franchise Federation (2018) the term “*franchise*” is a term that dates back to the 13th & 14th centuries in Europe. To be granted a franchise was to be granted a liberty, a privilege to do something. In Medieval Europe, towns developed as agglomerations in which traders and shopkeepers were granted rights/privileges/“franchises” to operate with relative independence from obligations usually due to the feudal authorities. Likewise, some of the first territories colonised in northern America – in the name of the English or French Kings - were developed on the basis of franchises granted to the first colonizers to open and develop new territories (European Franchise Federation, 2018). ¹⁹⁵According to Franchoice (2017:1) in the middle ages the local titled land owner would grant rights to the peasants or serfs, probably for a consideration, to hunt, hold markets or fairs, or otherwise conduct business on his domain. With the rights came rules and these rules became part of European Common Law. Isaac M. Singer (1811-1875) gets credit for starting the modern use of franchising in the U.S. During the early 1850s, Singer, who had improved an existing sewing machine model, wanted to find a wider distribution for his product but lacked the money to increase manufacturing. Another problem was that people wouldn’t buy his machines without training, as service retailers weren’t able to provide. Singer's solution, to charge licensing fees to people who would own the rights to sell his machines in certain geographical areas, provided money for manufacturing. These licensees became responsible for teaching people how to use his machines, which created opportunities to bring the first commercially successful sewing machine to the public. Franchising was employed on a limited basis after the success of Singer’s sewing machine distribution method. Business format franchising (*the licensing of the brand name/trademarks and of the entire business concept*). It was Ray Kroc (1902-1984), a milk shake mixer salesman who discovered the McDonald brothers' small San Bernardino, California hamburger stand in 1954, who is credited with unleashing the wave of franchising we know today. In 1961 Ray Kroc bought out the McDonald brothers’ interest and took the title of senior chairman (Franchoice, 2017:1).

¹⁹⁴ European Franchise Federation (2018) *Franchising Definition Description*. Available from: <http://www.eff-franchise.com/101/franchising-definition-description.html>

¹⁹⁵ Franchoice (2017) *History of Franchising*. Available from: <https://www.franchoice.com/wp-content/uploads/2017/04/History-of-Franchising.pdf> p1-2

It is important for entrepreneurs to be aware of the fact that the terms a ‘franchisor’/’franchiser’ and ‘franchisee’ are completely different and they have different meanings. In addition there is also a huge difference between the responsibilities of a franchisee and those of a franchisor. According to the European Franchise Federation (2018) the Mutual duties & services of the franchiser & each franchisee are depicted in Table 5.1 below.

Table 5.1 Mutual duties & services of the franchiser & each franchisee

<p>Brief overview of the franchisers and franchisee’s mutual duties, services, rights and obligations.</p> <p>These duties are specific to each party but complementary. They must be executed in a spirit of cooperation, dialogue and transparency. This list is illustrative and non-exhaustive.</p>	
Franchisee	Franchisor
Optimize his sales on his allocated territory or customer group	Steering the business’s overall development strategy
Doing so in full respect of business format as contractually defined, including respecting the common identity and reputation of the franchise network, as well as the confidentiality of the business know-how transferred	Protecting its concepts and IPRs, including the franchiser’s know-how. The EC Block Exemption Regulation 330/2010 (see below) defines IPRs as such: “‘intellectual property rights’ includes industrial property rights, KNOW HOW,
Meet the franchise format’s standards and procedures	Developing and improving the franchise concept and KNOW-HOW to ensure its continued competitiveness, reputation and customer satisfaction
Provide the requested information as well as allow personally developed improvements to be integrated into the company’s know-how for the benefit of the network	Developing and improving its start-up and continued assistance to the franchisee in the course of the agreement (training, general management assistance). It provides the marketing operations instructions (Manual or “bible”) to enable the franchisee to carry out the business
Cooperate with new promotion programs as well as upgrades of the format/system	Developing responsible recruitment strategies of franchisees
Guaranteeing the end-customer the best	Ensuring the promotion of the brand on the market

possible service	through appropriate advertising campaigns
Pay the fees* according to the contractual schedule	Develop efficient record-keeping systems for purposes of control, adjustment, advice, benchmarking
	Set up regular platforms for franchisor-franchisees communication, including working commissions
	Foresee conflict management procedures
	Update all binding documentation: contracts, operations manuals, pre-contractual disclosure obligations, as the case may be.

¹⁹⁶Source: European Franchise Federation (2018)

¹⁹⁷¹⁹⁸* Fees and costs: a franchisee buying a franchise “value package” including IPRs and access to the franchisor’s know-how will pay a combination of different types of fees. Each franchise format defines its own types of fees and fee schedule.

Fees may include:

- Entrance or start-up fee which usually included a licence fee
- On-going royalties as service fees for the on-going support services of the franchiser

Advertising fees

Franchisees will also, in the course of time, be asked to invest in the upgrading costs of the

¹⁹⁶ European Commission (2020) *Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (Text with EEA relevance)*. Available from: <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32010R0330>

¹⁹⁷ The British Franchise Association (2020) *Join a Franchise*. Available from: <http://www.thebfa.org/join-a-franchise/understanding-franchise-fees>

¹⁹⁸ European Franchise Federation (2018) *Mutual Duties and Services of the Franchiser & Each Franchisee*. Available from: www.eff-franchise.com/102/mutual-duties-and-services-of-the-franchiser-each-franchisee.html

format/system. Upgrades are necessary to keep up with market trends and to maintain the competitiveness of the brand. “understanding franchisee fees” see: <http://www.thebfa.org/join-a-franchise/understanding-franchise-fees>” (European Franchise Federation, 2020, www.eff-franchise.com/102/mutual-duties-and-services-of-the-franchiser-each-franchisee.html); The British Franchise Association, 2020, <http://www.thebfa.org/join-a-franchise/understanding-franchise-fees>). There are many reasons why entrepreneurs (*franchisors & franchisees*) are choosing franchising nowadays and these are discussed in the following section.

5.3 Motivations for choosing franchising

Franchisors and franchisees tend to have completely different reasons for choosing franchising as a way of doing business. According to the European Franchise Federation (2018) the motivations for choosing franchising are depicted in Table 5.2 below.

Table 5.2 Motivations for choosing franchising

Some motivations for opting to develop or join a franchise business.	
Franchisor	Franchisee
To develop and roll out a business format/system which will be sold for a regular fee to independent operators	To be able to start a business without having to start from scratch alone while being an independent entrepreneur; being in the business “for yourself but not by yourself”
To develop the business with the added input of franchisee capital which increases the possibilities for the franchiser of rapid expansion of the system	To buy into a system which, in principle, has been tested; proven successful in the given circumstances;
To develop the business in locations beyond the franchiser’s natural boundaries of business (new and international markets)	To gain immediate access to a market via the right to use the franchiser’s brand or trademark and to benefit from customers attracted to the brand
To develop a business in which the franchiser has his specific duties and obligations and the franchisees have their own	To benefit from the transfer of know-how and assistance during the term of the contract
	Buying into an existing and branded business can enhance the survivability of a new franchised

	business in the first crucial years after start-up.
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Source: European Franchise Federation (2018)

There are numerous misconceptions about franchising as being similar to other forms of business ownerships and this will be covered in the next section.

5.4 What ‘franchising is not’

The solution to misconceptions/myths that are commonly found in the field of entrepreneurship is the seeking of expert opinions or advice by entrepreneurs before making critical decisions or taking actions that may affect both the short and long term day-to-day operational activities of a business. Some of the entrepreneurs often make the mistake of assuming that franchising uses the same business concept as types of business ownerships such as cooperatives, voluntary chains and so on. Before choosing a form of business to start a new business entrepreneurs should ensure that they seek professional business advice from qualified experts to clearly explain to them ‘what franchising is’ and ‘what it is not’.¹⁹⁹ According to the European Franchise Federation (2018) the following business schemes may share elements with “business-format franchising” but should not be assimilated to business-format franchising, nor called “franchising”. (1) *corporate chain store* – a chain of outlets are commonly owned and controlled by a single company and its branches or subsidiaries; employ central buying and merchandizing and sell similar lines of merchandise, (2) *voluntary chain* – a network of independent retailers or service companies (i.e. hotel chains) engaged in centralised bulk buying, and eventually some common merchandising, common standards of service but leaving a fair margin for individuality in outlet name, design and operations. The chain entity is structured as an enterprise*²⁰⁰. The relationship between this structure and the chain members may be contractual or corporate (*corporate relationships being either cooperative or capitalistic*), (3) *cooperative* - a network of independent businesses each part-owner of a central entity which acts as a buying platform; may

¹⁹⁹ European Franchise Federation (2020) *What Franchising is Not*. Available from: www.eff-franchise.com/105/what-franchising-is-not.html [Accessed January 22, 2020]

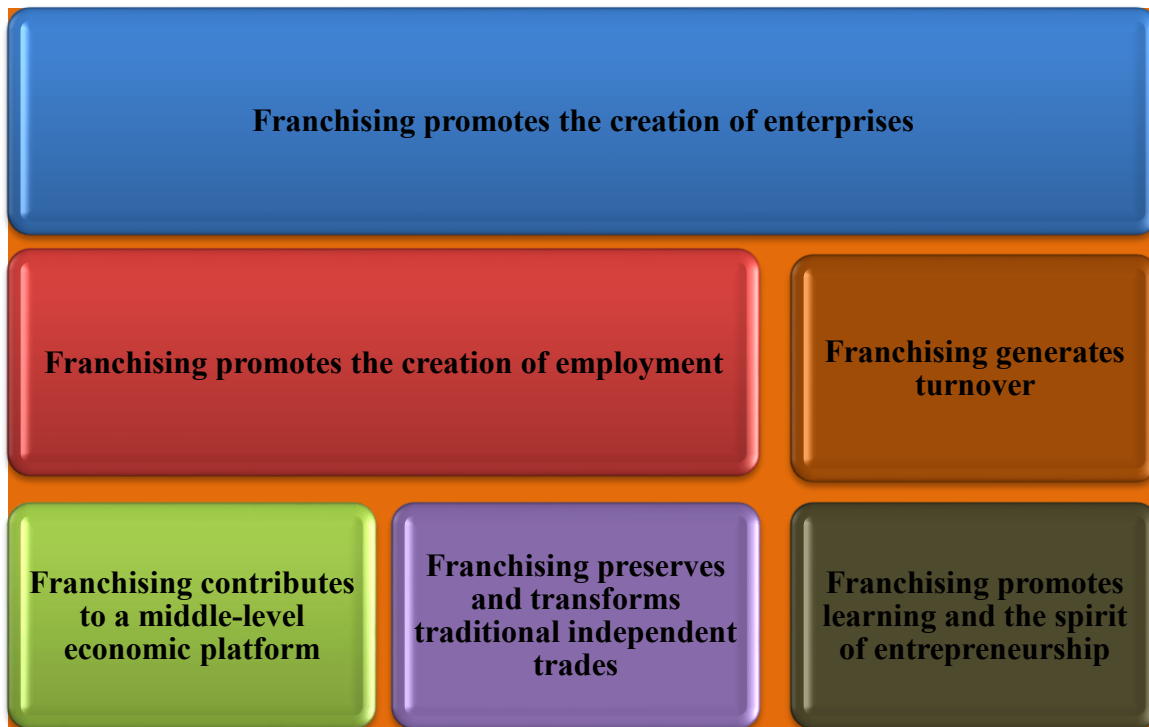
²⁰⁰ * source: Distribution Law in Europe, E&Y, 2001

conduct joint promotion efforts; many cooperatives today also develop a separate “business-format franchise” entity to accelerate the growth of the network in which the “distributor” may or may not also be a part-owner of the cooperative, (4) *licence or brokerage agreements* – a licence right may relate to any of the following Intellectual (*intangible*) Property Rights-IPRs: trademark, name/brand, patent, copyright, legally protected design, trade secret, manufacturing process or any item of value. The licensor sells the right to use the license (*not the ownership of the licence*) under the terms of the agreement to an independent licensee who in return pays a fee or royalty. All franchises necessarily have a licence component to their franchise contract, and this is an essential element of any franchise contract, but business-format franchising offers, in addition a business format which sells as a packaged business proposition (European Franchise Federation, 2018). There are several economic advantages of franchising to an economy and these are covered in the following section.

5.5 Economic advantages of franchising to a country

Franchising is one of the most critical components of entrepreneurship which plays a key role in the development of each and every economy in the world today. In growing global economic trading regions of Southern Africa; East Africa, Southeast Asia; the European Union (*EU*) including all of the North America region nations franchise systems have fueled economic growth and international trade. The six ways franchising contributes to economic growth are depicted in Figure 5.3 below.

Figure 5.3 Six ways franchising contributes to economic growth



Source: European Franchise Federation (2018)

According to the European Franchise Federation (2018:6) franchising is the vector of economic growth through the following:

5.5.1 Franchising promotes the creation of enterprises

Franchising promotes the creation of enterprises. The creation of enterprises occurs as a result of new franchise concepts being created, each with its potential of creating a network of new franchised enterprises. In other words, there is the creation of new franchise brands/concepts, and within each brand, the development of its network of franchised businesses with independent franchisees. A franchise head company may develop several brands, as well as variations of one brand. It may also allow its network of franchisees to develop as single-unit franchisees only, or allow a franchisee to have more than one unit (*multi-unit franchisees*) or allow a franchisee to operate more than one brand (*cross franchising*). Combinations of the latter two options are also

possible. Franchises may be imported or home-grown; in retail or in services, or a mix of both²⁰¹ (European Franchise Federation, 2018:6).

5.5.2 Franchising promotes the creation of employment

““Direct employment: employment is created at several levels in a franchised business: (1) at the level of the franchisor/head company/subsidiary office(s) with staff(s) of professionals, administration. Many franchises operate a combination of franchise network as well as company owned outlets, the latter contributing its share to employment, (2) at the level of each franchised unit. The unit can offer, as the case may be, employment to the owner who operates his unit(s) himself, to his family, to his employees. Indirect employment: Again, franchised businesses operate within the context of the general economy and therefore contribute to the employment in enterprises upstream and downstream of their own activity”” (European Franchise Federation, 2018:7).

5.5.3 Franchising generates turnover

““Turnover is generated as a result of increased customer service and quality standards as a result of the effective training that is provided to employees especially when it is a business format type of franchise. A significant aspect is that the organization & professionalism that accompanies the development of a franchise network contributes to integrating businesses from the informal sector into the formal & more transparent business sector”” (European Franchise Federation, 2018:7).

5.5.4 Franchising contributes to a middle-level economic platform

““Franchising, in the "*Distributive Trades*"²⁰² (including Retail) and Services, contributes to the existence of a middle-level platform between the large distribution & service groups and the small stand-alone enterprises, and in doing so, safeguards & develops business competition and diversity. Globalization has favored the growth of very large distribution groups which operates

²⁰¹ European Franchise Federation (2012) *European Franchise Report – Country Reports*. Available from: <http://www.eff-franchise.com/Data/PUBLICATION%202012%20EFF%20FRANCHISE%20REPORT.pdf> p11-57.

²⁰² Eurostat: 2011, *Key Figures on European Business with a special feature on SMEs*.

with vast networks of multiple distribution channels, including large company-owned outlets. At the same time, a lot of small independent traders and businesses have disappeared because of lack of resources and/or knowhow to compete with this competition. By virtue of the success factors described above, a tested franchised business system offers small independent business owners the opportunity to exist & develop in the face of such competition by virtue of being in a network context with its support system. Thus, franchised businesses offer the adaptability, flexibility and resources to operate in competitive markets. The relevance of this middle platform spurs global players also adopt franchising as one of their development strategies, thus developing franchised daughterbrands aimed at middle-level and smaller, more targeted markets (niche markets)''''²⁰³ (European Franchise Federation, 2018:8).

5.5.5 Franchising preserves and transforms traditional independent trades

''''Many classic, traditional "high-street" independent trades and artisans (*hairdressers, flower shops, small groceries, laundrettes, stationary/postal services, beauty parlours, specialized foods, hotel industry, restaurants, travel agencies, etc.*) have already opted for or converted their development strategy to franchising. This strategy contributes to modernizing their operations, image and appeal to customers, thereby dynamising a significant SME segment of the economy. This dynamism is an element which can influence and be transposed to countries where commerce and traditional trades are still largely prevalent, thus modernizing and giving a "global-identity" flavour to local trade and services'''' (European Franchise Federation, 2018:8).

5.5.6 Franchising promotes the learning and spirit of entrepreneurship

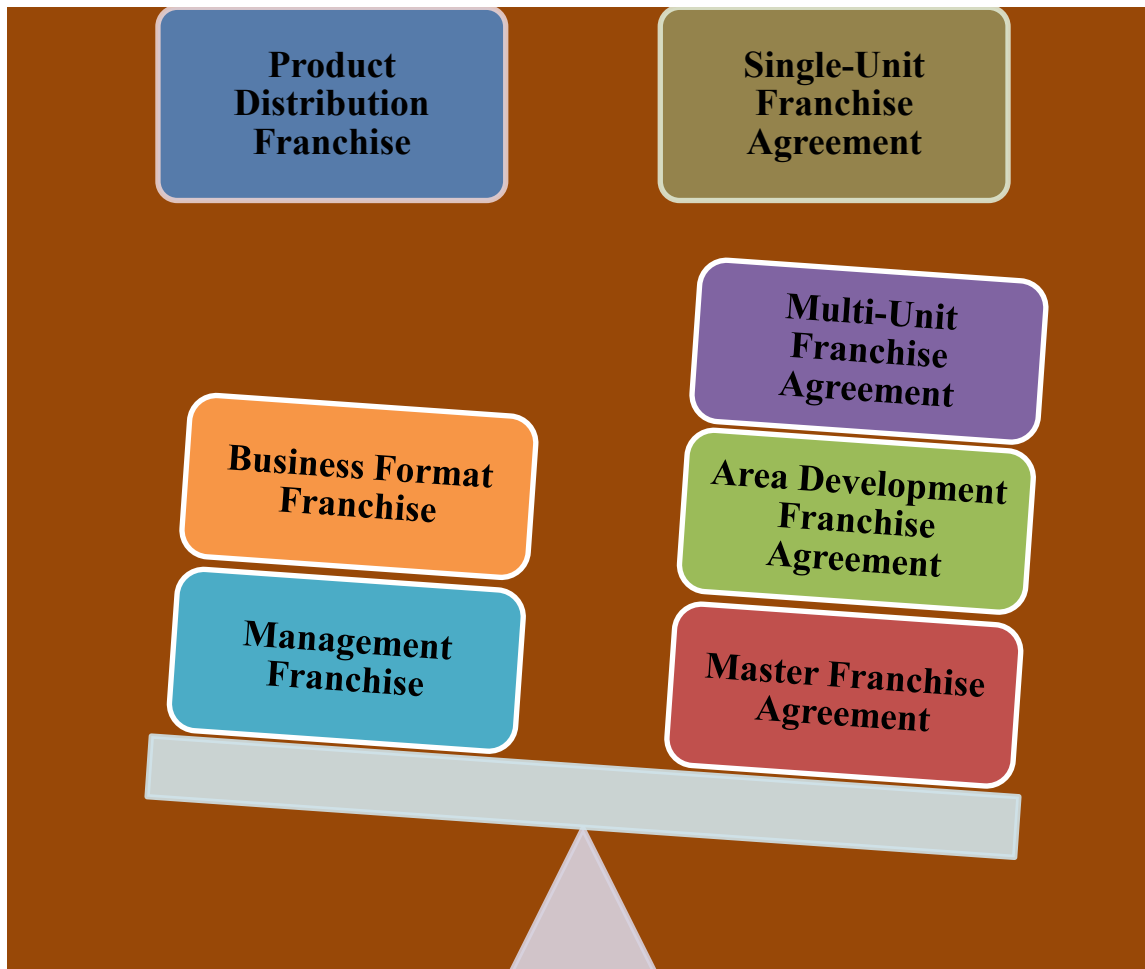
''''The "context of learning/training" promotes entrepreneurship. It can turn a non-entrepreneur into an entrepreneur. It enhances professionalism. It can help give other family members, acquaintances, employees, etc. the idea and confidence to become entrepreneurs too, franchising being an option. Entrepreneurial training is key to developing the desire and confidence to become an entrepreneur. Franchise companies factor this dimension into their franchise package'''' (European Franchise Federation, 2018:9). The different forms of franchising are many and these will be covered in the next section.

²⁰³ European Franchise Federation (2012) *European Franchise Report – Country Reports*. Available from: <http://www.eff-franchise.com/Data/PUBLICATION%202012%20EFF%20FRANCHISE%20REPORT.pdf> p11-57.

5.6 Forms of franchising

There are many forms/types of franchising being implemented around the world. Some of the popular types of franchising are depicted in Figure 5.4 below.

Figure 5.4 Seven types of franchises



Source: Modified (International Franchise Association, 2018; Company Bug, 2018; Franchise & Business Law Group, 2018)

5.6.1 Business Format Franchising

According to the International Franchise Association (2018) there are two different types of franchising relationships. Business Format Franchising is the type most identifiable to the average person. In a business format franchise relationship the franchisor provides to the

franchisee not just its trade name, products and services, but an entire system for operating the business. The franchisee generally receives site selection and development support, operating manuals, training, brand standards, quality control, a marketing strategy and business advisory support from the franchisor. More than 120 diverse industries use franchising as their route to market including: automotive, beverages, business services, children's services, cleaning - *maid and janitorial*, education, food, health & fitness, home services, home-based, retail products & services, senior care & medical services, travel & tourism²⁰⁴ (International Franchise Association, 2018).

5.6.2 Traditional or Product Distribution

“While less identified with franchising, traditional or product distribution franchising is actually larger in total sales than business format franchising. In a traditional franchise, the focus is not on the system of doing business, but mainly on the products manufactured or supplied by the franchisor to the franchisee. In most, but not in all situations, the manufactured products generally need pre- and post-sale service as found in the automobile industry. Examples of traditional or product distribution franchising can be found in the bottling, gasoline, automotive and other manufacturers” (International Franchise Association, 2018).

5.6.3 Management Franchise

²⁰⁵According to Company Bug (2018) this franchise focuses on the franchisee managing the franchise. The manager does not really need to part take in the day to day running of the business. This type of franchise would be ideal for somebody with previous managing experience as it allows individuals with transferable skills to really take ownership of a business and lead it to success. Business related skills such as having an entrepreneurial flair, preferably from experience, will only help you in the journey to success. For this type of franchise you will also be required to pay fees for the ability to use the trademarks of a franchise, and your focus is on business development, overseeing the business and managing the team. Management franchising is great for re-sale franchises, which are franchises that are bought from an existing franchisee, as all the operational day to day tasks and activities are in place including the existing

²⁰⁴ International Franchise Association (2018) *What Is A Franchise*. Available from:

<https://www.franchise.org/what-is-a-franchise>

²⁰⁵ Company Bug (2018) *Types of Franchises*. Available from: <https://www.companybug.com/types-of-franchises/>

staff. It may seem like you don't need to make changes and it's easy to run an existing franchise, however there are certain things you need to consider. If your chosen franchise has not been performing well, then you may have to implement serious changes to the staff or the day to day operations (Company Bug, 2018, www.companybug.com).

²⁰⁶According to Franchise & Business Law Group (2018) below are four types of agreements franchised businesses commonly form:

5.6.4 Single-Unit Franchise Agreement

In a single-unit agreement, the arrangement grants the franchisee the right to open and operate a single franchise unit. This type of agreement is the simplest and most frequently used. New franchisors are particularly keen on these franchise arrangements, as they're an easy way to take the first step into the world of franchising. As time goes on, if a franchisee is prospering, the franchisor can consider the possibility of expanding the contract to include additional units (Franchise & Business Law Group, 2018, www.franchisebusinesslawgroup.com).

5.6.5 “Multi-Unit Franchise Agreement

A multi-unit agreement is an arrangement that grants the franchisee the right to open and operate more than one franchise unit. A multi-unit arrangement is not bound to a specific territory. Franchisees may have units in different areas of town. In some cases, these franchise arrangements come with deadlines, in which the franchisee must adhere to a schedule for developing a predetermined number of units. If the franchisee fails to meet the agreed-upon schedule, the franchisor may have the right to contract with other interested parties” (Franchise & Business Law Group, 2018, www.franchisebusinesslawgroup.com).

5.6.6 “Area Development Franchise Agreement

An area development agreement is similar to a multi-unit agreement, as the franchisee is granted the right to open and operate multiple units during a specified time frame. However, with these

²⁰⁶ Franchise & Business Law Group (2018) *Franchise Arrangements: Understanding the 4 Types*. Available from: www.franchisebusinesslawgroup.com/blog/franchise-arrangements-understanding-the-4-types/

franchise arrangements, the franchisor also grants the franchisee exclusive rights for development in a particular territory. No other franchisees will be allowed to open units in that geographic area during the contract term” (Franchise & Business Law Group, 2018, www.franchisebusinesslawgroup.com).

5.6.7 “Master Franchise Agreement

Master franchise arrangements give franchisees even more rights than area development agreements. Along with the right and obligation to open a certain number of units within a specific territory, a master franchisee also has the right to sell franchises within their geographic location to other people. Basically, master franchisees are like franchisors who operate only in a particular area. They take on many of the franchisor responsibilities, including training and support, and they reap the benefits of franchisee fees and royalties” (Franchise & Business Law Group, 2018, www.franchisebusinesslawgroup.com). There are many benefits of franchising to franchisers and these are discussed below.

5.7 How does franchising benefit franchisers?

The advantages that are enjoyed by franchisers include the following: (1) businesses that have long term goals of expanding their operational activities geographically often take advantage of franchising especially in instances where they lack the required financial strength to do so, (2) franchising helps franchisers to enjoy economies of scale as a result of buying their materials and other services in bulk, (3) franchising generally enables franchisers to enjoy lower marketing and advertising costs since these costs are often shared between the franchiser and the franchisee. In addition franchisers with larger operations tend to possess adequate bargaining power to use to negotiate reduced advertising fees with media companies. There are several ways franchising benefits franchisees and this will be covered in the following section.

5.8 How does franchising benefit franchisees?

²⁰⁷There are several benefits that are enjoyed by franchisees when they enter the field of franchising and these include the following: (1) *“Explore a New Career, Work in a New Industry! No Experience Necessary.* Buying a franchise allows you to work in a field that you don’t necessarily have any previous work experience in, but that is intriguing to you. Franchise brands (also known as franchisors) offer extensive and thorough support and training to franchisees in order to educate them and help them understand their company’s business model, (2) *Lower Risk.* Franchises are a more secure investment than new businesses because they have the support and backing of a larger, established corporation, (3) *Loyal Customer Base and Brand Recognition.* Buying an established and recognized brand can give you an accelerated path to profitability by bringing in customers and prospective employees from day one, (4) *Collective Buying Power.* When you purchase a franchise and become part of the franchise system, you’ll benefit from your franchisor’s established deep-rooted relationships with suppliers. This means that materials will be less expensive because of the franchisor’s collective buying power” (Franchise Business Review, 2019, <https://franchisebusinessreview.com/post/franchise-advantages-disadvantages/>). There are many advantages of buying a franchise and these are discussed in the next section.

5.9 Advantages of franchising in general

There are numerous advantages that are associated with franchising and generally these advantages help to make franchising to become the ideal way of entering into the field of entrepreneurship by new entrepreneurs. ²⁰⁸According to Franchise Council of Australia (2018) there are countless benefits to becoming a franchisee, which is why Franchising is one of the fastest-growing sectors of the Australian economy. Here is a short list of 18 advantages of Franchising over stand-alone forms of small business:

²⁰⁷ Franchise Business Review (2019) *The Pros and Cons of Buying a Franchise: Is it Right for You?* Available from: <https://franchisebusinessreview.com/post/franchise-advantages-disadvantages/>

²⁰⁸ Franchise Council of Australia (2018) *Advantages of the Franchise System.* Available from: <https://www.franchise.org.au/process/knowledgebase/knowledgeBaseAnswers.html?categoryId=293&answerId=10>

- (1) The franchisor provides detailed training.
- (2) The franchisee has the incentive of owning their own business with the additional benefit of continuing assistance from the franchisor.
- (3) The franchisee benefits from operating under the name and reputation (brand image) of the franchisor, which is already well established in the mind and eye of the public.
- (4) The franchisee will usually need less capital than they would if they were setting up a business independently because the franchisor, through their pilot operations and buying power, will have eliminated unnecessary expense.
- (5) The franchisor provides the advice and/or help in identifying suitable trading locations or operating territories for the franchisee.
- (6) The franchisor helps the franchisee to obtain the following: (1) occupation rights to the trading location, (2) comply with planning (zoning) laws, (3) prepare plans for layouts, shopfitting & refurbishment, and (4) provide general assistance in calculating the correct level and mix of stock for the opening launch of the business²⁰⁹.
- (7) The franchisor trains the franchisee (*and the franchisee's staff as well*) in all areas of the business such as; manufacture, preparation, accounting, business controls, marketing, promotion and merchandising.
- (8) The franchisor may negotiate better rates of finance, or more favourable conditions, for franchisees with financial institutions.
- (9) The franchisee receives the benefit on a national scale (if appropriate) of the franchisors advertising and promotional activities at a lower cost than if they were to attempt such marketing themselves.

²⁰⁹ Franchise Council of Australia (2018) *Advantages of the Franchise System*. Available from:

<https://www.franchise.org.au/process/knowledgebase/knowledgeBaseAnswers.html?categoryId=293&answerId=1037>

(10) The franchisee taps into the bulk purchasing power and negotiating capacity made available by the franchisor by reason of the size of the franchised network.

(11) The franchisee can call on the specialised and highly-skilled knowledge and experience of the franchisor's head office organisation, while remaining self-employed in their business.

(12) The support and benefits provided by a Franchise system greatly reduce a franchisee's business risks.

(13) The franchisee has the services of the field operational staff of the franchisor who are there to assist with any problems which may arise from time to time in the course of business.

(14) The franchisee has access to use the franchisor's patents, trade marks, copyrights, trade secrets, and any secret processes or formula.

(15) The franchisee has the benefit of the franchisor's continuous research and development programs, which are designed to improve the business and keep it up-to-date and competitive.

(16) The franchisor provides a knowledge base developed from their own experience, as well as that of all the franchisees in the system, which would otherwise be impossible for a non-franchised business to access.

(17) Some global franchise enterprises have 'defined territories of operation' within the Franchise that help to protect the franchisee from competition.

(18) A franchisee can always speak to their franchisor or a fellow franchisee to discuss their business challenges or problems - something a non-franchised business will never can almost never do (Franchise Council of Australia, 2018). There are several disadvantages of buying a franchise and these are discussed in the following section.

5.10 Disadvantages of franchising in general

²¹⁰According to the Franchise Council of Australia (2018) disadvantages of the Franchise System:

(1) Inevitably, the relationship between the franchisor and franchisee must involve the imposition of controls. These controls will regulate the quality of the service or products to be provided or sold by the franchisee to the consumer. It has been mentioned previously that the franchisee will own his/her own business. However, the business which they own is one which they are licensed to carry out in accordance with the terms of their contract. They must accept that in return for the advantages enjoyed by them, by virtue of their association with the franchisor and all the other franchisees, control of quality and standards is essential. Each bad franchisee has an adverse effect, not only on his own business, but indirectly on the whole of the franchised chain and as such, all other franchisees. The franchisor, will, therefore, impose standards and demand that they are maintained so that the maximum benefit is derived by his franchisee (and indirectly the whole of the franchised chain) from the operation of the franchisee's business. This is not to say that the franchisee will not be able to make any contribution, or to impose their own personality on their business. Most franchisors do encourage their franchisees to make contributions to the development of the business of the franchised chain which their individual talent and qualities permit.

(2) The franchisee will have to pay the franchisor for the services provided and for the use of the system, i.e. the initial franchise fee and continuing franchise fees.

(3) The prospective franchisee may find it difficult to assess the quality of the franchisor. This factor must be weighed very carefully by the potential franchisee since it can affect the franchisee in two ways.

²¹⁰ Franchise Council of Australia (2018) *Disadvantages of the Franchise System*. Available from:

<https://www.franchise.org.au/process/knowledgebase/knowledgeBaseAnswers.html?categoryId=282&answerId=10>

- *A.* Firstly, the franchisor's offer of a business-format package may not amount to what it appears to be on the surface.
- *B.* Secondly, the franchisor may be unable to maintain the continuing services which the franchisee is likely to need in order to sustain their business. These aspects will be discussed in detail in a later chapter.

(4) ²¹¹The franchise contract will contain some restrictions against the sale or transfer of the franchised business. This is clear inhibition of the franchisee's ability to deal with their own business but, as with most of the restrictions, there is a proper reason for it. This provision is in the contract because the franchisor will have already been most meticulous in their choice of the franchisee as the original holder of the franchise for this particular outlet. Why then should they be any less meticulous in their approval of a replacement? Naturally, they will want to be satisfied that any successor to the original franchisee is equally suitable for that purpose. In practice, there is normally very little difficulty in the achievement of successful assignments of the franchised business. Some agreements provide for the payment of fees to the franchisor to cover the costs of dealing with applications and training the new, replacement franchisees.

(5) Franchisees may find themselves becoming too dependent upon the franchisor and fail to produce the personal drive which the system provides. Some franchisees lose their perspective. They delude themselves into believing that the franchisor has a duty to be so involved with their particular business to ensure that it has a flow of customers, and to provide a day-to-day involvement, which is inconsistent with franchising as a concept.

(6) The franchisor's policies may affect the franchisee's profitability. For example, the franchisor may wish to see his franchisee build up to a higher turnover from which he gets his continuing franchise fee, while the franchisee may be more concerned with increasing his profitability, which does not always necessarily follow from increased turnover.

²¹¹ Franchise Council of Australia (2018) *Disadvantages of the Franchise System*. Available from: <https://www.franchise.org.au/process/knowledgebase/knowledgeBaseAnswers.html?categoryId=282&answerId=10>

(7) The franchisor may make mistakes in their policies. They may arrive at decisions, relating to innovations in the business, which turn out to be unsuccessful and detrimental to the franchisee. This is why franchisors are always urged to market test innovations thoroughly in their own company-owned outlets, and to be able to demonstrate to franchisees the cost effectiveness of introducing new ideas²¹².

(8) The good name of the franchised business and its brand image may become less reputable for reasons beyond their own control (Franchise Council of Australia, 2018). The steps that help to guide entrepreneurs when they are developing a franchise system are discussed in the next section.

5.11 Steps taken when developing a franchise system

There is no fixed guideline that helps entrepreneurs to develop a successful franchise enterprise. Today entrepreneurship experts and researchers now develop various integrated process steps to follow when developing a franchise system.²¹³ According to Stowe (2015):

(1). *Undertake a feasibility study* (or just your own due diligence to prove that the concept you have can work). I become very concerned when I hear from potential franchisors that they have not opened nor run the business they are planning to franchise. Even major international companies intending to open in Australia can tell me that trialling the concept is up to the master franchisor – and they ask me if I know anyone with \$5m to invest?

(2) *Understand that the costs* to develop a workable franchise system are likely to range from \$50,000 to \$100,000 and attempting to achieve this more cheaply is a false economy. I am often asked to postpone payment for my company's service, and I remind the client that we are consultants, not a bank.

²¹² Franchise Council of Australia (2018) *Disadvantages of the Franchise System*. Available from: <https://www.franchise.org.au/process/knowledgebase/knowledgeBaseAnswers.html?categoryId=282&answerId=1038>

²¹³ Stowe, S. (2015) *15 Steps to Setting Up a Franchise*. Available from: <http://www.franchisebusiness.com.au/news/15-steps-to-setting-up-a-franchise>

(3) *Arrange the writing of your operations manuals.* Either do it yourself or work with a professional who will have templates. Don't limit yourself to thinking only of printed manuals; in today's digital environment franchisees like to access information online.

(4) *Strategic network planning.* This is thinking in terms of what the network may look like in five or 10 years and the kinds of locations you will need. This investment may save you from expensive mistakes, as there is no cheap reversal in leaving or closing a store. Consider too that if the store you approved turns out to be a disaster you will need to demonstrate the process used to make the decision; lost court cases can be very costly.

(5) *Site selection policy* – decide what type of stores you are seeking in terms of size, where they sit in terms of impulse or destination purchasing, and how you can instruct other people in what you are looking for. Issues need to be considered include size, traffic (*vehicle or pedestrian*), visibility, parking, access, local generators (*or neighbours*).

(6) *Most service franchises need to grant territories.* This is particularly important if you have a central ordering concept where 'leads come-in by phone or computer'. Decide on the size of territories and how many there should be in each main market. Well thought-out territories make it easier to grow your business.

(7) *Sort out your marketing* and make the necessary decisions on who is your potential customer and how to find them. How will you attract them, inform them and entice them to make the call to purchase?

(8) *Find your first few stores.* This can be undertaken internally, or you may want to appoint a professional site finding company which is an expert in negotiating with leasing agents and real estate agents²¹⁴.

(9) *Appoint a law firm* to write your disclosure agreements and franchise agreements. This may involve some major decisions as the agreements need to be in line with what you are offering a franchisee. Considerations include the length of the franchise period and options to

²¹⁴ Stowe, S. (2015) *15 Steps to Setting Up a Franchise*. Available from:
<http://www.franchisebusiness.com.au/news/15-steps-to-setting-up-a-franchise>

renew, whether or not the business is territory based, will territories be exclusive or non-exclusive, exclusion zones and many other issues that will govern how you operate in the future.

(10) *Attract future franchisees*. This is crucial to the future of the business so how will this be done? Review the options and decide how much involvement you want in the process of acquiring leads and selecting franchise buyers. You can manage everything yourself, engage help along the way with lead generation or appoint a specialist who will qualify future franchisees on your behalf. Decide on a process to approve franchisees. How will franchise buyers be profiled and interviewed?

(11) *Match up an approved franchisee and the desired site*. The timing isn't always right, so decide whether if you will keep a franchisee on hold and wait for the right site, or take on a location to run as company-owned until the right franchisee turns up.

(12) *Fit-outs*. Once you have the franchisee and site in place, if you have a retail business you will need to fit-out the premises. Consider whether if you will appoint a company or allow the franchisee to organise the store fit-out themselves? Either way controls need to be in place to ensure that it meets the brand standards, which hopefully must be well documented in your operations manuals – step 3.

(13) *Training* - your franchisee now needs to be trained in the system. Ensure there is a clear training plan (*which may or may not feature business skills*), and consider whether any of this training will be handled by an external trainer. The better trained and confident the franchisee, the more effective their initial trading period will be.

(14) *Plan the opening*. Many things need to come together at the same time to open successfully. This can include stock, equipment, staff, vehicles and local area marketing.

(15) *Open the new franchise*, and support the franchisee who is probably taking the biggest business decision in their lives. They may need their hand held and that is what field staff and operations teams need to do – even if one person is holding the title of franchisor, managing director, development manager and chief operations officer²¹⁵ (Stowe, 2015). There are several

²¹⁵ Stowe, S. (2015) *15 Steps to Setting Up a Franchise*. Available from:

<http://www.franchisebusiness.com.au/news/15-steps-to-setting-up-a-franchise>

guidelines that help franchisees before they purchase a franchise and these are discussed in the following section.

5.12 Guidelines to follow before buying a franchise

Entrepreneurs must ensure that they select franchise enterprises that relate to their personality and entrepreneurial mindset to succeed in having long term mutual relations. Nowadays several organizations provide free advise on how to guide entrepreneurs about what they can or cannot do when buying a franchise business for instance professional associations, financial institutions, accounting & auditing consultants, legal firms and so on. ²¹⁶According to the Franchise Council of Australia (2018) in Australia today there is a franchise operating in almost every type of business category, with varying levels of complexity and cost. Prior to buying a franchise, potential franchisees should do the following;

- (1) Assess your own reasons for wanting to own a business;
- (2) Assess the lifestyle and income implications of owning and operating a business;
- (3) Assess the franchise opportunities consistent with 1 and 2 above.
- (4) Build your understanding of the franchise relationship by reading the Franchise Guide.
- (5) Narrow your franchise search to a few systems, then request further information.
- (6) If appropriate, and you are comfortable with the decision, select a system and commence the application process.
- (7) Ensure that you have adequate borrowing capacity, including working capital, to successfully establish this type of business.
- (8) Be sure you receive and evaluate all disclosure material during the application process.

²¹⁶ Franchise Council of Australia (2018) *What is Franchising*. Available from: <https://www.franchise.org.au/what-is-franchising.html>

(9) Be sure you receive legal and accounting advice from lawyers and accountants with franchise experience before making any final commitment.

(10) Use the cooling-off period to check your facts and figures and determine if you still want to proceed.

This is by no means an exhaustive list of things you should consider prior to buying a franchise, but if you work through these 10 steps you will be at less risk of rushing headlong into a hasty and ill-informed decision (Franchise Council of Australia, 2018). There are several common mistakes entrepreneurs make about franchising and this will be covered in the following section.

5.13 Common mistakes entrepreneurs make about franchising

Most entrepreneurs have a tendency to make misinformed decisions when it comes to franchising. The common mistakes most entrepreneurs make about franchising are depicted in Figure 5.5 below.

Figure 5.5 Common mistakes made by franchisees & franchisors



Source: Modified (Stowe, 2016; Whichfranchise.co.za, 2018)

5.12.1 The four common mistakes made by ‘franchisors’ include the following:

5.12.1.1 Not investing in expert advice

²¹⁷According to Stowe (2016) have you obtained expert advice to ascertain franchise viability prior to franchising? Franchising is a complex, specialized, regulated industry. Before charging into the franchising arena, deliberation and research should be carried out prior to embarking into franchising. Professional franchising specialists conduct client feasibility studies to evaluate the franchising proposition for their business client. Most importantly, a properly executed franchise feasibility study should ascertain whether both the franchisee and the franchisor can profit from the venture. Judging by recent franchising horror stories, it is apparent that some franchise systems are so flawed that franchisees are unable to return any profit. A responsible franchising consultant will not take a business down the franchising path unless they are confident and have documented evidence in the form of a franchising feasibility report that a franchisee and the franchisor can profit from franchising (Stowe, 2016, www.franchisebusiness.com.au/).

5.12.1.2 “Running flawed systems

There are franchisors who do not review their franchise system on a regular basis and run flawed systems. Some of the biggest franchises are the worst culprits; they focus on turnover and sales as opposed to the bottom line. Franchise systems need to be reviewed on a regular basis. An objective, professional opinion is always worthwhile” (Stowe, 2016, www.franchisebusiness.com.au/).

5.12.1.3 “Franchisors' inconsistency

In best practice franchise systems, franchise agreements do not change from franchisee to franchisee. The agreements remain unchanged and consistent. The reality is that in many smaller franchise systems, a franchisor in an effort to secure a sale will amend the franchise agreement. This can result in each franchisee having a slightly different franchise agreement. The logistics of a franchisor being able to recall every different agreement is impractical and confusing and should be avoided. Inconsistency can also occur when a franchisor treats franchisees differently in terms of support or benefits and this can extend to turning a blind eye to compliance matters and breaches of the system. Franchisor senior management need to manage this situation closely” (Stowe, 2016, www.franchisebusiness.com.au/).

²¹⁷ Stowe, S. (2016) *Six Common Mistakes Made By Franchisors*. Available from: www.franchisebusiness.com.au/news/six-common-mistakes-made-by-franchisors

5.12.1.4 “Franchisors not enforcing compliance

Franchisors who wish to be every franchisee's 'mate' have problems when they want to enforce compliance to the system. Franchisees are protected by their franchisor enforcing compliance to the system. It is the franchisor's obligation to protect the brand and the system on behalf of the franchisees. Typical problem area examples are; when a franchisee elects to supply non-approved products or services. This can have repercussions with safety issues, general quality control issues, and brand control. If one franchisee gets away with supplying non-approved items by the franchisor turning a blind eye, the situation can deteriorate as other franchisees may choose to follow” (Stowe, 2016, www.franchisebusiness.com.au/).

5.12.2 Common mistakes made by ‘franchisees’

²¹⁸According to www.whichfranchise.co.za (2018) navigating the financial aspects of franchising can be challenging and common mistakes can range from lapses in judgment to serious miscalculations. The most common causes of franchise failure are: lack of funds, poor people skills, reluctance to follow the formula, a mismatch between the franchisee and the business, and poor management (www.whichfranchise.co.za). Furthermore, according to www.whichfranchise.co.za (2018) here are some common financial mistakes made in the early stages of buying and operating a franchise business:

5.12.2.1 Failing to understand the legal and financial obligations

Failing to understand the legal and financial obligations contained in the *franchise disclosure document* (FDD), the franchise agreement, any accompanying development agreements, as well as related franchise contracts. It is a good idea to invest some money in obtaining advice from legal and financial advisers with experience in franchising, to help you understand the legal and financial obligations of the franchise relationship.

²¹⁸ www.whichfranchise.co.za (2018) *Common Financial Mistakes Made By New Franchisees*. Available from: <https://whichfranchise.co.za/common-financial-mistakes-made-new-franchisees/>

5.12.2.2 Underestimating the startup costs

Underestimating the start-up costs of a franchise business. It is important to have a good understanding of all the costs that will be incurred so that you can arrange for appropriate levels and sources of financing.

5.12.2.3 Not planning properly for future capital needs

Not planning properly for future capital needs, including renovations, refurbishment, and new equipment, etc. to comply with the franchisor's requirements and keep the business up-to-date. It is important to set aside a reserve fund for these requirements.

5.12.2.4 Undervaluing your personal liability as the owner

Undervaluing your personal liability as the owner. It is common for the franchise owner to be required to personally guarantee all kinds of obligations for the business, and it is therefore vital to understand the exact nature of personal liabilities (www.whichfranchise.co.za).

5.14 Conclusion

Therefore, franchising has now become a popular form of starting up a small business. A good franchisor assists franchisees with training support, provides prime locations for franchise outlets and so on. Some of the common mistakes made by entrepreneurs or potential franchisees when buying a franchise business include: failure to read and seek professional advice when reading the franchise disclosure agreement, failure to conduct in-depth market research in order to have a better understanding of the franchisor's (*products, services, history, market share, positioning, brand power, marketing strengths or weaknesses and so on*). Nowadays it has become the norm that almost all franchise enterprises around the world are supposed to fully disclose their terms and conditions statement or uniform franchise offer circular (UFOC) in order to explain to franchisees about their services and the actual costs of buying a franchise business from them.

5.15 Discussion questions

1. Define a franchisor, franchisee, and franchise? Briefly explain the history of franchising where it is believed to have originated?
2. Outline at least four motivations of franchisors and franchisees to decide to enter the field of entrepreneurship via franchising?
3. Discuss at least five economic advantages of franchising to an economy? Identify seven types of franchises that can be used by entrepreneurs to enter the field of entrepreneurship and please provide relevant examples?
4. Describe at least three benefits of franchising to franchisors and franchisees? Discuss the steps entrepreneurs can follow when designing a franchise system?
5. Outline the 10 guidelines to follow when buying a franchise? Discuss the common mistakes often made by both franchisors and franchisees?

Chapter 6: Small business marketing & human resources management

After studying this chapter you should be able to:

- Define marketing and identify the importance of marketing in a small business today.
- Describe the marketing concept and market research in-depth. Discuss why market research is important for a small business.
- Explain in detail what market segmentation entails and the four bases of segmenting markets. Highlight the meaning of the terms product positioning and branding.
- Discuss the integrated marketing communication and its benefit to a small business. Describe the elements of the marketing mix 4 P's (product, price, place and promotion).
- Outline the various functions of the human resources management. Discuss the meaning of the term human resources management.
- Describe the importance of human resources management activities to an organization.

6.1 Introduction

Today the success of every small business revolves around effective marketing and human resources management. The marketing function tends to be one of the most critical business activity in a small business that wants to successfully sell its products/services at a profit. Generally marketing activities in every small business enable it to sell and develop good long term relationships with customers at a profit. The globalization of the world into a single economy has been accelerated by technology which has increased the levels of competition for small businesses thus making the marketplace highly saturated with global competition. Small businesses today are now forced to vigorously educate, create awareness and persuade customers to buy their products or services while consistently offering them real value and convenience. Customer focus is now the main goal of marketing in each and every organization that wants to offer its products/services to customers at the right time, quality, price and place. The business environment (*especially technological, social, economic and legal factors*) is consistently changing on a regular basis due to global competition, technology, changing legislation and

socio-demographic patterns. Consumer buying behavior and culture are consistently changing on a daily basis thus this has created the need for small businesses to place more emphasis on carrying out market research so that accurate strategic decisions can be made using real facts or figures. The marketing function easily achieves its goals if it works in liaison with other departments namely: the operations & production department (*in order to receive adequate supplies of finished products of the right quality ordered by customers*), human resources (*to receive adequate supply of well qualified & trained salespeople*), finance (*to receive adequate advertising & sales promotion budget allocations*), information technology (*to receive technology support such as creation of attractive company websites & social media accounts*) and so on. Therefore, the key sub-components of effective marketing management of a small business that will be covered in this chapter are depicted by Figure 6.1 below.

Figure 6.1 Eight components of effective marketing management of a business



The meaning of the term marketing has been highlighted in several publications and this topic will be covered in the following section.

6.2 Definition of marketing

Marketing involves the process of identifying and satisfying customer needs or wants through providing them with high quality products, services and value at a profit whilst at the same time managing customer relationships and retaining loyal customers²¹⁹ (Tabassum, 2014:41). A small business in order to be able to market its products or services profitably it has to offer something of value to its customers (Tabassum, 2014:41). By doing so an exchange relationship is created since the business provides the customers with the right products or services in return for money or credit on an on-going basis. The exchange relationship can only function properly if the customers continue to receive products or services that satisfy their needs and wants or they perceive to have something of value²²⁰ (Wilkie and Moore, 2007:269). For example, a good example of an organization that offers its customers key benefits they consider to be of high value is Qantas Airways founded in the Queensland in 1920. Qantas has grown to be Australia's largest domestic and international airline. Registered originally as the *Queensland and Northern Territory Aerial Services Limited* (QANTAS), Qantas is widely regarded as the world's leading long distance airline and one of the strongest brands in Australia²²¹ (Qantas, 2018). Today Qantas has built a reputation for excellence in safety, operational reliability, engineering and maintenance, and customer service (Qantas, 2018). The Qantas Group's main business is the transportation of customers using two complementary airline brands - Qantas and Jetstar (Qantas, 2018). It is important to highlight the fact that creating *utility* is one of the main responsibilities of the marketing function in a business. Generally everything about a product/service that makes customers to see it as highly attractive and valuable is referred to as *utility*. A good example of an organization that offers its customers utility is Qantas. Today

²¹⁹ Tabassum, S. (2014) The Changing Role of Marketing in Contemporary Organization. *International Journal of Managerial Studies and Research (IJMSR)*, Volume (2) (9) October Available from:

<https://www.arcjournals.org/pdfs/ijmsr/v2-i9/5.pdf>

²²⁰ William L. Wilkie and Elizabeth S. Moore (2007) What Does the Definition of Marketing Tell Us About Ourselves?. *Journal of Public Policy & Marketing: Fall 2007, Vol. 26, No. 2*, pp. 269-

276. <http://journals.ama.org/doi/abs/10.1509/jppm.26.2.269>.

²²¹ Qantas (2018) *Our Company*. Available from: <https://www.qantas.com/travel/airlines/company/global/en>

Qantas offers customers a number of products and one of them is the Qantas Explorer which enables Qantas customers to fly from the Great Barrier Reef in North Queensland, to the Northern Territory's red centre or cityscapes of Sydney, Melbourne, Brisbane and Perth including more than 30 Australian destinations that encompass over 80 routes so that its customers may see more of Australia for less²²² (Qantas, 2018). ²²³In this 21st century Qantas is one of the leading airline carriers' with a state-of-the-art fleet (Qantas, 2018). The definition of marketing concept will be covered in the following section.

6.3 The marketing concept

The *marketing concept* is also known as the marketing orientation which refers to the continuous collection of information in the market pertaining to customer's current preferences or tastes and how the organization focuses on strategically integrating the sharing of such valuable customer information in a well coordinated manner²²⁴ (Kohli and Jaworski, 1990:6). The *marketing concept* is a marketing philosophy that helps to ensure that the company treats its customers as kings or queens in order to show them that their views or choices are highly valued and respected by the company (Wright and Pearce, 1995:136). In addition the marketing concept is guided by four dimensions namely: customer focus, profitability, customer value and customer satisfaction. A firm that focusses on fulfilling the needs of its customers through regularly conducting market research and adding perceived value to its products or services through new product innovation, pricing or after sales services in a well coordinated manner is more likely to achieve high customer satisfaction at a profit (Kohli and Jaworski, 1990:6). Nowadays the marketing concept helps to guide businesses to aim to produce products or services that customers' need and want

²²² Qantas (2018) *Qantas Explorer*. Available from:

https://www.qantas.com/us/en/promotions/alaskaairlines.html?int_cam=us%3Aen%3Aarticle%3Ait-s-a-g-day-to-fly%3Aen%3Ann

²²³ Qantas (2018) *Subsidiary Companies*. Available from:

<https://www.qantas.com/travel/airlines/subsidiaries/global/en>

²²⁴ Ajay K. Kohli and Bernard J. Jaworski (1990) Market Orientation: The Construct, Research Propositions, and Managerial Implications, *Journal of Marketing*, Vol. 54, No. 2 (April), pp. 1-

18. https://www.jstor.org/stable/1251866?seq=1#page_scan_tab_contents.

not what they think customers want by ensuring that they consistently gather market intelligence about their current or future needs (Kohli and Jaworski, 1990:6).

Companies that follow the marketing orientation continuously develop new products so that they can keep up with the rapidly changing customer tastes or preferences which lead to consistent customer satisfaction and ultimately higher profitability. Most businesses that implement the marketing concept tend to have a higher market share and customer satisfaction than their counterparts that do not implement the concept²²⁵ (Wright and Pearce, 1995:137). Another key element of the marketing concept is that it helps to guide the company to develop long term customer relationships through maintaining customer satisfaction which also helps to improve the firm's overall financial performance (Tabassum, 2014:41). Building relationships with customers allows companies to create customer loyalty. The marketing orientation philosophy should be one of the company's objectives that should also be coordinated into other departments' strategies so that they become fully aware of the customers' needs and wants (Kohli and Jaworski, 1990:6). The marketing concept mainly thrives if the company consistently conducts market research on the customers' attitudes, opinions, demographic data and so on. In the following section market research will be covered in detail.

6.4 Market research

The consistent changes in customer demographics, consumer buying behavior and so on puts enormous pressure on small businesses to continue to carryout market research in order to gather information about their updated customer needs or wants so that they successfully continue to develop new products or services that can fully satisfy them. "Research carried out to provide information for organisations, to help guide decisions and policy. Regularly used by commercial businesses, it is also employed by public sector and non-profit organisations. *Market research* often involves collecting information about how, why and what people buy, but it is sometimes

²²⁵ Wright, N. and Pearce, J. (1995) The Marketing Concept and Customer Satisfaction: An Empirical Examination of Customer Service, Financial Performance and Integrated Effort. *Journal of Consumer Satisfaction, Dissatisfaction and Complaining Behaviour, Volume 8, p136-139.*

used as an umbrella term covering opinion research and some kinds of social research”²²⁶ (Association for Qualitative Research, 2018, www.aqr.org.uk/). Today market research is critical in an organization’s operational life. Today market intelligence gathering, communication and storage are now playing a critical role in every business today and there has been numerous innovations aimed at refining market intelligence gathering technologies. Innovations on how to improve the communication and storage of market intelligence has enabled entrepreneurs and decision makers in businesses to have unlimited access to critical up-to-date marketing information in order for them to solve problems they need to be able to make good decisions. Generally the problems that are found in businesses often need to be thoroughly investigated in order to expose their root causes so that entrepreneurs can effectively seek permanent solutions to deal with them thus marketing research is one way of effectively investigating the root causes of organizational problems²²⁷ (Hyman and Sierra, 2015:1).

Business decisions are made using facts and these are found by carrying out market research on a regular basis. Competitors’ maneuvers and changing consumer buying trends can easily be tracked through conducting market research. A typical good example is that of an automobile manufacturer headquartered in the United States of America through carrying-out market research it can quickly discover that its targeted customers’ tastes in automobiles are changing. They may now be preferring vehicles that are more fuel efficient and that have features such as: (1) voice technology control systems, (2) reverse/park cameras in all their vehicle models, (3) electric rechargeable options instead of being fuel powered vehicles only and so on. Thus market research is a vital cost saving activity that helps a small business to save money through ensuring that the organization has adequate factual information about its consumers needs/wants so that it may produce the right products/services its targeted customers need at the right price, cost, time and place. In general before a ‘firm opens its doors for business’ it must first determine whether a market really exists for its products or services and the definite way to achieve this is by

²²⁶ Association for Qualitative Research (2018) *Market Research*. Available from: <https://www.aqr.org.uk/glossary/market-research>

²²⁷ Hyman, M.R. and Sierra, J.J. (2015) Marketing Research Process: Six Stages. *Business Outlook, Volume (13) (4) April*.

conducting market research. It is important for entrepreneurs to know that the marketing research process consists of various interrelated stages or steps as conclusions from one stage can help to generate ideas on problem solving²²⁸ (Hyman and Sierra, 2015:1). Segmenting of markets is critical for small businesses and this will be discussed in the following section.

6.5 Market segmentation

One of the first things a new small business must do is identifying who its customers are and how to reach them. The firm should analyze the industry it will operate in so that it establishes the various possible target markets that exist in that industry. It is the goal of every firm to focus on a specific group of customers it can sufficiently fulfill its needs in a cost effective way and be able to customize its marketing strategies that enable it to develop good relationships with its customers at a profit (Goyat, 2011:45). When a firm divides its customers into groups or segments that share similar needs and wants in order to adequately fulfill their needs with its products/services is called *segmentation* (Goyat, 2011:45). *Market segmentation* – is the process of splitting a diverse market into similar sub-units that have a common characteristic and that also share identical product needs and wants (Saxena, 2006:198; Ferrell and Hirt, 2000:307). When a segment is measurable and accessible it becomes easy for the small business to provide its products/services to the market segment at a reasonable cost that enables it to make a profit. Most firms use segmentation to focus their marketing efforts and limited resources on a particular target market in order to create an effective marketing strategy and be able to gain competitive advantages through effectively serving that particular segment cost effectively²²⁹ (Goyat, 2011:45). Therefore, market segmentation allows a business to conduct niche marketing. Small businesses are commonly faced with capital financing challenges and niche marketing is one way they can reduce marketing costs. Niche marketing includes the company choosing a market segment and in that segment it selects a small exclusive segment with a distinctive and

²²⁸ Hyman, M.R. and Sierra, J.J. (2015) Marketing Research Process: Six Stages. *Business Outlook, Volume (13) (4) April*.

precise set of needs (Goyat, 2011:45). Marketers use five bases to segment markets and these will be discussed in the next section.

6.6 The four bases for segmenting markets

Many companies segment their markets using the following four bases;

6.6.1.1 Demographics

The *demographics* involve the subdividing of the customers based on various demographic qualities that include the following: social class, race, age, marital status, culture and so on.

6.6.1.2 Geographics

Thus, *geographics* involves segmenting the market according to geographical areas such as cities, regions, suburbs or townships. Geographics assist businesses to properly customize their marketing activities and create products/services that can cater for the needs of customers physically located in different geographical areas. For example, a food manufacturer based in the United States of America that manufactures tea, coffee, ice creams, peanut butter, soft drinks, yoghurts, chocolates and many other products can use geographic segmentation. In cold regions of the United States of America such as the magnificent State of Alaska the food manufacturing firm will sell more of its coffee, tea, biscuits or cookies, peanut butter and chocolates products since they are more likely to be consumed in high quantities due to the cold weather conditions often experienced in the region. On the other hand hot weather regions in the United States of America such as the magnificent States of Texas and Arizona (*where temperatures can range as high as 32° - 37° degrees Celsius*) the firm will sell more of its ice creams, soft drinks, chocolates and yogurts due to high demand as a result of the hot weather conditions that make customers consume more refrigerated products to cool down their body temperatures.

6.6.1.3 Psychographics

In general *psychographics* involves the analyzing of customers psychological thinking by specifically looking at customers' attitudes, views, personality and buying behavior such as brand choices, media choices, ethics and self-esteem (Goyat, 2011:48). For example, a company can analyze the external influences that affect a customer to continue to travel using the same airline carrier brand from their childhood until they have reached retirement age. Generally some

customers simply prefer to fly with one airline carrier because their parents used to continuously use it when they were travelling to domestic or international destinations. In addition other people simply use the same airline brand due to the fact that they recognize its strong brand and excellent customer service history. ²³⁰A good example of a leading global airline brand that has high customer loyalty is Qantas Airways founded in the Queensland in 1920 and today it is one of the few airlines with a high customer loyalty rate in the world as result of its good reputation for excellence in operational reliability, engineering, maintenance, and customer service (Qantas, 2018). The Qantas Group's main business is the transportation of customers using two complementary airline brands - Qantas and Jetstar²³¹ (Qantas, 2018).

6.6.1.4 Behavioral segmentation

When a market is sub-divided based on the rate at which customers consume a product/service and or using their general behavior it is called *behavioural segmentation*. The market positioning of products is important for small businesses and this will be discussed in the following section.

6.7 Market Positioning

One of the critical steps that must be taken by a business that has successfully chosen its niche market or target market is positioning its products in the market. Product positioning is one of the most critical component of any marketing plan in an organization. ²³²“*Market Positioning* refers to the ability to influence consumer perception regarding a brand or product relative to competitors. The objective of market positioning is to establish the image or identity of a brand or product so that consumers perceive it in a certain way. For example: • A handbag maker may position itself as a luxury status symbol, • A TV maker may position its TV as the most innovative and cutting-edge, • A fast-food restaurant chain may position itself as the provider of cheap meals. *Types of Positioning Strategies*. There are several types of positioning strategies. A few examples are positioning by:

²³⁰ Qantas (2018) *Our Company*. Available from: <https://www.qantas.com/travel/airlines/company/global/en>

²³¹ Qantas (2018) *Subsidiary Companies*. Available from:
<https://www.qantas.com/travel/airlines/subsidiaries/global/en>

²³² Corporate Finance Institute (2020) *Market Positioning*. Available from:
<https://corporatefinanceinstitute.com/resources/knowledge/strategy/market-positioning/>

- *Product attributes and benefits*: Associating your brand/product with certain characteristics or with certain beneficial value
- *Product price*: Associating your brand/product with competitive pricing
- *Product quality*: Associating your brand/product with high quality
- *Product use and application*: Associating your brand/product with a specific use
- *Competitors*: Making consumers think that your brand/product is better than your competitors” (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com/>). The following section will cover in-depth aspects relating to market repositioning.

6.7.1 Market Repositioning

²³³“*Market repositioning* is when a company changes its existing brand or product status in the marketplace. Repositioning is usually done due to declining performance or major shifts in the environment. Many companies, instead of repositioning, choose to launch a new product or brand because of the high cost and effort required to successfully reposition a brand or product” (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com/>). In the following section product positioning will be covered in-depth.

6.7.2 Product positioning

²³⁴“*The product positioning process*. In order to successfully sell to the various market segments that will make up any consumer base, a product must have an explicit and distinct place in the minds of all potential customers. In [the age of the customer](#), where consumers have vastly increased information and choice, a product must be marketed to specific groups, with a clear identity that highlights the benefits to the consumer. Product positioning is most successful after an analysis of the market and the different sections your product can appeal to. Called the

²³³ Corporate Finance Institute (2020) *Market Positioning*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/strategy/market-positioning/>

²³⁴ Brandwatch (2020) *A Complete Guide to Product Positioning*. Available from: <https://www.brandwatch.com/blog/guide-product-positioning/>

segmentation, targeting and positioning model (or STP process), this framework allows more directed marketing. *Product positioning*. *Product positioning* is the part of the strategy concerned with how you are going to market to your segments. It identifies the benefits that each segment will receive from your product. You need to understand where you can reach these groups, and communicate the benefits in a targeted way that appeals to what you have learned about them” (Brandwatch, 2020, <https://www.brandwatch.com/>). Product positioning is associated with branding and this will be discussed in the following section.

6.8 Branding

“*Branding* is a way of identifying your business. It is how your customers recognise and experience your business. A strong brand is more than just a logo; it's reflected in everything from your customer service style, staff uniforms, business cards and premises to your marketing materials and advertising. Your brand should reflect what your business stands for and what sets it apart from your competitors - it expresses the qualities, strengths and 'personality' of your business. Creating a strong brand involves in-depth market research to work out why customers should be attracted to your business”²³⁵ (State of Queensland, Australia, 2020, www.business.qld.gov.au). ²³⁶According to Bhati (2017) building a brand takes years of strategizing, planning, and money; a fact some of the biggest brands in the world would easily confirm. In this era of unlimited choices, a startup is required to build a brand that is consistent, memorable and differentiated to captivate consumers and eventually capture mind share. However, there is no instruction manual for building a brand. Brand position and reputation are built slowly and earned over a period of time, and the process takes years. Emerging startups can, however, look to a few key aspects to ensure a great brand recall, salience and reputation over the years. Good names, like good logos, evoke a strong passion for your brand, while bad names elicit distaste or worse still, indifference. A great brand name can be a solid competitive advantage for your company, especially when feature sets between two or more brands are

²³⁵ State of Queensland, Australia (2020) *Branding for Business: the Basics*. Available from: <https://www.business.qld.gov.au/running-business/marketing-sales/marketing-promotion/branding-basics> © The State of Queensland 2019 [Accessed February 04, 2020] © Commonwealth of Australia 2020.

²³⁶ Bhati, R. (2017) *Why Brand Name is Important for Start-Ups?* <https://www.entrepreneur.com/article/288155>

roughly the same. A brand's value is what it offers its customers and what it promises to do for them in the long run and must convey its uniqueness in a way that the customer is drawn to use it just by the mention of its name. (Bhati, 2017, www.entrepreneur.com). Good examples of some of the world's leading brands in the market today include: Microsoft, LinkedIn and many others. "Used with permission from Microsoft". [Entrepreneurship & Business Innovation: A North America, Europe, Africa, Oceania & Asia 21st Century Perspective 1st Edition] is an independent [publication] and is neither affiliated with, nor authorized, sponsored, or approved by, Microsoft Corporation. "TWITTER, TWEET, RETWEET and the Twitter logo are trademarks of Twitter, Inc. or its affiliates." It is important for a new small business to create brands for their products so that they can better position them in the market. In addition a *brand name* is a sub element of the brand that can be communicated via speaking, using numerals and or writing. Whilst a *trademark* is whereby an individual or company registers their brand at the intellectual property or patents office in order for the brand to become exclusively owned by them²³⁷ (Ferrell and Hirt, 2000:331). Generally, a company can develop its brands using various methods that include: advertising, publicity (*free media coverage*), public relations activities and so on. The process of developing a marketing mix in a small business will be covered in the following section.

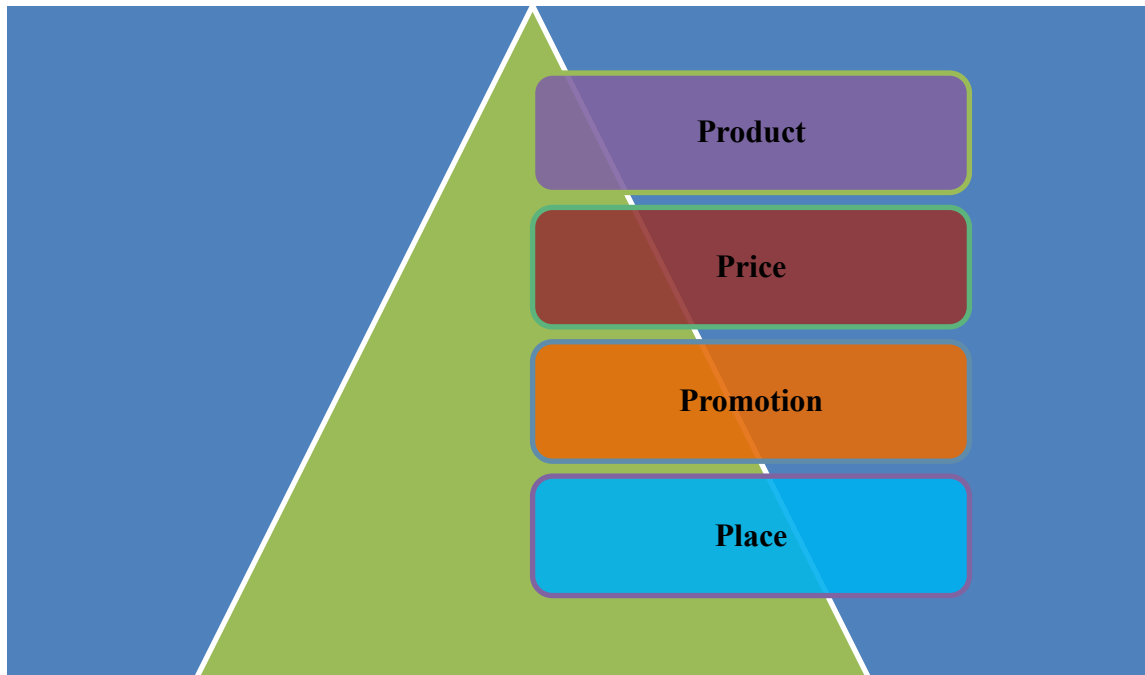
6.9 Developing a marketing mix

A small business's marketing activities should clearly support its business model and mission statement. Soon after clearly identifying the market and collecting all the necessary market intelligence the logical action to take is clearly determining how to appropriately channel the direction of the market programming including devising the various methods that will be used to fulfill the needs or wants of the consumers and outcompete market rivals (Singh, 2012:40). The marketing mix is made up of the 4 P's namely; product, price, place and promotion. One of the major components of establishing a marketing strategy is sustaining the right marketing mix that fulfills the needs of the niche market and results in the establishment of long term relationships with customers (Singh, 2012:40). The marketing mix should be used in such a way that it creates a competitive advantage in the marketplace because the firm has to choose at least one of the 4

²³⁷ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p42 – 341.

P's to offer a unique customer benefit that customers value²³⁸ (Singh, 2012:40). The 4 P's of marketing are depicted in Figure 6.2 below.

Figure 6.2 Four P's of Marketing



6.9.1 Product

A *product* is something that the firm offers to its customer in exchange for money and customers are willing to pay. The product is a key component of a firm's marketing mix since it directly affects customer satisfaction through product use, features, design or durability (Singh, 2012:40). Products can be tangible such as a brand new sport utility vehicle (*SUV*) BMW X7 and they can also be intangible in the form of a service such as a haircut from a saloon (Singh, 2012:40). Conducting marketing research will enable a company to know what type of product or service its target market wants and also the product should be able to offer some form of customer benefits in the minds of the customers. A product should be able to change people's lives or solve a problem that exists for example Luxembourg headquartered Skype Communications

²³⁸ Singh, M. (2012) *Marketing Mix of 4P's for Competitive Advantage*. *IOSR Journal of Business and Management*, Volume (3) (6) September – October. Available from: www.iosrjournals.org/iosr-jbm/papers/vol3-issue6/G0364045.pdf.

SARL which was founded in 2003 a division of United States of America headquartered Microsoft Inc. Skype introduced Internet communications software that was new in the market and life changing offering voice and video calling which completely simplified the way businesses carryout meetings or interviews since people no longer needed to fly millions of miles to attend a meeting or job interview. All they had to do was to connect their computers, mobile phones including television sets on the Internet and upload Skype app software and subscribe to the service then connect with anyone they wanted to communicate with at a much more affordable cost (Skype, 2018). “Skype’s text, voice and video make it simple to share experiences with the people that matter to you, wherever they are. With Skype, you can share a story, celebrate a birthday, learn a language, hold a meeting, work with colleagues – just about anything you need to do together every day. You can use Skype on whatever works best for you - on your phone or computer or a TV with Skype on it. It is free to start using Skype - to speak, see and instant message other people on Skype for example. You can even try out group video, with the latest version of Skype. If you pay a little, you can do more things, in more ways, with more people – like call phones or send texts. You can pay as you go or buy a subscription, whatever works for you” (Skype, 2018) (*the Skype software provides Internet communications products*) “Used with permission from Microsoft”. “[Skype is a trade mark or other intellectual property of the Microsoft group of companies] and [*Entrepreneurship & Business Innovation :A North America, Europe, Africa, Oceania & Asia 21st Century Perspective 1st Edition*] is not affiliated, sponsored, authorized, or otherwise associated with or by the Microsoft group of companies.” Generally products are classified into two categories namely: consumer products and industrial products. *Consumer products* are products meant for domestic use only. These products are classified into three categories namely; convenience products (*salt, tea and cooking oil*), shopping products (*furniture and so on*), and ‘service products’ as well (Ferrell and Hirt, 2000:328). A good example of an organization that offers its customers excellent ‘service products’ is Qantas the leading Australian airline. Qantas offers customers a number of products and one of them is the Qantas Explorer which enables Qantas customers to fly from the Great Barrier Reef in North Queensland, to the Northern Territory’s red centre or cityscapes of Sydney, Melbourne, Brisbane and Perth including more than 30 Australian destinations that encompass over 80 routes so that its customers may see more of Australia for less²³⁹ (Qantas, 2018). In this 21st century Qantas is one of the leading airline *carriers’ with a*

²³⁹ Qantas (2018) *Qantas Explorer*. Available from:

state-of-the-art fleet (Qantas, 2018). *Industrial products* are classified as follows raw materials (*natural resources such as cotton*), equipment and machinery (*such as a forklift*), component parts and so on²⁴⁰ (Ferrell and Hirt, 2000:329). It is crucial that an organization maintains the relationships of its products. A manufacturer's total range of products is referred to as its product mix and a product line refers to the manufacturer's total range of products associated by function for example product lines can include soap, soups, body lotions and so on (Williams, 2015). It is also critical for entrepreneurs to understand the product life cycle as it helps to determine the sales of a product during its life and the marketing strategy suitable for a product at a particular stage of the life cycle (Singh, 2012:41). Some products have shorter life spans especially technological gadgets such as computers, mobile phones or television sets due to ever-changing technological innovations. Other products tend to have longer life spans such as famous beverage soft drink brands have been in existence for over 100 years. Pricing is important for every small business and this will be covered in the next section.

6.9.2 Price

In general *price* refers to the financial value or worth of a product or service that is offered by a business that its customers are willing to pay so that they may use and own the product/service in question for their own benefit. Prices of goods/services are highly susceptible to changes in the business environment especially economic factors and this makes pricing a highly flexible or dynamic marketing mix element. "As the price of a product depends on different elements and hence if it changes constantly thus the pricing should be dynamic so that it can bear the changes over duration. The important factor in pricing is deciding the cost of the product, strategy for marketing & its expenses related to distribution, advertisement expenses or any kind of price variation in the market. Nonetheless if there is change in all the variables then the pricing of the product may vary accordingly" (Singh, 2012:42). Branding and product positioning are also influenced by the pricing strategy the organization uses. For instance most of the world's leading

https://www.qantas.com/us/en/promotions/alaskaairlines.html?int_cam=us%3Aen%3Aarticle%3Ait-s-a-g-day-to-fly%3Aen%3Ann

²⁴⁰ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p42 – 341.

automobile brands in the United States of America, India, Sweden, Germany, the United Kingdom and Italy charge premium prices for their vehicles and their customers are willing to pay more money so that they can enjoy excellent high quality driving, latest technological features (*such as artificial intelligence systems, voice recognition technology, night vision reverse/parking cameras, driverless functions, biometric central locking and so on*), elegance, innovative engine performance, latest safety features, durability and so on. The operational and research development costs that are incurred by a business when developing its products/services and target market influence its pricing strategies. Therefore, the pricing strategies that a business can use to sell its products to its target market include: the price skimming strategy, penetration strategy, psychological pricing and price discounting strategy. Promotion is one of the marketing mix elements that will be discussed in the following section.

6.9.3 Promotion

“Promotion in marketing means generally the introduction of a product and highlighting its merits to let the customers know why your product is better than the rest in the market and promotion helps to attract the business. Promotion is also realized as “what *makes a customer to value your product*”. Infact, it is not enough to produce the good product and hope for a sale but it is only the promotion factor which gives your product an edge over other products in the market. Interaction with business stakeholders can also help in the promotion of a product” (Tabassum, 2014:43). “*Choose your promotional activities*. The goal of marketing is to stand out and be noticed. Good marketing keeps drawing your customers' attention to your products and services. Your clearly defined, well-packaged, competitively-priced products and services are the foundation of your marketing. The newer you are in your market, the harder you have to work to attract and retain new customers. Many of your marketing activities will focus on communicating to customers the features and benefits of your products (i.e. compared to your competitors). Consider which promotional activities will best meet your marketing needs”²⁴¹

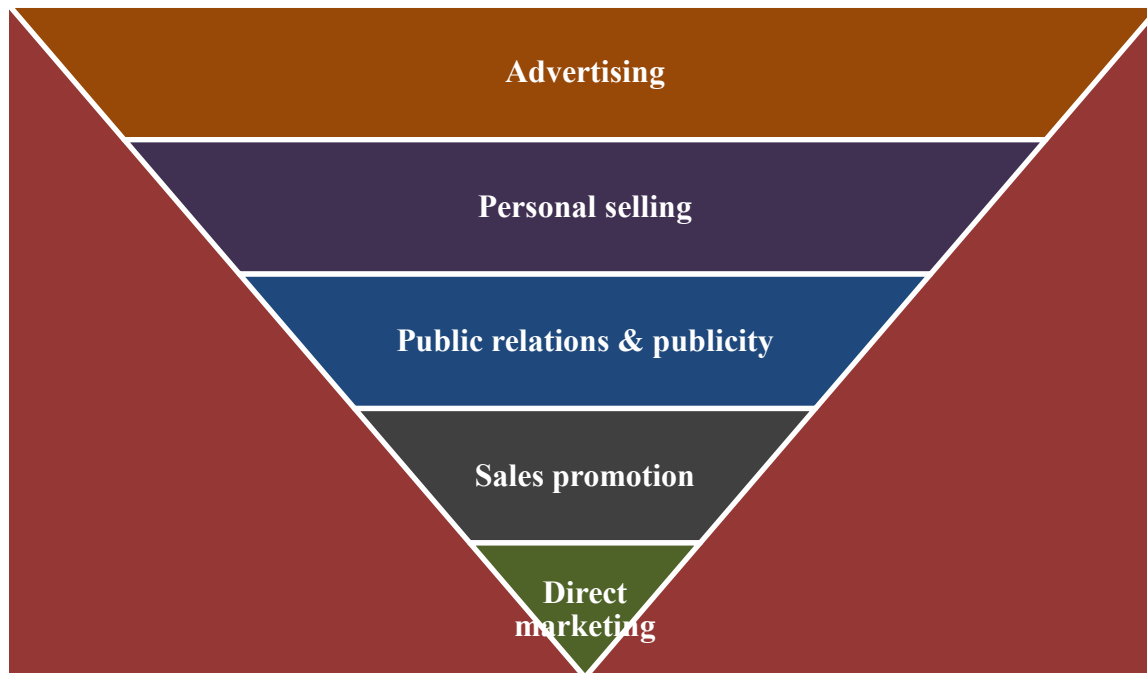
²⁴¹ State of Queensland, Australia (2020) *Promotional Activities*. Available from:

<https://www.business.qld.gov.au/running-business/marketing-sales/marketing-promotion/marketing-basics/promotional-activities> © The State of Queensland 2019 [Accessed February 04, 2020] © Commonwealth of

Australia 2020.

(State of Queensland, Australia, 2020, www.business.qld.gov.au). An integrated marketing communications ensures that a firm increases its sales, improves its image and creates good relations with its target audience. The five elements of the promotional mix are depicted in Figure 6.3 below.

Figure 6.3 Five elements of the promotional mix



Source: Modified: (Singh, 2012:40; Tabassum, 2014:43; Entrepreneur.com, 2018, www.entrepreneur.com; State of Queensland, Australia, 2020, www.business.qld.gov.au).

6.9.3.1 Advertising

According to Entrepreneur.com (2018) the definition of *Advertising* is “*To call the public's attention to your business, usually for the purpose of selling products or services, through the use of various forms of media, such as print or broadcast notices*”. Advertising provides a direct line of communication to your existing and prospective customers about your product or service²⁴² (Entrepreneur.com, 2018, www.entrepreneur.com). ²⁴³“*Advertising is an effective way*

²⁴² Entrepreneur.com (2018) *Advertising*. Available from: <https://www.entrepreneur.com/encyclopedia/advertising>

of promoting your products and services to your target audience and is usually a paid form of promotion. When you advertise you tell prospective customers who you are, where you are and what you can do for them. Good advertising should:

- build the image of your business
- explain the benefits of your products and services
- increase awareness of new products and services before, when and after they are launched
- generate interest from your target market, as well as a new audience of prospective customers
- encourage customers to ask for information about your business and provide options for how they can contact you
- increase the demand from customers and increase your sales” (State of Queensland, Australia, 2020, www.business.qld.gov.au).

Various forms of media can be used for advertising both paid or non-paid for instance radio, newspaper, podcasts, magazines, online adverts and social media to help the organization communicate integrated marketing messages. A successful advertising campaign leads to increased sales levels, market share, customer loyalty and enhanced brand recognition of the firm’s products/services including its corporate identity in the marketplace. According to Entrepreneur.com (2018) all products and businesses go through three stages, with different advertising goals for each one.

1. *The start-up business* - you're new in the market and need to establish your identity. Your company needs high levels of promotion and publicity to grab consumers' attention.
2. *The growing business* - once your identity is established, you need to differentiate yourself from your competition and convince buyers that yours is the service or product to try.
3. *The established business* - the purpose at this point is to remind consumers why they should continue buying from you (Entrepreneur.com, 2018, www.entrepreneur.com). The topic of public relations will be covered in the following section.

6.9.3.2 Public relations and publicity

One of the simplest ways of doing business whilst uplifting the community is through conducting public relations and publicity activities. In a company the *public relations* activity is concerned

²⁴³ State of Queensland, Australia (2020) *Advertising*. Available from: <https://www.business.qld.gov.au/running-business/marketing-sales/marketing-promotion/advertising> © The State of Queensland 2019 [Accessed February 04, 2020] © Commonwealth of Australia 2020.

with establishing good long lasting mutual relationships through consistently informing and educating customers and other stakeholders about the benefits of the firm's products/services while simultaneously communicating press release news about: the company's recent developments, corporate social responsibility goals, sponsorships, trade exhibitions, charity foundations and so on. As a result of the above mentioned activities the firm will automatically receive free media coverage in the mass media (*newspaper, radio or television*) and this is what is referred to as 'publicity'. "Public relations, or PR, is the practice of managing and guiding perceptions of your business to attract new customers and strengthen the loyalty of existing customers. Customers' perceptions can be shaped by direct experiences, the actions and observations of others, and the statements you make in the media and marketplace. Well-planned PR strategies are powerful tools for business. Unlike marketing and advertising, PR takes advantage of unpaid communication channels such as local and regional media, the internet, business networks and community and customer relationships. Typically PR garners more credibility than paid marketing efforts as the end result is usually produced by a third party. PR involves communicating with your market to raise awareness of your business, build and manage your business's reputation and cultivate relationships with consumers. While marketing focuses on promoting actual products and services, public relations focuses on promoting awareness, attitudes and behaviour change"²⁴⁴ (State of Queensland, Australia, 2020, www.business.qld.gov.au). Another promotional mix aspect is personal selling and this will be discussed in the following section.

6.9.3.3 Personal selling & direct selling

Direct selling is almost similar to personal selling and it is important to point-out the fact that in the field of sales management the term 'personal selling' and direct selling are dominantly used around the world. ²⁴⁵"*Direct selling* is an effective way to build long-lasting customer

²⁴⁴ State of Queensland, Australia (2020) *Public Relations*. Available from: <https://www.business.qld.gov.au/running-business/marketing-sales/marketing-promotion/pr> © The State of Queensland 2019 [Accessed February 04, 2020] © Commonwealth of Australia 2020.

²⁴⁵ State of Queensland, Australia (2020) *Direct Marketing*. Available from: <https://www.business.qld.gov.au/running-business/marketing-sales/marketing-promotion/direct-marketing/direct-selling> © The State of Queensland 2019 [Accessed February 04, 2020] © Commonwealth of Australia 2020.

relationships and grow a flexible, low-cost business. Independent sales people use direct selling to sell their products and services directly to customers in meeting places such as homes, offices and cafes, instead of in retail outlets. *Types of direct selling. Direct selling methods include:*

- **person-to-person sales** - arranging individual appointments with customers to make presentations, demonstrate new products or arrange product tests or fittings
- **door-to-door sales** - approaching homes and businesses by appointment or unannounced to leave catalogues and offer products or product demonstrations
- **in-home presentations** - arranging parties and at-home gatherings to present products (often called 'party plan').

Tips for direct selling. Know your products and have confidence in their ability to meet your customers' needs. Salespeople who are passionate about their products sell more. Support your passion with a thorough knowledge of your products. *Keep thorough customer records.* A detailed customer database helps build and track your networks, and is an invaluable source of information that can influence sales. Use your database to communicate periodically with your customers and distribute marketing material such as e-newsletters and event or product updates. *Organise your sales environment.* Arrive early at your party or event and carefully plan your product display, presentation space and seating position. Choose a layout that will help your customers maintain eye contact with you rather than each other. Consider ways to remove distractions in the room. For example, ask your host or hostess to close doors that are letting in noise or external activity. *Build your networks.* Your [network marketing strategies](#) are central to growing your business. Build strong, mutually beneficial relationships with your direct marketing colleagues. Catch up with, or communicate with, your colleagues regularly to share your selling tips and keep them motivated. *Polish your sales skills.* Your conversation skills, listening skills and well-developed approach to communication will help you build lasting customer relationships and grow a rewarding business” (State of Queensland, Australia, 2020, www.business.qld.gov.au/). Nowadays high value goods/services and or specialty products are usually sold using the personal selling methods for instance construction equipment manufacturers such as earth movers, excavators and so on. Additional examples of products such as cars, art, furniture and electrical appliances for households require the salesperson to educate the customers about their features or warranty. It is the most flexible promotional tool as a salesperson can change the terms of the sale in order to close a sale whereas with advertising or public relations it is not possible to quickly change the

terms of the sale. Personal selling helps an organization to effectively demonstrate and sell the key benefits of its products that distinguish them from competitor's products in the marketplace. In addition effective personal selling happens when salespeople uphold their ethical principles of honesty and listening to customer's concerns and ensuring that they address those needs with the right products/service in order to maintain long term good relationships. Personal selling prospers when salespeople in an organization are properly trained. The topic of sales promotion will be covered in the following section.

6.9.3.4 Sales promotion

"Sales Promotion. This is actually a catch-all term that covers any type of promotions other than the ones that are specifically mentioned here. The advantage of them is that they can induce traffic and sales by changing a buyer's perception of a product or service value. The disadvantage of sales promotions is the short-term nature of them often overshadows your company's long-term sales goals. Sales promotions can be done by putting coupons on a flyer or snack chips being sold on a point-of-purchase display"²⁴⁶ (Anastasia, 2015, <https://www.cleverism.com/>). Another important advantage of sales promotion is that they help to boost customer loyalty through offering incentives or rewards to customers thus increasing repeat purchases from loyal customers.²⁴⁷ A good example of an organization that offers its customers incentives or bonuses is Qantas Airways founded in the Queensland, Australia in 1920 which was originally registered as the *Queensland and Northern Territory Aerial Services Limited* (QANTAS).²⁴⁸ Today Qantas has since diversified its global presence and airline brand by partnering with several global airlines and one of them is *Alaska Airlines*. Today the Alaska Airlines Mileage Plan members will receive bonus miles with eligible Business and First fares. Plus base miles earned and class of service bonuses on Qantas count toward Mileage Plan elite status (Qantas, 2018). The topic of direct marketing is covered in the following section.

²⁴⁶ Anastasia (2015) *An Introduction to an Effective Promotional Mix*. Available from:

<https://www.cleverism.com/introduction-effective-promotional-mix/>

²⁴⁷ Qantas (2018) *Our Company*. Available from: <https://www.qantas.com/travel/airlines/company/global/en>

²⁴⁸ Qantas (2018) *Qantas Explorer*. Available from:

https://www.qantas.com/us/en/promotions/alaskaairlines.html?int_cam=us%3Aen%3Aarticle%3Ait-s-a-g-day-to-fly%3Aen%3Ann

6.9.3.5 Direct marketing

“*Benefits of direct marketing.* Good direct marketing campaigns focus on promoting a specific product or service, and call on your customers to act - to receive further information, register their interest, visit your website, make a booking or a purchase. Direct marketing gives you the opportunity to promote your products and services directly to the customers who most need them”²⁴⁹ (State of Queensland, Australia, 2020, www.business.qld.gov.au). ²⁵⁰ “*Types of direct marketing.* **Direct mail.** Direct mail is posted mail that advertises your business and its products and services. There are several different types of direct mail (e.g. catalogues, postcards, envelope mailers). Direct mail campaigns are usually sent to all postal customers in an area or to all customers on a marketing list. Learn more about [direct mail](#). **Telemarketing.** Telemarketing involves contacting potential customers over the phone to sell products or services. It is capable of generating new customer prospects in large volumes and is also a useful tool for following up on direct marketing campaigns. However, successful telemarketing involves planning and using accurate and well-researched customer data to match customer profiles to product profiles. Find out about [telemarketing](#). **Email marketing.** Email marketing is a simple, cost-effective and measurable way of reaching your customers. It can include e-newsletters, promotional emails to generate new leads or offers for existing customers, or ads that can appear in other business's emails. Learn more about [email marketing](#). **Text (SMS) marketing.** Text messaging allows businesses to reach individual customers and send messages to large groups of people at a low cost. You could use short message service (SMS) messaging to send customers sales alerts, links to website updates, appointment or delivery reminders, or personalised messaging. Find out about [text \(SMS\) marketing](#). **Leaflet marketing using letterbox drops and handouts.** Distributing

²⁴⁹ State of Queensland, Australia (2020) *Benefits of Direct Marketing*. Available from: <https://www.business.qld.gov.au/running-business/marketing-sales/marketing-promotion/direct-marketing/using/benefits> © The State of Queensland 2019 [Accessed February 05, 2020] © Commonwealth of Australia 2020.

²⁵⁰ State of Queensland, Australia (2020) *Types of Direct Marketing*. Available from: <https://www.business.qld.gov.au/running-business/marketing-sales/marketing-promotion/direct-marketing/using/types> © The State of Queensland 2019 [Accessed February 04, 2020] © Commonwealth of Australia 2020.

well-designed leaflets or flyers through letterbox drops and handouts can work well for a local business whose products or services appeal to a broad audience. It is a simple, inexpensive and effective way of reaching customers, although it is a less targeted form of direct marketing. Learn more about [leaflet marketing using letterbox drops and handouts](#). *Social media marketing*. Social media can be used effectively as a marketing tool for business as it gives you the opportunity to interact directly with your customers and regularly share relevant product or service information. Social media platforms also make it very easy for your customers to share your content with their entire network, increasing your reach exponentially. Consider developing a profile for your business that allows you to promote your products and services while also encouraging customers to provide feedback by leaving comments. Find out about [social media marketing](#)” (State of Queensland, Australia, 2020, www.business.qld.gov.au). The distribution of products is important and this will be covered in the following section.

6.9.3.6 Place

In addition *place* is also known as the distribution method and it is an important element of the marketing mix (Singh, 2012:42). The success of a product mainly centers on how easily accessible it is to customers and ‘can the customers easily purchase it anytime’ they wish to do so. This has led to the same companies adding wheels to their businesses in order to be mobile or easily accessible to customers for example mobile clinics, mobile restaurants or food trucks, mobile internet cafes, mobile bakeries and so on (Singh, 2012:42). The movement of goods from the manufacturer to the customers is greatly influenced by marketing channels distribution. A *marketing channel* is a group of intermediaries such as wholesalers and retailers that help to distribute products from manufacturer’s warehouses to the final consumers²⁵¹ (Ferrell and Hirt, 2000:335). The three main forms of product distribution that are used by organizations around the world include: (1) *intensive distribution* – involves the firm using almost every retail outlet or wholesaler that can be used to distribute the firm’s products and this type of distribution is used when distribution is a key success factor for example most beverage manufacturers use it to distribute their drinks nationally to supermarkets, hotels, restaurants, kiosks and so on (Saxena,

²⁵¹ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p42 – 341.

2006:460), (2) *selective distribution* – this is whereby a firm carefully selects a certain number of outlets to use in distributing its products in order to place more emphasis on its selling strength as the manufacturer to a certain number of outlets rather than spreading it to many marginal outlets. Since a few carefully selected retailers or wholesalers will be used in a selective distribution channel this often makes it easy for the manufacturer to establish good harmonious long term relationships with channel members while simultaneously gaining significant control and the best possible market coverage at a much lower cost if compared to intensive distribution²⁵² (Saxena, 2006:460). Products or services that are of high quality, high social status and expensive are usually associated with this type of distribution in general (Ferrell and Hirt, 2000:338), (3) *exclusive distribution* – is when a firm uses one or two outlets to exclusively sell and deal with its products or services brands without the presence of other similar products or services brands of competitors in the same outlets. This type of distribution is used for products or services that have a high prestigious image in a specific geographical area (*for example an entire continent, region of a continent, country, province/state, city, town/community and so on*). Typical examples of such products include automobiles, wrist watches, designer clothing wear and so on. In general when the manufacturer grants a retailer or wholesaler the sole rights to distribute their firm's products or services brands it often leads to the manufacturer having significant control over the retailer's or wholesaler's pricing, promotion, service policies and so on (Saxena, 2006:460).

Marketing and human resources functions play a key role in the success of a small business today and the human resources management functions that entrepreneurs must implement in their organizations will be covered in the following section of this book chapter.

6.10 Human Resources Management

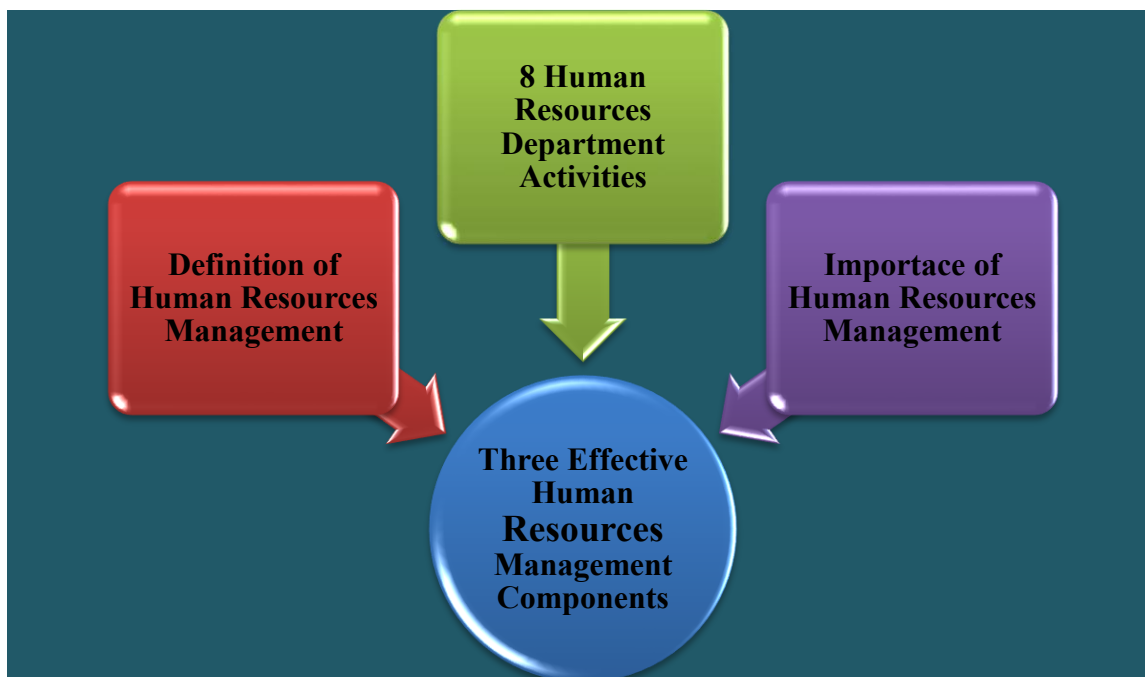
6.10.1 Introduction to human resources management

People related problems at the workplace are becoming complex daily and the need to manage people has gained value globally. Today the human resources function has gained recognition and importance in organizations as most organizations' now view their human resources as a

²⁵² Saxena, R. (2006) *Marketing Management*. Third Edition, New Delhi: Tata McGraw-Hill, p198-461

competitive advantage since competent employees serve customers satisfactorily, attain high quality standards, develop unique innovative products/services and so on. Knowledge has become one way an organization can get a competitive advantage nowadays and the key to knowledge is a firm's human resources assets therefore this places more value on the management of people. The aim of the human resources function is to ensure that employees' needs at the workplace are professionally managed so that they are consistently well motivated, happy and committed to continue to work for the organization. Human resources management is vital for every organization and the key components of effective human resources management that will be covered in this second part of the book chapter are depicted by Figure 6.4 below.

Figure 6.4 Three components of effective human resources management by a small business



The modern day meaning of the term 'human resources management' will be discussed in greater detail in the following section as highlighted by Figure 6.4 above.

6.10.2 The definition of human resources management

By understanding the meaning of a function in the organization it becomes easy to understand its essence in the organizational system as a whole²⁵³ (Hunter, 2002:5). ²⁵⁴*Human resources management* can be defined as all the people related practices and policies that involve human resources planning, learning & development, recruitment, talent management, compensation, health & safety of employees, work/life balance and leadership with the main aim of fulfilling the workforce needs of the organization²⁵⁵ (Ferrell and Hirt, 2000:270; Al Wahshi, Omari and Barrett, 2013:3). Nowadays most of the organizations are now fully aware of the fact that employees need to be provided with a conducive working environment so that they may be able to produce good quality results. The human resources function has a significant impact on the organization's profitability, productivity and employee retention. It is important to note that there is a difference between management and human resources management. *Management* is involved with the accomplishing of tasks via other people and it also encompasses the carrying-out of various tasks that enable them to attain both individual and organizational goals. The human resources function falls under the management specialization hence the human resources manager performs the basic functions of management namely: planning, organizing, leading, controlling and coordination in order to achieve the organization's human resources needs (Kotter, 2001:86, *What Leaders Really Do. Harvard Business Review- December*). In general the human resources management functions are generally implemented across all departments as they also deal with all people related issues on a daily basis at the workplace thus making them critical role players in making the human resources function a success in the organization. There

²⁵³ Hunter, C (2002) *Managing People in South Africa*. 3rd Edition, University of KwaZulu-Natal, Pietermaritzburg.

²⁵⁴ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p42 – 341.

²⁵⁵ Al Wahshi, A. S., Omari, M., & Barrett, R. (2013). Human Resource Planning: Sector Specific Considerations. *In 27th Australian and New Zealand Academy of Management Conference 2013: Managing on the Edge, 4-6 December*, Hobart, Tasmania. Available from:
www.ro.ecu.edu.au/cgi/viewcontent.cgi?article=1257&context=ecuworks2013

are many activities that are done by the human resources department and these are covered in the following section.

6.10.3 Human resources department activities

The human resources department functions include: recruitment and selection, training and development, talent management, change management, performance management, compensation management, labour relations and human resources information systems. Business professionals in the organization with academic qualifications (*such as certificates, diplomas, university degrees and professional qualifications*) that specialize in business management, strategic management, labour law, human resources management, information technology (IT), organizational behavior and industrial psychology work in the HR department or function. The numerous functions of the human resources department are depicted in Figure 6.5 below.

Figure 6.5 Functions of the human resources department



Source: Modified: (Hunter, 2002:83; State of Queensland, Australia, 2020, <https://www.business.qld.gov.au>).

6.10.3.1 Recruitment and selection – this human resources department function ensures that job applicants continue to apply for jobs in the organization. The recruitment and selection function ensures that the recruitment of employees is aligned to the recruitment policies of the organization for example, hiring of relatives, the preferred method of job advertising, discrimination laws and so on. Recruitment lays-out the direction the organization should take in order to be successful and achieve its human resources strategy or vision (Hunter, 2002:83). The first step an organization takes towards staffing its human resources needs is recruitment which is then followed by the selection process. Therefore, if the recruitment process is carried-out in a proficient and transparent manner it will help the organization to lay-out the required basic foundations for achieving a successful selection, induction and talent retention strategy. *Selection* is the process of gathering all the relevant information about job applicants through carrying-out interviews, selection tests and reference checks including using the gathered information to evaluate job applicants who meet the job requirements of the vacancy using a specific criteria²⁵⁶(Ferrell & Hirt, 2000:271; Hunter, 2002:83-92). Recruitment and selection processes are the critical parts of the human resources function in every organization nowadays since more research studies results are revealing that the establishment of a positive psychological contract with new employees results in the firm having a high organizational commitment and motivation. Recruitment and selection can influence a positive psychological contract through offering employees competitive remuneration rates and conducive working environments, induction training, effective leadership styles and in return the employee should offer high productivity, loyalty and commitment.

6.10.3.2 Training and development – it is a human resources function that is responsible for all individual and organizational training needs and development. The performance of employees at the workplace is determined by the amount and quality of training and development they receive from the organization. Generally the efficiency and effectiveness of an organization and its employees' is enhanced by training. It is essential for an organization to devise effective training programs and the training of employees must be carried-out in such a way that helps to fulfill the

²⁵⁶ Ferrell, O. and Hirt, G. (2000) *Business: A Changing World*. 3rd Edition, New York: McGraw-Hill Incorporation, p42 – 341.

employees' training needs. Training and development programs begin with the trainer conducting a training needs assessment. A training needs assessment is whereby the trainer or human resources manager evaluates the areas of job performance the employees perform poorly in order to identify the gap in training so that the employees may be properly trained to improve their performance. Therefore, when training needs have been identified the human resources manager can then proceed to set the goals of the training program he or she intends to achieve when conducting the training program with the employees. In addition the human resources manager must also make a decision to choose a training method to use between 'on-the-job training method' or 'off-the-job training method'. Employees need to be trained regularly so that they keep on performing better at the workplace. Generally 'on-the-job training method' is usually carried-out whilst the trainees' are conducting their day-to-day work activities. However, with 'off-the-job training method' the training of employees is done in a completely different working environment away from the employee's usual day-to-day working space for example attending a degree program at a local university. Some of the organizations prefer to have 'off-the-job training' via using classroom training institutions where their employees are required to attend lectures with leading academics and industry experts. Therefore, employees exposed to such high quality training often tend to perform better and they consistently remain up-to-date with the ever-changing business trends.

6.10.3.3 Talent management – this human resources function is responsible for the proper management of the organization's talent and ensuring that it keeps working for the organization for a very long time period. In addition talent management is also responsible for creating employer branding strategies that help to build the brand name of the organization to become an employer of choice in the labour market. Talent management has become a critical aspect in most of the organizations today because of the scarce skills shortages in the global labour market. Furthermore, the elements of talent management encompass the following; recruitment and selection, employer branding, employee retention strategies and provision of a conducive working environment. Organizations that strive to be employers of choice in the labour market offer highly attractive intrinsic and extrinsic rewards, attractive work/life balance schedules such

as flexible working hours, study tuition reimbursement and so on²⁵⁷ (Kinnear and Sutherland, 2000:106). It is the role of the talent management experts to ensure that the organization's assets (*its people*) are happy and willing to increase their tenure in the organization.

6.10.3.4 Change management – this human resources function is responsible for managing all the change interventions in the organization. *Change management* is a structured approach that redirects or redefines the use of resources, business processes, budget allocations, technologies, the corporate culture of the organization with the aim of moving the organization from its current state to the desired future state of enhancing its efficiency and effectiveness. Strategic human resources management therefore means that human resources management professionals in the organization should be capable of handling any change intervention activities in the organization such as job cuts, job redesigning and so on. This will be done in conjunction with all members of the change management team (*who usually include: the CEO, middle management and employees from all departments chosen to be part of the team*). The change process in every organization follows certain steps until it has been successfully adopted by everyone. Change interventions only succeed in most organizations if there is total commitment from the bottom level employees and top level management. Therefore, human resources professionals are responsible for the management of all working relationships between employees in organizations especially after change interventions have taken place so that people quickly start to perform as expected at the workplace.

6.10.3.5 Performance management – this human resources management function is responsible for identifying employees' strengths and areas of weaknesses. One of the challenging task most of the human resources managers are faced with on a day-to-day basis is the failure to apply corporate strategy by employees in most organizations. The human resources department activity helps to guide the focus of employees towards attaining the organization's goals via performance management since it seeks to measure the job performance of employees. Managers have to ensure that they properly assess their employees so that they can properly identify their training needs and be able to align their employees' work performance to compensation. Performance

²⁵⁷ Kinnear, L. and Sutherland, M. (2000) The Determinants of Organizational Commitment Amongst Knowledge Workers, *South African Journal of Business Management Volume (31) (3) March*, p106-108.

management is often confused with performance appraisal in most organizations by managers. Therefore, performance management is the everyday management of employees to ensure that they are consistently working towards attaining the goals of the organization. Therefore, performance management is a critical function that helps to determine which employees are top performers who deserve to be recognized and which employees are incompetent in the organization.

6.10.3.6 Compensation – The shifting of the global economy from a manufacturing based economy to a service or information-based economy means that highly qualified people are now needed in organizations. Therefore, organizations nowadays must ensure that they pay employees competitive remuneration rates so that they may successfully retain their talented employees. The changing nature of jobs in organizations nowadays is being caused by: (1) the high advancements in technology, (2) the shifting of the global economy from being a manufacturing-based economy to both a manufacturing and service-based economy and this has enormously created the high demand for jobs that require high levels of knowledge. Therefore, the high demand for jobs that require high levels of knowledge ultimately creates the need for organizations to pay employees using skill-based remunerations instead of job-based remunerations. The compensation function keeps all payroll systems updated to ensure that every pay date is effectively processed so that the salaries/wages reach the intended recipients on time in the right amount to enhance the image of the organization and boost employee loyalty.

6.10.3.7 Labour relations – this human resources function is responsible for dealing with legal issues pertaining to the welfare of employees in the organization. “*Industrial relations* is the management of work-related obligations and entitlements between employers and their employees”²⁵⁸ (State of Queensland, Australia, 2020, <https://www.business.qld.gov.au>). According to the Australian Association of Social Workers (AASW) (2015) the term ‘*industrial relations*’ generally refers to employment issues and the employment relationship between an

²⁵⁸ State of Queensland, Australia (2020) *Industrial Relations*. Available from: <https://www.business.qld.gov.au/running-business/employing/employee-rights/ir> © The State of Queensland 2019 [Accessed January 31, 2020] © Commonwealth of Australia 2020.

organisation and its staff”²⁵⁹ (Australian Association of Social Workers, 2015, www.aasw.asn.au/). Furthermore, *industrial relations* refers to the relationship between employers and employees in an organization with interactions taking place in the following forms: collective bargaining, workplace forums, staff meetings, disciplinary hearings, grievance and dispute settlements and so on. Most organizations today face the challenge of keeping consistent harmonious relationships with their employees and labor trade unions over workplace disputes. ²⁶⁰“*Trade unions* are independent, membership-based organisations of workers that represent and negotiate on behalf of working people. They give advice when their members have problems at work, represent members in discussions with employers, and help improve wages and working conditions by negotiating with employers. Unions also make sure that their members’ legal rights are enforced, provide and broker education and learning opportunities for members, promote equal opportunities at work, fight against discrimination and help to ensure a healthy and safe working environment” (Ethical Trading Initiative, 2010:1, www.ethicaltrade.org/). According to the Ethical Trading Initiative (2010) *the benefits of working with a recognised trade union. Build trust among the workforce*. Unions provide a mechanism for dialogue between workers and employers, which helps to build trust and commitment among the workforce and ensures that problems can be identified and resolved quickly and fairly, *Audit non-compliance with labour codes*. Unions are a good source of information on workplace practice, and are well placed to work with employers to identify and address poor working practices and non-compliance with labour standards, *Promote equality*. Trade unions actively fight discrimination and help to promote equal opportunities at work (Ethical Trading Initiative, 2010:2, www.ethicaltrade.org/). Therefore, an organization that wants to establish good harmonious relationships between itself, employees and trade unions must adopt group dynamics, encourage high worker involvement in decision-making and properly maintain a two-way channel of communication. The human resources function of labour relations is responsible for liaising with labour unions that represent all the employees in the

²⁵⁹ Australian Association of Social Workers (AASW) (2015) *Industrial and Workplace Issues Information Sheet*. Available from: <https://www.aasw.asn.au/document/item/7265>

²⁶⁰ Ethical Trading Initiative (2010) *Working with Trade Unions to Improve Working Conditions: The Benefits for Retailers and Suppliers*. Available from: https://www.ethicaltrade.org/sites/default/files/shared_resources/benefits_of_working_with_trade_unions.pdf

organization in the collective bargaining process. The labour relations function is also responsible for ensuring that all labour laws are adhered to in the organization to help protect the organization from consistently having labour disputes with its employees or their trade union representatives. For instance, labour laws cover occupational health and safety, recruitment laws, employment contracts, job dismissals, lay-offs and so on. The designing of employee complaints, procedures at the workplace and arbitration of employee complaints fall under the function of labour relations.

6.10.3.8 Human resources information systems (HRIS) – this function is responsible for ensuring easy adoption of all human resources information technology by the organization’s human resources professionals and department. The rapid technology evolution which is increasing at a faster pace across the world has put enormous pressure on organizations to adopt HRIS. *Human resources information system (HRIS)* is comprised of a complex system that can only be found in a computer and generally the human resources function utilizes the HRIS to administer the organization of the human resources processes and protocols (Tannenbaum, 1990 cited Karikari, Boateng and Ocansy, 2015:425). The HRIS function is also responsible for ensuring that employees quickly learn how to use the human resources technology in order to improve their human resources day-to-day activities. Human resources information technology experts in an organization are responsible for the following tasks: managing the HRIS software and associated hardware that helps the organization to automate all its human resources activities, ensuring that employee data is accurate all the time, ensuring that employees spend less amount of time in processing clerical tasks by adopting new technologies that can easily perform such clerical tasks for them. For example payroll software or electronic data processing and tracking software systems, also HRIS(s) manage the human resources integrated profile database including internet security systems and they also help to protect the organization from hackers and competitor attacks. The HRIS is also responsible for designing the human resources management website since it helps to make the organization achieve its employer of choice goals and improve its employer brand ratings in the labour market. Therefore, the human resources department is critical for the organization’s survival. Human resources management is a critical function in every business and this topic will be covered in the following section.

6.10.4 Importance of the Human Resources Management

In this 21st century the success of every organization is controlled by its people as they are its strategic assets. One of the most strategic role of management in today's modern organizations' is the management of human resources due to the fact that it continuously aims to *promote the dignity of people* at the workplace through the provision of decent work, performance targets, effective job design, compensation, career-growth and training opportunities. The various reasons why the human resources management function of an organization is important are depicted in Figure 6.6 below.

Figure 6.6 Nine reasons why the human resources department is important



6.10.5 Conclusion

It can be concluded that every business needs both marketing and human resources functions to thrive. Every business needs to sell its products through implementing the marketing mix and an effective branding strategy. In this 21st century every successful business has to sell products that customers need or want at a profit and ensure that it builds long term customer relationships with them. Small businesses that are guided by the marketing orientation philosophy thrive.

Consistently conducting marketing research is the key to a successful marketing orientation approach. A small business should be able to identify its target customers hence it should first segment the market in order to find a niche market to focus on selling its products or services effectively with its limited resources. After choosing a market segment to serve a small business should position its products in the market according to the customer benefits its products offers its customers. It is the responsibility of every entrepreneur to ensure that their human resources needs are managed effectively and basic knowledge in the field is essential because people are one of the most valued assets in the organization. Entrepreneurs should ensure that they employ the services of human resources management professionals who will work fulltime to deal with all the people related problems at the workplace. The human resources function is responsible for handling the organization's recruitment and selection of employees, training and development, compensation management, talent retention strategies, managing the organization's employer brand, change management, human resources planning and so on.

6.10.6 Discussion questions

- 1). Describe the importance of marketing in a small business and define marketing?
- 2). Discuss market segmentation and the four bases of segmenting markets? Define what is product positioning and branding whilst giving relevant examples?
- 3). Define the meaning of integrated marketing communications? Describe how a small business can develop its marketing mix 'the 4 P's' (*product, price, place and promotion*) whilst giving relevant examples?
- 4). Define the term human resources management? Discuss the importance of human resources management to a business?
- 5). Discuss the functions of a human resources department?

Chapter 7: Small business financing

After studying this chapter you should be able to:

- Define the term small business financing or funding. Highlight the global statistics of small business financing.
- Outline the difference between owner's equity and debt financing.
- Identify the reasons why owner's equity and debt financing is important to most small businesses.
- Outline the three types of capital.
- Describe the various sources of personal funding/owner's equity funding.
- Outline the sources of debt funding of a small business.

7.1 Introduction

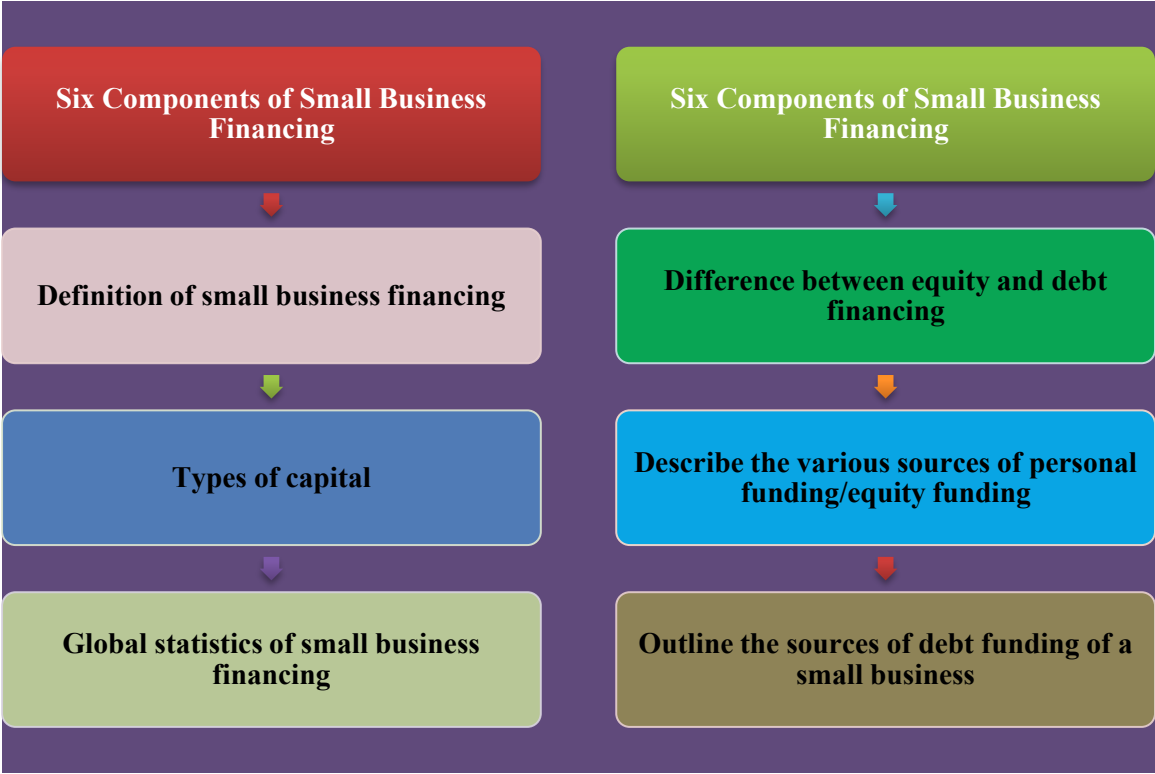
Small, micro, medium enterprises (*SMMEs*) in North America, Africa, Asia, Oceania, South America and the Middle East now play a pivotal role in generating foreign currency cash inflows (*gained from export sales revenue remittances*).²⁶¹ In addition SMMEs play a vital role of boosting the following in their countries of origin: (1) employment (*of hundreds of millions of young – middle aged citizens*), (2) international trade (*import/exports of goods/services*), (3) economic development, (4) opportunities for 'women & youth' entrepreneurs and (5) technological innovations in their home countries. One of the main reasons why some of the startups fail is because they lack adequate capital funding²⁶² (World Bank, 2011). The failure to meet strict debt funding requirements from financial institutions and lack of collateral to use as security has also contributed enormously to the capital funding problems experienced by small businesses across the world. In this 21st century it costs money to make money due to the fact that businesses need to buy factors of production such as land, buildings, machinery, supplies of inventory, labour and so on therefore capital financing is a critical ingredient in small business

²⁶¹ World Bank Group (2011) World Bank Small Business Finance Facility Makes First Loan Tunisia. Available from: <http://www.worldbank.org/en/news/press-release/2011/07/14/new-world-bank-group-small-business-finance-facility-makes-first-loan-tunisia>

²⁶² World Bank (2018) *SMEs*. Available from: www.blogs.worldbank.org/psd/category/tags/smes

development. One of the key trends often associated with the sourcing of capital nowadays by entrepreneurs is the lack of training on how to seek capital financing which often results in entrepreneurs relying on a single source of capital that is convenient to them to finance their business whilst paying less attention to other available sources of capital. In the operational life of each and every small business various financial obligations arise on a daily basis hence adequate funding is needed in order to fulfill these day-to-day financial obligations of the business. Financing helps a small business to successfully meet both its short and long term debt payments, acquire modern day new technologies and be able to cater for its day-to-day operational expenditure. The key components of small business financing that will be covered in this chapter are depicted in Figure 7.1 below.

Figure 7.1 Six components of small business financing



Small business financing is critical for the development of the business and this will be discussed in detail in the following.

7.2 Definition of small business financing

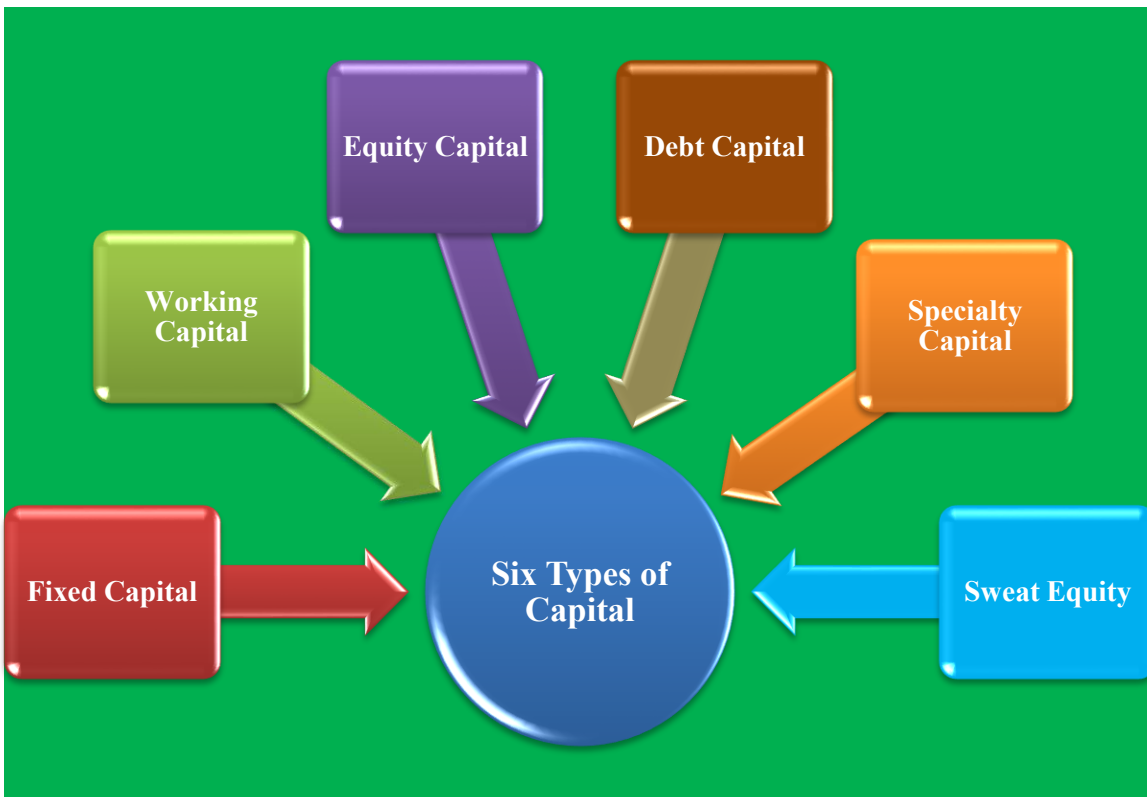
Startup financing is also referred to as *small business financing* and it refers to the money that is used by the owner(s) of a new business to pay for all their business formation and operational costs including the acquisition of assets (*both fixed and current assets*). Small business financing is a term that is often interchangeably used to refer to capital. The definition of capital and the different types of capital will be covered in the next section.

7.3 Types of capital

“Capital is the investment made to create wealth. The investment may be sourced from money, credit, or some other form of funding. Capital mostly denotes financial capital. However, it may also refer to human capital or the value of manpower. Social capital refers to the value of the human network. There are three different types of capital:

- Debt
- Equity
- Specialty capital” (Upcounsel LLC, 2020, <https://www.upcounsel.com/financial-capital-definition>). The six types of capital that can be used by entrepreneurs in starting or running a currently existing business are depicted in Figure 7.2 below.

Figure 7.2 Six types of capital



Source: Modified: (European Commission, 2018, <http://ec.europa.eu/>; Upcounsel LLC, 2020, <https://www.upcounsel.com>; Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>)

7.3.1 Fixed capital

One of the forms of capital used by startup enterprises is fixed capital. According to the European Commission (2018) *fixed capital* is the value of capital [assets](#) available for production purposes at a given point in time. All capital goods are included which are accounted for in [gross fixed capital formation](#). This is measured by the value of acquisitions less disposals of new or existing fixed assets²⁶³ (European Commission, 2018). Fixed capital and working capital are interrelated in the sense that they both appear on the balance sheet despite the fact that they have different meanings altogether. Fixed capital is used to acquire assets that cannot be easily converted into cash such as land, fixtures & fittings.

²⁶³ European Commission (2018) *Glossary: Fixed Capital*. Available from: http://ec.europa.eu/eurostat/statistics-explained/index.php/Glossary:Fixed_capital

7.3.2 Working capital

²⁶⁴²⁶⁵ “*What is working capital?* Working capital is the difference between a company’s current assets and **current liabilities**. It is a financial measure, which calculates whether a company has enough liquid assets to pay its bills that will be due within a year. When a company has excess current assets, that amount can then be used to spend on its day-to-day operations. **Current assets**, such as **cash and equivalents**, inventory, accounts receivable, and marketable securities, are resources a company owns that can be used up or converted into cash within a year. **Current liabilities** are the amount of money a company owes, such as **accounts payable**, short-term loans, and accrued expenses, that are due for payment within a year. The working capital formula is:

Working capital = Current Assets – Current Liabilities

The working capital formula tells us the short-term liquid assets remaining after short-term liabilities have been paid off. It is a measure of a company’s short-term liquidity and is important for performing financial analysis, **financial modeling**, and managing **cash flow**²⁶⁶²⁶⁷²⁶⁸²⁶⁹ (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>).

²⁶⁴ Corporate Finance Institute (2020) *What is the Working Capital Formula?* Available from: <https://corporatefinanceinstitute.com/resources/knowledge/modeling/working-capital-formula/> [Accessed October 02, 2020]

²⁶⁵ Corporate Finance Institute (2020) *What is Financial Modelling.* Available from: <https://corporatefinanceinstitute.com/resources/knowledge/modeling/what-is-financial-modeling/> [Accessed October 02, 2020]

²⁶⁶ Corporate Finance Institute (2020) *Cashflow.* Available from: <https://corporatefinanceinstitute.com/cash-flow> [Accessed October 02, 2020]

²⁶⁷ Corporate Finance Institute (2020) *Current Liabilities.* Available from: <https://corporatefinanceinstitute.com/current-liabilities> [Accessed October 02, 2020]

²⁶⁸ Corporate Finance Institute (2020) *Cash Equivalents.* Available from: <https://corporatefinanceinstitute.com/cash-equivalents> [Accessed October 02, 2020]

²⁶⁹ Corporate Finance Institute (2020) *What is Accounts Payable.* Available from: <https://corporatefinanceinstitute.com/resources/knowledge/accounting/what-is-accounts-payable/> [Accessed October 02, 2020]

7.3.3 Equity Capital

²⁷⁰“[Equity](#) is the amount of funds raised by selling a share in ownership of the business. Investors may accept an ownership interest in return for their investment if they believe that the business will give them an acceptable return on their money. Since equity investors are owners of the company, they share risks and profits alike. Unlike lenders, they cannot claim any interest or guaranteed payments. Equity is especially helpful when the business is not able to get enough funds required to buy capital goods. Common sources of equity for startups include family members, friends, angel investors, and venture capitalists. Once the business is well-established, it can raise equity by issuing stock to the public” (Upcounsel LLC, 2020, <https://www.upcounsel.com/financial-capital-definition>).

7.3.4 Debt Capital

- “[Debt](#) is the amount of funds raised from loans and bonds.
- Business must pay back the debt with interest.
- Debt lets you raise funds without giving ownership rights to the lender.
- Initially, entrepreneurs borrow funds from their friends and family or through their credit cards.
- Once you have built a track record, you can apply for bank loans and assistance schemes from the federal government”²⁷¹ (Upcounsel LLC, 2020, <https://www.upcounsel.com/financial-capital-definition>).

7.3.5 Specialty Capital

“*Specialty Capital*. Sometimes, a company may be able to generate additional cash flow through efficiency in business operations. The funds so generated are called specialty capital. If your business suppliers agree for a delayed payment, it's known as vendor financing. Supply chain financing, on the other hand, is similar to payday loans. Often, banks lend the invoice amount of

²⁷⁰ Upcounsel LLC (2020) *Equity Capital*. Available from: <https://www.upcounsel.com/equity-financing> [Accessed October 02, 2020]

²⁷¹ Upcounsel LLC (2020) *Debt Financing*. Available from: <https://www.upcounsel.com/debt-financing> [Accessed October 02, 2020]

your business after deducting their fee. You can also create some capital by making wise investments” (Upcounsel LLC, 2020, <https://www.upcounsel.com/financial-capital-definition>).

7.3.6 Sweat Equity

²⁷² “*Sweat equity* is a non-monetary contribution that the individuals or founders of a company make towards the company. Cash-strapped startups and business owners typically use sweat equity to fund their companies. For example, the founder of a tech startup company may value the efforts placed towards developing the company at \$200,000. If an [angel investor](#) is interested in investing in the business, the founder may sell a 25% [ownership](#) of the company at \$1,000,000. The stake places the company at a valuation of \$4,000,000. After selling the 25% stake in the company, the founder remains with \$3,000,000. After deducting the contribution to the company of \$200,000, the founder benefits from a \$2,800,000 sweat equity”²⁷³²⁷⁴ (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>). The global statistics of small business financing are covered in the following section.

7.4 Global statistics of small business financing

“Micro, small and medium enterprises (*MSMEs*) in the Middle East and North Africa are key to driving employment for millions of young citizens but businesses on the smaller end of the scale in this region have some of the lowest levels of access to finance in the world. The World Bank Group’s MSME Facility is expected to channel over \$500 million to Middle East and North

²⁷² Corporate Finance Institute (2020) *What is Sweat Equity*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/valuation/sweat-equity/#:~:text=Sweat%20Equity%20in%20Real%20Estate,the%20value%20of%20the%20house>. [Accessed October 02, 2020]

²⁷³ Corporate Finance Institute (2020) *What is Angel Investor*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/finance/what-is-angel-investor/> [Accessed October 02, 2020]

²⁷⁴ Corporate Finance Institute (2020) *What is Equity Valuation*. Available from: <https://corporatefinanceinstitute.com/resources/knowledge/valuation/what-is-equity-value/> [Accessed October 02, 2020]

Africa (*MENA*) countries over the next five years including support from the International Finance Corporation, regional partners such as the African Development Bank, and donors”²⁷⁵ (World Bank, 2011). According to Shamshad Akhtar cited in World Bank (2011) the Vice President for the Middle East and North Africa (MENA) region at the World Bank; “*SMEs in the region have enormous potential to create much-needed employment opportunities for a growing, young population. A dynamic, open and growing micro, small and medium enterprises (MSME) sector can create jobs and open up access to market opportunities at a rate that keeps pace with this growth. We urgently need to start this engine and creating access to finance is critical*” (Shamshad Akhtar cited in World Bank, 2011). Global financial institutions such as the World Bank and the International Finance Corporation (*IFC*) have made tremendous efforts in supporting and providing technical assistance to several governments, regulators, financial institutions, micro, small and medium enterprises (*MSMEs*) through linking innovative and high potential small businesses to growth capital, markets, technical knowhow and so on (World Bank, 2011). ²⁷⁶According to the World Bank (2011) IFC, the private sector arm of the World Bank Group, will invest up to \$150 million in the facility that will make it easier for SMEs to access financing and create opportunities and jobs. Additionally, it will offer a comprehensive package of advisory services to governments, regulators, financial institutions, and MSMEs to support the growth of this sector. IFC is also collaborating with other international financial institutions, including those in Europe, to support the new facility and to provide a comprehensive response to the challenges in the region. “*There are up to 20 million SMEs in the Middle East and North Africa, and millions of young people facing unemployment. But in their efforts to grow, these companies face numerous challenges, including red tape, a lack of access to finance and insufficient training resources. With this facility we want to demonstrate that unlocking the potential of SMEs can have a great effect on the growth of regional economies,*

²⁷⁵ World Bank (2014) *Micro Small Medium Businesses Get US\$500 million Boost from World Bank Group and Development Partners*. Available from: <http://www.worldbank.org/en/news/feature/2014/09/25/micro-small-and-medium-businesses-get-500-million-boost-from-world-bank-group-and-development-partners>

²⁷⁶ World Bank (2018) *SMEs*. Available from: www.blogs.worldbank.org/psd/category/tags/smes

and job creation” said Dimitris Tsitsiragos, IFC Vice President for Eastern and Southern Europe, Central Asia, Middle East and North Africa²⁷⁷ (World Bank, 2011).

On the African continent some of the countries such as Nigeria which is one of Africa’s unquestionable economic powerhouses have already started taking measures to finance their small businesses to grow and develop their economy with the Nigerian banking system being considered as one of the well capitalized, liquid and profitable banking system in the Economic Community of West African States (*ECOWAS*) trading bloc. “In support of the Nigerian government’s effort to stimulate economic growth and create jobs for its citizens, the World Bank Group has approved a \$500 million International Bank for Reconstruction and Development (*IBRD*) credit to fund the Development Finance Project. The project will help facilitate increased access and availability of financing for Micro, Medium and Small-Scale Enterprises (*MSME*) in agriculture, trade, light-manufacturing, services, and other areas. The Development Finance Project will also provide a stable and predictable funding source through the establishment of a Development Finance Institution (*DFI*). The DFI will provide funding to eligible financial institutions to finance long-term lending to MSMEs, as well as funding to Micro-Finance Banks for on-lending and to expand their outreach”²⁷⁸ (World Bank, 2014).

The current economic growth of the continent of Africa is unquestionable and this may be due to the fact that small micro medium enterprises play a key role in uplifting the lives of its citizens through (1) job creation, (2) exports/imports of goods and (3) providing entrepreneurial opportunities for women. Today most of the small businesses in Africa now have access to business loans since the continent’s banking systems are becoming well capitalized. Global development finance institutions such as the International Finance Corporation (*IFC*), a member of the World Bank Group, offer financial assistance to various financial institutions through the SME Banking Program so that they may be able to provide business loans to small micro

²⁷⁷ World Bank Group (2011) World Bank Small Business Finance Facility Makes First Loan Tunisia. Available from: <http://www.worldbank.org/en/news/press-release/2011/07/14/new-world-bank-group-small-business-finance-facility-makes-first-loan-tunisia>

²⁷⁸ World Bank (2014) *Micro Small Medium Businesses Get US\$500 million Boost from World Bank Group and Development Partners*. Available from: <http://www.worldbank.org/en/news/feature/2014/09/25/micro-small-and-medium-businesses-get-500-million-boost-from-world-bank-group-and-development-partners>

medium enterprises in their respective countries. “The IFC SME Banking Program assists banks across Sub-Saharan Africa to profitably establish and expand lending and other banking services to micro-, small-, and medium-sized businesses. The advisory services provided cover strategy, credit and risk management, staff training, sales and marketing product development, alternative delivery channels, and information technology. Since its launch in 2007 as the Africa Micro, Small, and Medium Enterprise Finance Program, the SME Banking Program has supported 24 partner institutions across Africa and facilitated over \$1 billion in loans to African SME clients. Across the world, IFC’s Global SME Banking program advised clients through 61 projects in 35 countries in the fiscal year of 2016, totaling \$52.2 million. About a fourth of the projects were targeted at lending to women business owners” (International Finance Corporation, 2017).

Notably *Malaysia* and *India* are some of the countries in Asia that have achieved milestones in creating new policies to provide their small businesses with high access to capital and they have even gone an extra mile by partnering with global financial institutions such as the World Bank. The Indian government is driving the development and finance of startups in its country due to the fact that they create jobs, growth and innovation²⁷⁹ (Andrianaivo, M. and Bell, S., 2017 cited in World Bank, 2018). According to the Andrianaivo, M. and Bell, S. (2017) cited in World Bank (2018) the World Bank has been supporting India for several years in the area of MSME finance, which is one of the most widely recognized impediments to SMEs, particularly for start-up enterprises. Through the \$500 million [MSME Growth Innovation and Inclusive Finance Project](#), the World Bank supports MSMEs in the service and manufacturing sectors as well as start-up financing for early stage entrepreneurs. The start-up support under this project (\$150 million) is for early stage debt funding (*venture debt*) which isn’t well evolved. (*Unlike India’s market for early stage equity which is considered to be already reasonably well developed*)²⁸⁰ (Andrianaivo, M. and Bell, S., 2017 cited in World Bank, 2018). There are many global statistics of small business financing across the world. Owner’s equity and debt financing will be discussed in the following section.

²⁷⁹Andrianaivo, M. and Bell, S. (2017) cited in World Bank (2018) *India, Malaysia Share Experiences How to Support Start-Up SMEs*. Available from: <https://blogs.worldbank.org/psd/psd/india-malaysia-share-experiences-how-support-start-smes>

²⁸⁰ The World Bank Group (2020) *Summary*. Available from: <https://projects.worldbank.org/en/projects-operations/project-detail/P151544?lang=en>

7.5 Difference between equity and debt financing

It is important for entrepreneurs to be fully knowledgeable of the fact that there are key differences between debt financing and owner's equity when starting or running their businesses. Generally *debt financing* involves any form of short - long term basis borrowing of financial resources by the business to enable it to remain financially healthy.²⁸¹ *Equity financing* is where you trade ownership of your business to angel investors or venture capitalists -- in return for their capital. Equity is especially important for certain industries and kinds of businesses, like technology startups and companies with global aspirations. Pros of equity financing: (1) you don't have to pay interest on the capital you raise, so there's no need to put your business's profits into debt repayments. (2) with the right investors, you can get great experience, wisdom, industry connections and much more" (Hecht, 2016, www.entrepreneur.com). The various sources of personal funding will be covered in the following section.

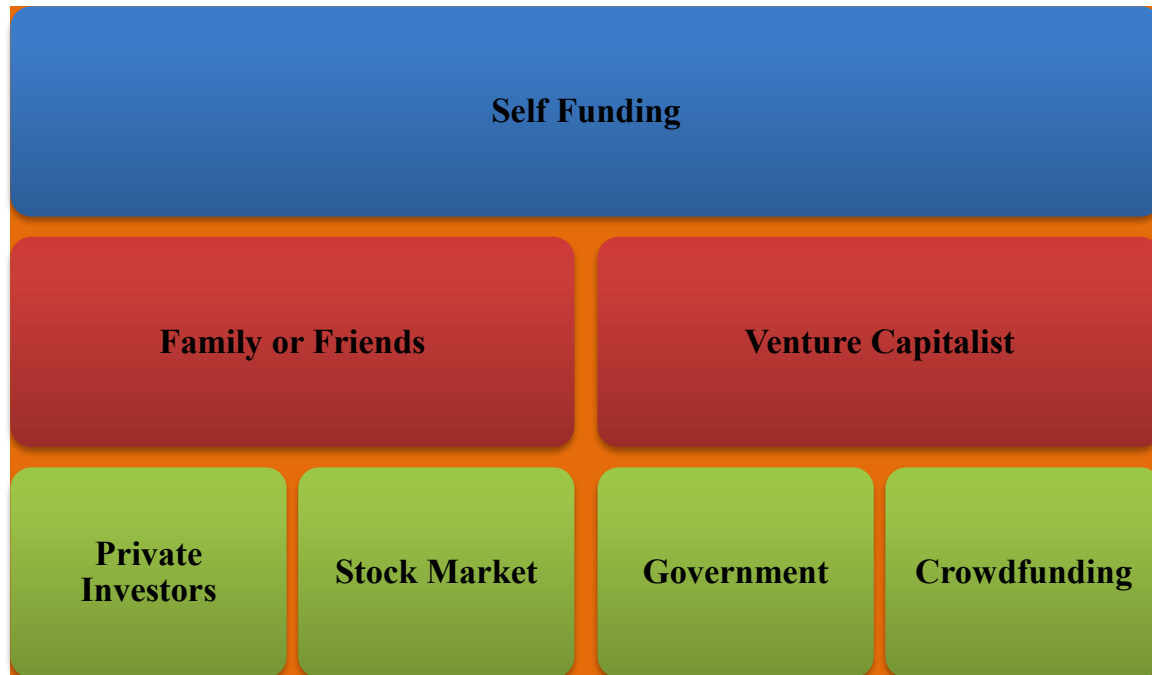
7.6 Describe the various sources of personal funding/equity funding

There are various sources of equity funding that can be used by entrepreneurs today and some of the seven sources of equity funding that were identified by the Government of Australia Department of Industry, Innovation & Science (2018) are depicted in Figure 7.3 below²⁸².

²⁸¹ Hecht, J. (2016) *Debt vs. Equity Financing: Which Way Should Your Business Go?* Available from: <https://www.entrepreneur.com/article/278430>

²⁸² Government of Australia Department of Industry, Innovation & Science (2018) *Sources of Finance: Debt vs. Equity*. Available from: <https://www.business.gov.au/info/run/finance-and-accounting/seeking-finance/sources-of-finance-debt-vs-equity-finance> © Commonwealth of Australia 2018.

Figure 7.3 Seven sources of equity funding



Source: Modified: (Government of Australia Department of Industry, Innovation & Science, 2018)

According to the Government of Australia Department of Industry, Innovation & Science (2018):

7.6.1 Self funding

Often called 'bootstrapping', self-funding is often the first step in seeking finance and involves funding purely through personal finances and revenue from the business. Investors and lenders will both expect some amount of self-funding before they agree to offer you finance²⁸³ (Government of Australia Department of Industry, Innovation & Science, 2018).

²⁸³ Government of Australia Department of Industry, Innovation & Science (2018) *Sources of Finance: Debt vs. Equity*. Available from: <https://www.business.gov.au/info/run/finance-and-accounting/seeking-finance/sources-of-finance-debt-vs-equity-finance> © Commonwealth of Australia 2018.

7.6.2 “Family or friends

Offering a partnership or share in your business to family or friends in return for equity is often an easy way of obtaining finance. However, consider this option carefully to ensure your relationship is not adversely affected” (Government of Australia Department of Industry, Innovation & Science, 2018).

7.6.3 “Private investors

Investors can contribute funds to your business in return for a share in your profits and equity. Investors such as business angels can also work in the business providing expertise or advice as well as funds” (Government of Australia Department of Industry, Innovation & Science, 2018).

7.6.4 “Venture capitalists

Venture capitalists are usually large corporations that invest large sums in start-up businesses with the potential for high growth and large profits. They typically require a large controlling share of the business and often provide management or industry expertise”²⁸⁴ (Government of Australia Department of Industry, Innovation & Science, 2018).

7.6.5 “Stock market

Also known as an Initial Public Offering (IPO), floating on the stock market involves publicly offering shares to raise capital. This can be a more expensive and complex option and carries the risk of not raising the funds needed due to poor market conditions” (Government of Australia Department of Industry, Innovation & Science, 2018).

²⁸⁴ Government of Australia Department of Industry, Innovation & Science (2018) *Sources of Finance: Debt vs. Equity*. Available from: <https://www.business.gov.au/info/run/finance-and-accounting/seeking-finance/sources-of-finance-debt-vs-equity-finance> © Commonwealth of Australia 2018.

7.6.6 “Government

In general, the government doesn't provide finance for starting up or buying a business. However, you may be suitable for a grant, such as business expansion, research and development, innovation or exporting” (Government of Australia Department of Industry, Innovation & Science, 2018).

7.6.7 “Crowdfunding

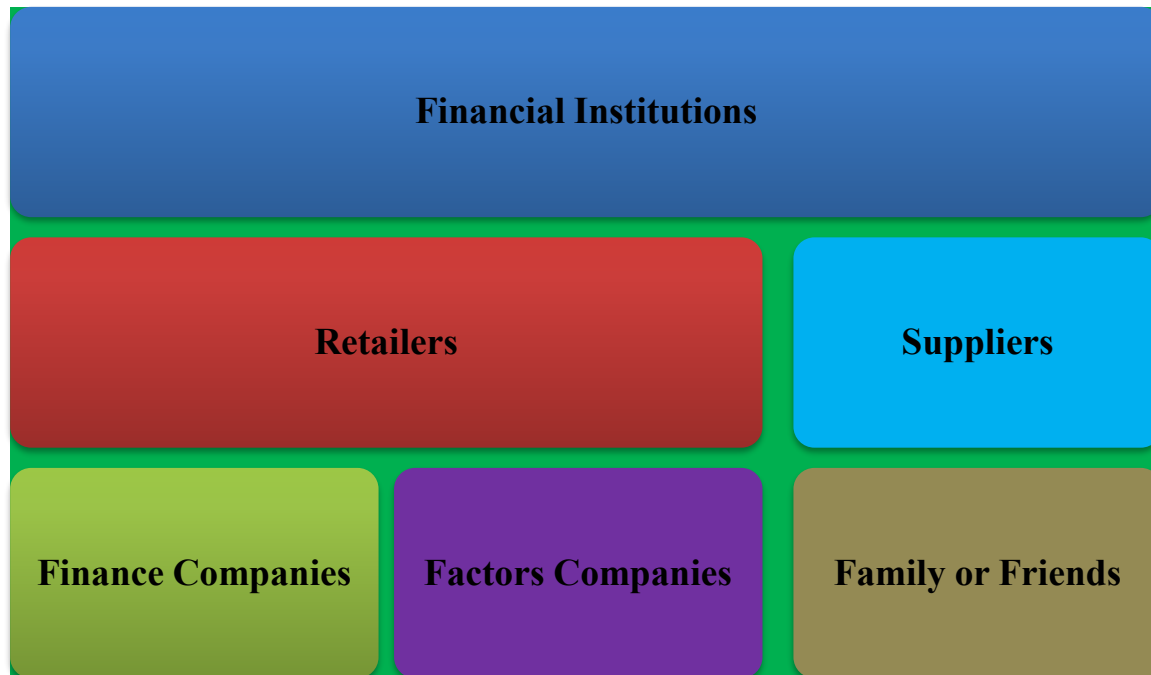
Some social media websites offer entrepreneurs a crowdfunding platform for their product prototypes or innovative projects. It involves setting a funding goal, providing project and budget details and inviting people to contribute to a startup capital pool” (Government of Australia Department of Industry, Innovation & Science, 2018). There are several sources of debt funding that can be used by entrepreneurs today and this will be covered in the next section.

7.7 Outline the sources of debt funding of a small business

Every business whether small, large, new or old they all have one thing in common that is ‘*they all borrow money*’. Liquidity is critical for every business in order to pay its day-to-day operational costs, debts and expansion plans. Highly successful organizations in the world continue to prosper on a yearly basis due to the fact that they have the ability to borrow and they have unlimited access to capital funding. One of the ways entrepreneurs can use to finance their small business’s formation costs, expansion plans and daily operational expenditure is debt financing. ²⁸⁵There are several methods that can be used by an entrepreneur to access debt financing and some of them were identified by the Government of Australia Department of Industry, Innovation & Science (2018). The six debt financing methods that can be used by entrepreneurs today are depicted in Figure 7.4 below.

²⁸⁵ Government of Australia Department of Industry, Innovation & Science (2018) *Sources of Finance: Debt vs. Equity*. Available from: <https://www.business.gov.au/info/run/finance-and-accounting/seeking-finance/sources-of-finance-debt-vs-equity-finance> © Commonwealth of Australia 2018.

Figure 7.4 Six debt financing methods



Source: Modified: (Government of Australia Department of Industry, Innovation & Science, 2018)

According to the Government of Australia Department of Industry, Innovation & Science (2018):

7.7.1 Financial institutions

Banks, building societies and credit unions offer a range of finance products with both short and long-term finance solutions. Some products include business loans, lines of credit, overdraft services, invoice financing, equipment leases and asset financing²⁸⁶ (Government of Australia Department of Industry, Innovation & Science, 2018).

²⁸⁶ Government of Australia Department of Industry, Innovation & Science (2018) *Sources of Finance: Debt vs. Equity*. Available from: <https://www.business.gov.au/info/run/finance-and-accounting/seeking-finance/sources-of-finance-debt-vs-equity-finance> © Commonwealth of Australia 2018.

7.7.2 “Retailers

If you require finance to purchase goods such as furniture, technology or equipment, many stores offer store credit through a finance company. Generally, this is a higher interest option and suits businesses that can pay the loan off quickly within the interest-free period” (Government of Australia Department of Industry, Innovation & Science, 2018).

7.7.3 “Suppliers

Most suppliers offer trade credit that allows businesses to delay payment for goods. Trade credit terms often vary and may only go to businesses that have a reputable connection with the supplier” (Government of Australia Department of Industry, Innovation & Science, 2018).

7.7.4 “Finance companies

Most finance companies offer finance products via a retailer. Finance companies must have a registration, so before you obtain finance check *the professional registers* on the Australian Securities and Investments Commission (ASIC) website”²⁸⁷ (Government of Australia Department of Industry, Innovation & Science, 2018).

7.7.5 “Factor companies

Factor companies offer a form of finance where they purchase a business's outstanding invoices at a discount. The factor company then chases up the debtors. While factoring is a way to get quick access to cash, it can be quite expensive if compared to traditional financing options”²⁸⁸ (Government of Australia Department of Industry, Innovation & Science, 2018).

²⁸⁷ Australian Securities & Investments Commission (ASIC) (2020) *About ASIC*. Available from: <https://asic.gov.au/about-asic/> [Accessed January 31, 2020] '© Australian Securities & Investments Commission. Reproduced with permission.' © Commonwealth of Australia

²⁸⁸ Government of Australia Department of Industry, Innovation & Science (2018) *Sources of Finance: Debt vs. Equity*. Available from: <https://www.business.gov.au/info/run/finance-and-accounting/seeking-finance/sources-of-finance-debt-vs-equity-finance> © Commonwealth of Australia 2018.

7.7.6 “Family or friends

If a friend or relative offers you a loan, it's called a debt finance arrangement. If you decide on this option, carefully consider how this arrangement could affect your relationship” (Government of Australia Department of Industry, Innovation & Science, 2018).

7.8 Conclusion

Small business financing is important because it enables entrepreneurs to finance their various operational activities of their new business. It is very common for small businesses to face liquidity challenges or experience capital funding challenges during their initial startup phase hence the entrepreneur has to borrow or find a potential investor. When a business is started entrepreneurs can use their own personal sources to fund the business operations until the business grows namely; family or friends and bootstrapping. The owners’ equity sources that can be used by the business include; business angels, venture capital, venture capitalist and so on. The sources of debt capital include financial institutions, factoring companies, family or friends, retailers, suppliers and so on.

7.9 Discussion questions

- 1). Define small business financing? Identify the reasons why owners equity and debt financing is important to most small businesses? Provide relevant examples.
- 2). Define the term capital? Outline the difference between fixed capital and working capital?
- 3) Outline the six types of capital available to small businesses today?
- 4). Describe the seven sources of equity funding that can be used by entrepreneurs to finance their small businesses?
- 5). Explain what is debt financing? Describe the six sources of debt financing that can be used by entrepreneurs to finance their small businesses?

Chapter 8: Purchasing management

After studying this chapter you should be able to:

- Define what is purchasing and highlight the origins of the purchasing function.
- Outline the importance of the purchasing function to an organization.
- Explain in-depth the purchasing policy. Describe the functions of the purchasing function in an organization.
- Identify the job responsibilities found in the purchasing department.
- Outline the different types of purchases.
- Discuss the purchasing process steps.

8.1 Introduction

In general on a daily basis most of the organizations make use of their supplies or stock materials hence they have to ensure that they consistently purchase all the supplies they intend to use during their operational activities. This responsibility of buying these required supplies on time, in the right quality and at the right price rests with the purchasing department. The purchasing function is also known as the procurement function in some organizations despite the fact that the modern day term is the 'purchasing function'. Some of the key goals of a purchasing department in an organization includes the following: (1) to determine the accurate amount of goods/services that must be purchased, (2) select an appropriate supplier, (3) to bargain for the lowest possible price without compromising the quality of the supplies, (4) to acquire goods/services in a manner that is in direct alignment with the purchasing strategy, (5) reading, understanding and identifying the terms and conditions of a purchasing agreement before a purchase is made by the department, (6) placing supplies orders on time, (7) receiving deliveries of goods/services on time and (8) administering supplier payments and receipts as quickly as possible. Globalization has revolutionized competition and nowadays organizations that offer their customers real value for money (*such as offering them high quality products, convenience, on-time deliveries and so on*) ultimately win their customers long term loyalty. Products that are highly positioned and recognized in the marketplace nowadays by most consumers are only high quality products therefore entrepreneurs must consistently be aware of the fact that the success of

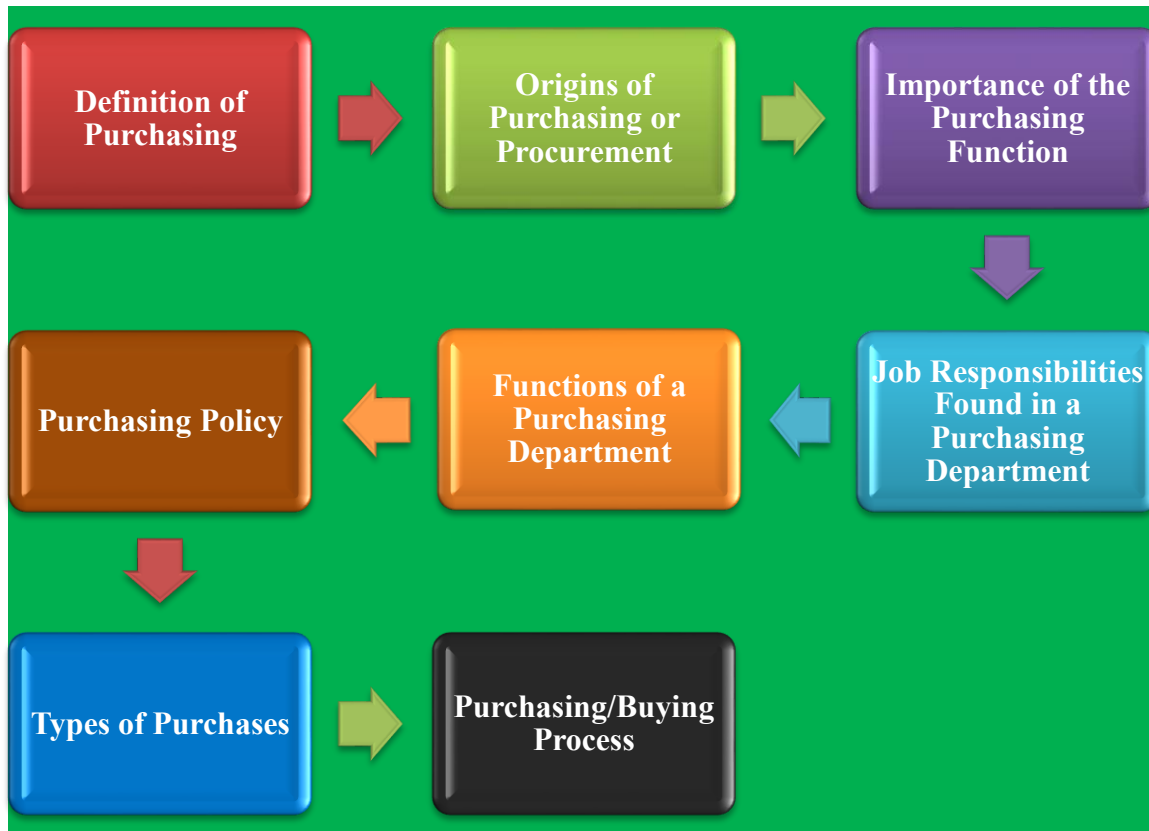
the products or services in the market depends on the quality of materials they purchase from their suppliers. Purchasing costs must generally be well managed on a regular basis to establish an effective purchasing strategy of buying supplies at bargained prices since purchasing costs tend to consume a significant proportion of the business's sales revenue and this fact is highlighted in the business's quarterly or yearly financial statements and or bookkeeping records.

Over the few years there has been an accelerated increase in the implementation of electronic procurement known as *e-procurement* due to the integration of the World Wide Web (*www*) and business. Generally *e-procurement* was introduced around the early 2000s²⁸⁹ (Eei, Husain and Mustaffa, 2012:14). Many organizations have adopted e-procurement in order to improve their quality management systems, facilitate inter-departmental coordination since the purchasing function requires input from other departments to properly function, it also enhances productivity and efficiencies (Eei, Husain and Mustaffa, 2012:14). According to a survey published in the International Journal on Advanced Science Engineering Information Technology by Eei, Husain and Mustaffa (2012) that researched on the benefits and barriers of e-procurement in Malaysian firms. The survey pointed-out that in 2005 there were 552 849 businesses in Malaysia and more than 99% of these were small-to-medium enterprises operating in the manufacturing, services and agricultural sectors that are considered to be vital in the Malaysian economy. It was revealed in the survey that 56% of the Malaysian workforce is employed by small-to-medium enterprises (*SMEs*). The survey further mentioned that 53% of the small-to-medium enterprises (*SMEs*) in Malaysia use the Internet everyday to perform their business functions. In addition the survey identified that e-procurement offers two benefits namely: tangible (*such as cost saving in terms of order placement, lead time order cost and so on*) and intangible benefits (*such as minimized bureaucracy, clearer and more transparent processes, it helps to lower the handling of too much paperwork, it enables the purchasing department employees to have more time to handle other important purchasing function issues and so on*) (Eei, Husain and Mustaffa, 2012:16). Thus the meaning of purchasing must be clearly understood by business owners in order for them to properly manage their day-to-day purchasing activities. The key components of effective

²⁸⁹ Eei, K.S., Husain, W. and Mustaffa, N. (2012) Survey on Benefits and Barriers of E-Procurement: Malaysian SMEs Perspective. *International Journal on Advanced Science Engineering Information Technology*. Available from: www.insightsociety.org/ojaseit/index.php/ijaseit/article/download/238/241

purchasing management in the purchasing department of a small business that will be covered in this chapter are depicted in Figure 8.1 below.

Figure 8.1 Eight components of effective purchasing management



There are various definitions of purchasing that have been developed over the past years by academics and researchers. The definition of purchasing will be discussed in the following section.

8.2 Definition of purchasing

Today the definition of purchasing is broad and it encompasses the following six elements namely; specify, select, contract, order, monitor and aftercare²⁹⁰ (International Federation of Purchasing & Supply Management, 2015:1). According to Abrahamsson, Badenfors, Bedey,

²⁹⁰ International Federation of Purchasing & Supply (2015) *Definitions*. Available from: <http://www.ifpsm.org/wp-content/uploads/2015/06/IFPSMDefinitions.pdf> p1-3

Bolotova, Dahl, Eklund, Eliasson, Gölgeci, Imen, Mostafavi, Najafi, Rand, Schollin, Shen, Szymelfejnik, Wahrén, Westberg, Westerlund, Zander and Zendejas (2008:2) *strategic purchasing is often described and defined as: when purchasing activities are linked to the corporate strategic planning process*²⁹¹ (Abrahamsson, Badenfors, Bedey, Bolotova, Dahl, Eklund, Eliasson, Gölgeci, Imen, Mostafavi, Najafi, Rand, Schollin, Shen, Szymelfejnik, Wahrén, Westberg, Westerlund, Zander, and Zendejas, 2008:2). *Strategic purchasing (which is part of procurement)*. Focus is on improvement of fundamental processes, business process re-engineering and major outsourcing issues (International Federation of Purchasing & Supply Management, 2015:1). The purchasing function in an organization relates to the management of all activities that significantly influence the smooth running of the organization's acquisition and supply of goods/services (*at the lowest possible cost without compromising quality*) that are used to produce the organization's final products/services it sells to its valued customers (International Federation of Purchasing & Supply, 2015:2). ²⁹²*“Strategic purchasing. Intense competitive pressures have forced companies to re-examine their approach to managing suppliers and their supply base. An increasing focus on core competencies, and the concomitant increase in outsourcing of components and services, has also placed greater emphasis on supplier management. In addition, much of the traditional in-house development activities have been pushed onto suppliers. Purchasing is thus increasingly regarded as a strategic weapon, centred on its ability to create collaborative relationships for firm advantage. Partnerships with suppliers can have a strong positive influence on firm performance through the development of joint resources and the exchange of valuable knowledge with these individual partners. In practice, many firms fail to realize these benefits when they implement sourcing agreements at a lower negotiated price. They fail to follow through with the relational processes that capture benefits over the*

²⁹¹ Abrahamsson, J., Badenfors, R., Bedey, L., Bolotova, L., Dahl, M., Eklund, S., Eliasson, M., Gölgeci, I., Imen, S. D., Mostafavi, M., Najafi, N., Rand, K., Schollin, N., Shen, S., Szymelfejnik, T., Wahrén, W., Westberg, P., Westerlund, K., Zander, H and Zendejas, J. (2008) *Purchasing Management*. Chalmers University of Technology. Available from: <http://publications.lib.chalmers.se/records/fulltext/90488.pdf>

²⁹² NC State University (2005) *Strategic Purchasing: Strategic Purchasing and Supply Management Practices – Part 2*. Available from: <https://scm.ncsu.edu/scm-articles/article/strategic-purchasing-strategic-purchasing-and-supply-management-practices-part-2>

course of the contract. The ability to extract benefits from supplier relationships is linked to the way these relationships are managed. For example, those relationships characterised by close interactions and successful process integration between buyer and supplier are better able to create, coordinate and protect joint resources for a sustained competitive advantage. Thus, it is not enough for a firm to possess a strategic purchasing orientation, they must also create conditions which allow the buyer and supplier to contribute and develop the relationship. Various supply management practices facilitate this process” (NC State University, 2020, <https://scm.ncsu.edu/>). The origins of purchasing will be covered in the following section.

8.3 Origins of ‘Purchasing’ or ‘Procurement’

Interestingly, around the 1960s and also the mid 1980s the importance of purchasing including purchasing management in each and every business was strongly emphasized by top researchers, business experts, leading publishers and trade journals. It is during the 1960s and the mid 1980s where most of the businesses began to realize the various benefits that were interrelated to the purchasing activity. Most businesses began to place higher value on purchasing since its role was categorized as strategic in the business whilst simultaneously being categorized as a strategic resource of the business (Carr and Pearson, 2002:1032-1052). In addition researchers Kemppainen and Vepsäläinen (2003) in their study discovered that during the 1990s the perceived importance of purchasing increased at a higher rate and this was due to the increasing role or status of supply chain management ²⁹³ (Kemppainen & Vepsäläinen, 2003; Carr *et al.*, 2002 in cited Abrahamsson *et al.*, 2008:11). The procurement/purchasing function is critical to every organization and this will be discussed in the following section.

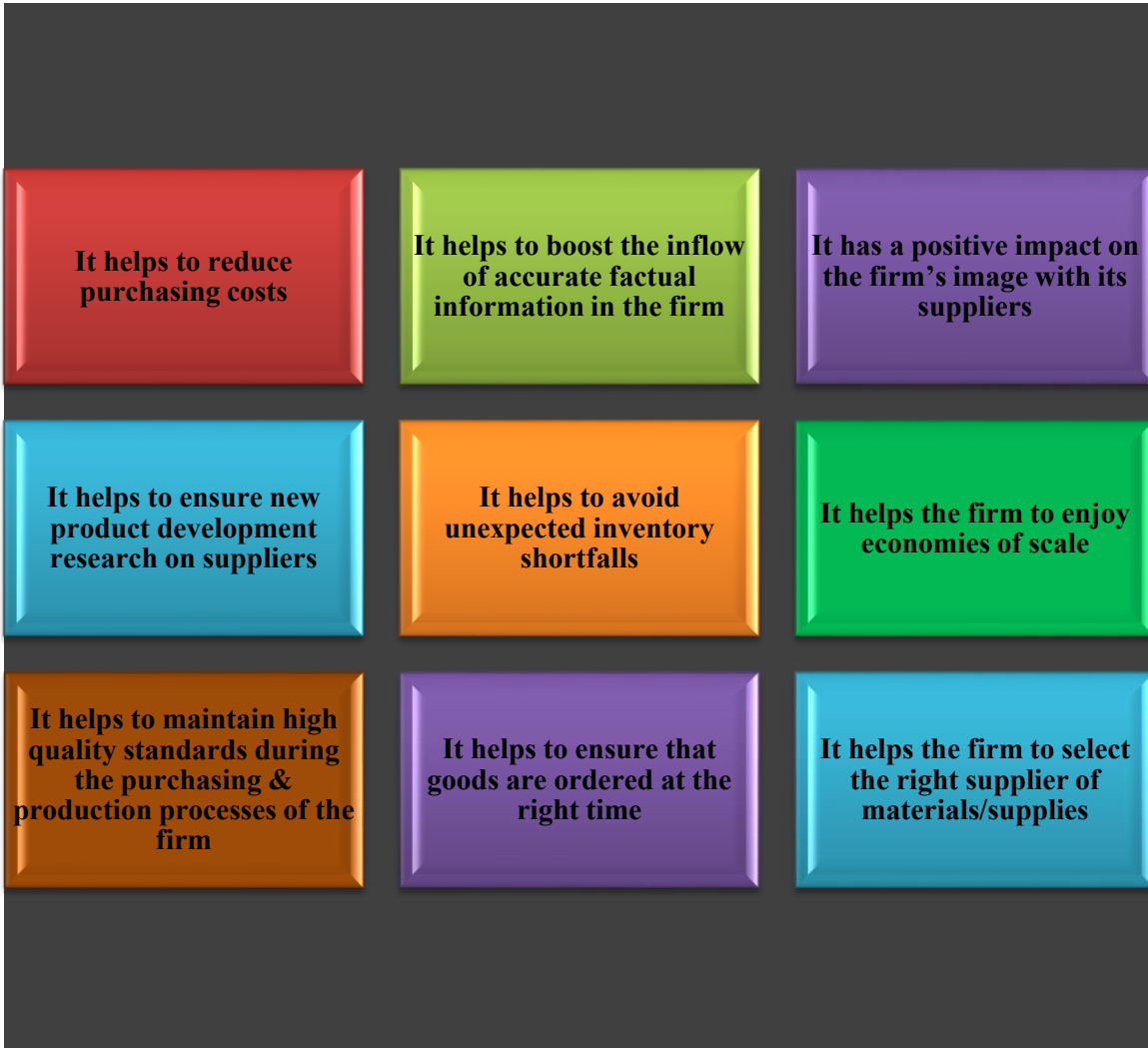
8.4 Importance of the purchasing function

The function of the purchasing department has enormously shifted from being a simple clerical function to being a key tool used to structure, create and manage the supply of materials and services in line with the purchasing strategy which is formulated in direct alignment of the

²⁹³ Abrahamsson, J., Badenfors, R., Bedey, L., Bolotova, L., Dahl, M., Eklund, S., Eliasson, M., Gölgeci, I., Imen, S. D., Mostafavi, M., Najafi, N., Rand, K., Schollin, N., Shen, S., Szymelfejnik, T., Wahrén, W., Westberg, P., Westerlund, K., Zander, H and Zendejas, J. (2008) *Purchasing Management*. Chalmers University of Technology. Available from: <http://publications.lib.chalmers.se/records/fulltext/90488.pdf>

corporate strategy. There is a plethora of reasons why the purchasing function is critical to an organization and some of the few reasons are highlighted in Figure 8.2 below.

Figure 8.2 Nine reasons why the purchasing function is important



Source: Modified: (Arnell, 2005, www.boeing.com/; Eei, Husain and Mustaffa, 2012; Davis, Aquilano and Chase, 2003:214; Dobler, 1996:214).

8.4.1 It helps to reduce purchasing costs

The main aim of the purchasing department is to adhere to the purchasing budget in order to save the money of the organization through buying the right type of goods in the right quality and quantity at the lowest possible price without compromising on quality. Notably the quality of the goods or materials purchased by the organization can result in the goods that are being produced

or sold by the organization to be rejected in the market due to poor quality. Thus the firm's buyers are responsible for carrying out the negotiation process with suppliers to purchase materials at reasonable prices. The purchasing department enables the firm to enjoy price discounts, trade discounts, economies of scale and so on through its price bargaining processes when liaising with suppliers therefore it helps the firm's overall purchasing costs.

8.4.2 It helps to boost the inflow of accurate factual information in the firm

In general the purchasing function can only place orders to purchase goods or services needed in the organization after liaising with other departments. The operations & production department (*helps to provide a list of the accurate quantities of materials that are needed for the firm to sufficiently produce its finished goods*) while the marketing department helps to provide information about the type and quality of materials that are used to produce the finished products that are currently in high demand in the marketplace. Therefore the purchasing function helps to boost the inflow of accurate factual information in the firm.

8.4.3 It has a positive impact on the firm's image with its suppliers

The purchasing function plays a critical role in enhancing the organization's reputation with its current and future suppliers and vendors. One of the responsibilities of a purchasing function is to liaise with suppliers and vendors on a continuous basis to maintain harmonious relations. The purchasing function is responsible for ensuring that the organization is fully stocked of all the materials or supplies it needs at any particular moment and it also helps to ensure that supplies are purchased at a bargain price without compromising on quality or quantity. The fact that the purchasing function develops a purchasing policy it must follow when carrying out its purchasing process helps to ensure that its employees (*buyers or purchasing agents*) perform their duties in a highly respectable and ethical manner that strengthens the relationship of the firm with suppliers/vendors. The purchasing policy helps to set the requirements of a credible supplier-selection process the organization must follow on a regular basis. A typical good example is that of Illinois, Chicago, United States of America headquartered Boeing Corporation founded on July 15, 1916 by Bill Boeing who had an inspirational philosophy that stated; "*build something*

*better*²⁹⁴ (Boeing, 2018). According to Boeing Corporation (2018) Boeing is the world's largest aerospace company and leading manufacturer of commercial jetliners, defense, space and security systems, and service provider of aftermarket support. As America's biggest manufacturing exporter, the company supports airlines and U.S. and allied government customers in more than 150 countries. With corporate offices in Chicago, Boeing employs more than 140,000 people across the United States and in more than 65 countries (Boeing Corporation, 2018). The procurement department of Boeing the aircraft manufacturer spends large sums of money on a regular basis buying the organization's materials for its Boeing 787 Dreamliner aircraft model and they follow a set of strict supplier selection criteria when choosing suppliers or vendors to use (Arkell, 2005, www.boeing.com/). Boeing adopted the lean manufacturing principles such as just-in-time (*JIT*) and it now requires its suppliers to do the same. Furthermore, the aircraft manufacturer uses the consumption-based ordering (*CBO*) which is a enterprise wide online supply-chain tool to liaise or communicate with its suppliers. The online supply chain tool allows suppliers to predict demand and place orders if they see it that it is necessary to build the materials and then deliver them to Boeing's production facilities when its inventory levels have dropped beyond the required minimum levels (Arkell, 2005, www.boeing.com/). Therefore, the purchasing of inventory is based on consumption rates that are needed to facilitate production and it also helps Boeing to maintain its lean principles of reducing the number of warehouses at its production facilities. This also enables Boeing to save on costs such as storage costs, pilferage costs, inventory expiry or becoming outdated costs and so on. Boeing when it wanted to improve its purchasing efficiency through-out the supply chain it designed a new supplier model for its 787 Dreamliner jet that transformed the role of a supplier to that of a true partner and it further reduced the number of its suppliers in order to strengthen its partnership relationships with high-performing partners²⁹⁵ (Arkell, 2005, www.boeing.com/).

²⁹⁴ Boeing, *Our History*, [Website], 2018, <https://www.boeing.com/history/>, (accessed 29 Jun e 2018)

²⁹⁵ Arkell, D., *As Boeing Transforms into a Large-Scale Systems Integrator, the Supplier's Role has Fundamentally Changed. Here's a Look at What's Different - and What These Changes Means for Boeing People*, [Website], 2005, www.boeing.com/news/frontiers/archive/2005/march/mainfeature1.html, (accessed 02 October 2015)

8.4.4 It helps to ensure new product development research on suppliers

The key role of a purchasing manager is to remain updated with the latest trends in the market and any changes in the consumer buying patterns in most instances often results in changes in the manufacturing processes of the firm's products. Thus it is the role of the purchasing department to ensure that they consistently carryout research on the firm's supplier's new product development activities so that the firm is supplied with materials that help the firm to produce products that are in line with current consumer buying patterns in the market.

8.4.5 It helps to avoid unexpected inventory shortfalls and overstocking

In addition, one of the key roles of the purchasing function is to avoid the overstocking of inventory through placing more emphasis on the careful management of inventory levels by purchasing the appropriate amounts of materials/supplies from selected suppliers. It helps to ensure that the organization has adequate inventory whenever it is needed even during lead time periods. A *lead time* period is the time period the organization places an order to its suppliers up to the time that order is processed and received. Therefore, organizations have to ensure that production is not disrupted due to material shortages (Eei, Husain and Mustaffa, 2012:14),

8.4.6 It helps the firm to enjoy economies of scale

When buyers of the firm implement their purchasing strategies they often end up buying supplies or materials at discounted prices and in bulk which tremendously lowers the purchasing costs in the firm. Suppliers tend to offer different types of discounts to their customers and these include the following: cash discounts, trade discounts, quantity discounts and seasonal discounts. Economies of scale help the firm to save a lot of money that it may use for other purposes.

8.4.7 It helps to maintain high quality standards during the purchasing & production processes of the firm

The number one rule of every purchasing policy is that the purchasing department employees' must never compromise the quality of supplies or materials when implementing their bargaining processes, supplier-selection processes or making an order and so on. The purchasing policy

often dictates that the purchasing department must adopt a total quality management approach and buy from quality accredited suppliers/vendors and therefore this helps to ensure high quality standards are upheld in the firm. It has become an issue of utmost importance for organizations to ensure that quality is maintained all the time when buying materials, component parts, finished goods or supplies for the organization. Today competitive advantages and high customer satisfaction levels can easily be achieved via selling high quality products or services. Global competition has also shifted the traditional way of doing business in the marketplace that is, from being a producers' market where organizations dictate quality standards to a consumers' market where organizations have to adhere to customers quality demands in order to survive profitably²⁹⁶ (Davis, Aquilano and Chase, 2003:214). The Internet revolution over the past decades has been boosted by electronic commerce (*e-commerce*) while simultaneously opening the doors for global competition in various parts of the world. One of the critical ingredients of success in the purchasing management function today is quality management during the purchasing process since the selection of suppliers and components or materials is based on quality. *Quality* means the ability to produce goods or services that perform as expected by customers at minimal cost of material wastage, labour of rework or repairs. The quality of goods covers aspects such as durability, features and so on. Quality of services involves aspects such as timeliness, dependability, friendliness and so on (Davis *et al.*, 2003:221). The *total quality management* approach includes all the departments in the organization and the suppliers working together to boost the quality standards of the organization's products or services in order for them to meet customer expectations at a profit (Davis *et al.*, 2003:226).²⁹⁷ The purchasing function helps to uphold high quality standards in the firm by partnering with international quality standard associations such as the International Organization for Standardization (*ISO*) and buying goods from suppliers/vendors that are ISO accredited so that they successfully adhere to the quality rules stipulated in the purchasing policy of the organization. The International

²⁹⁶ Davis, M., Aquilano, N. and Chase, R. (2003) *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-630.

²⁹⁷ International Organization for Standardization (2018) *An Opportunity for Collaboration*. Available from: <https://www.iso.org/files/live/sites/isoorg/files/store/en/PUB100420.pdf>

Organization for Standardization (*ISO*) is headquartered in Geneva, Switzerland. ²⁹⁸According to the International Organization for Standardization (2018:2) standards define how products, processes and people interact with each other and their environments. They provide requirements, specifications, guidelines or characteristics that can be used consistently to ensure that materials, products, processes and services are fit for their purpose. Some of the quality standard products' of ISO include: ISO 9000 - Quality Management, ISO 14 000 - Environmental Management, ISO 3166 – Country Codes, ISO 22 000 – Food Safety Management, ISO 26 000 – Social Responsibility, ISO 50 001 – Energy Management, ISO 31 000 – Risk Management, ISO 4217 – Currency Codes, ISO 639 – Language Codes, ISO 20 121 – Sustainable Events, ISO 27 001 – Information Security, ISO 45 001 – Occupational Health and Safety and many others²⁹⁹ (International Organization for Standardization, 2018).

8.4.8 It helps to ensure that goods are ordered at the right time

Time has become the epicenter of every business activity in the modern day business world and even 'innovation' is also guided by time since all new ideas or inventions are developed overtime. Similarly, time is critical when purchasing inventory for the organization. Some raw material supplies can only be done during certain climate seasons and thus it is the role of the purchasing function to ensure that the firm's warehouses are well stocked.

8.4.9 It helps the firm to select the right supplier of materials/supplies

A successful purchasing process can only be attained if the organization is able to select the right supplier as they help it to achieve buying goods or materials of the right quality, on-time, at the right place, provide the needed after sales services support and so on³⁰⁰ (Dobler, 1996:214). The origins of the procurement/purchasing function will be discussed in the following section.

²⁹⁸ International Organization for Standardization (2018) *Standards: Publication List*. Available from: <https://www.iso.org/publication-list.html>

²⁹⁹ International Organization for Standardization (2018) *An Opportunity for Collaboration*. Available from: <https://www.iso.org/files/live/sites/isoorg/files/store/en/PUB100420.pdf>

³⁰⁰ Dobler, D.W. and Burt, D.N. (1996) *Purchasing and Supply Management*. New York: McGraw-Hill, p214.

8.5 Purchasing policy

³⁰¹ “*Why policies are important.* Policies serve several important functions: (1) Communicate values and expectations for how things are done at your organization, (2) Keep the organization in compliance with legislation and provide protection against employment claims, (3) Document and implement best practices appropriate to the organization, (4) Help management to make decisions that are consistent, uniform and predictable, (5) Protect individuals and the organization from the pressures of expediency” (HR Council of Canada, 2018, <http://hrcouncil.ca/>). In general an already existing small business tends to have some form of knowledge on what to buy or what not to buy meaning in a way every business has a set procedure it follows when purchasing inputs whereas a completely new business has to first determine the do’s and don’ts during the buying process of materials/services to use in the organization. Generally abiding to a purchasing policy is a moral choice made by both the purchasing department employee(s) and the business itself despite the fact that all its terms are mandatory for directors, managers, negotiators and employees to adhere to when carrying-out the purchasing process on behalf of the purchasing department. In a nutshell a purchasing policy is a guideline that is devised by the organization in order for the purchasing department’s employees and management to use during the buying or negotiation process. Every small business must ensure that it has a person who is responsible for the purchasing function and it must also develop a clearly detailed purchasing policy. There are several functions of a purchasing department.

8.6 Functions of a purchasing department

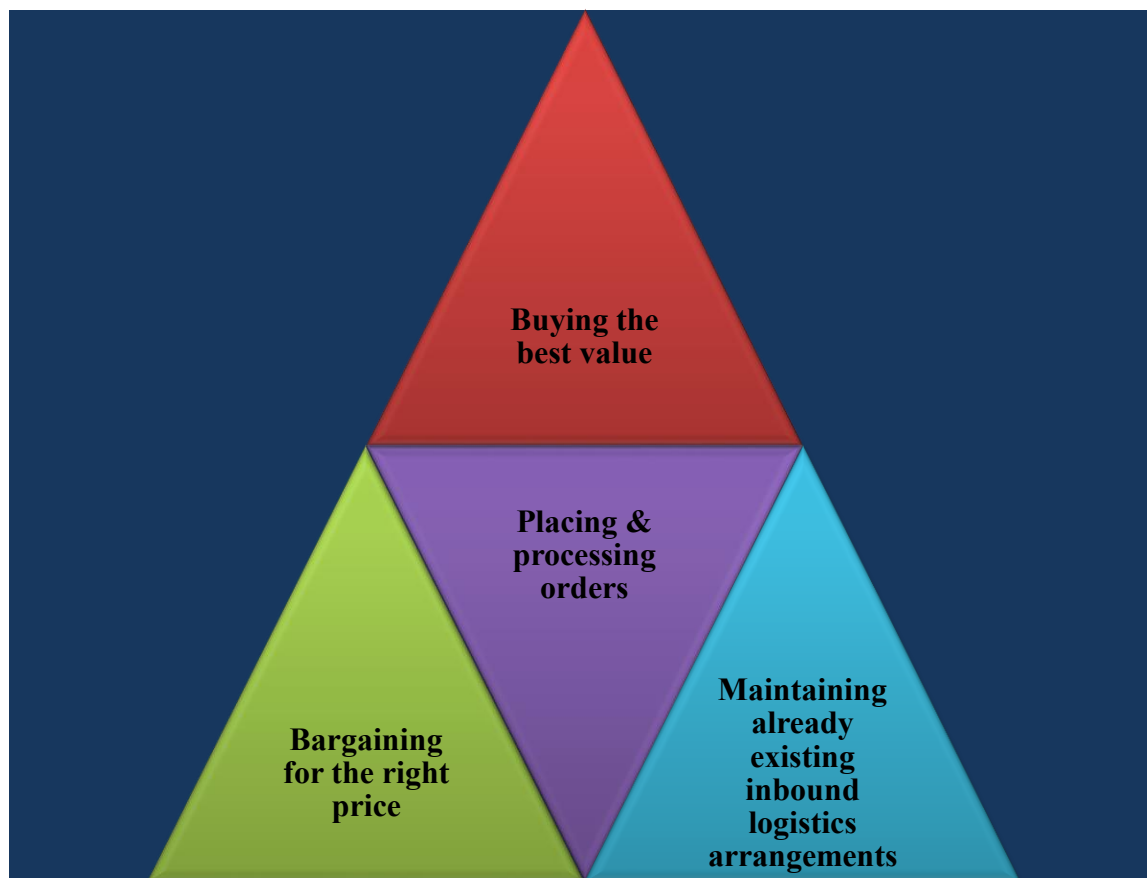
³⁰²The activities of the purchasing function support the strategic and tactical plans of the organization in terms of ensuring that the organization consistently has a steady supply of

³⁰¹ HR Council of Canada (2018) *HR Policies & Employment Legislation*. Available from: <http://hrcouncil.ca/hr-toolkit/policies-guideline.cfm>

³⁰² Abrahamsson, J., Badenfors, R., Bedey, L., Bolotova, L., Dahl, M., Eklund, S., Eliasson, M., Gölgeci, I., Imen, S. D., Mostafavi, M., Najafi, N., Rand, K., Schollin, N., Shen, S., Szymelfejnik, T., Währén, W., Westberg, P., Westerlund, K., Zander, H and Zendejas, J. (2008) *Purchasing Management*. Chalmers University of Technology. Available from: <http://publications.lib.chalmers.se/records/fulltext/90488.pdf>

goods/services it needs to fulfill its production and marketing objectives (Abrahamsson, Badenfors, Bedey, Bolotova, Dahl, Eklund, Eliasson, Gölgeci, Imen, Mostafavi, Najafi, Rand, Schollin, Shen, Szymelfejnik, Währén, Westberg, Westerlund, Zander and Zendejas, 2008:11). Numerous academic studies and researchers have since discovered that there is an interrelation between the purchasing function and supply chain management (SCM) to the extent that none of the two concepts can succeed without the other despite the fact that ‘purchasing’ is a sub-function of ‘supply chain management’. There are numerous functions of purchasing and these are depicted in Figure 8.3 below.

Figure 8.3 Four functions of purchasing



Source: Modified (Liraz, 2018; Abrahamsson *et al.*, 2008:11)

“At first glance, it may seem to be to find and purchase a quantity of material for the best price. But price is not the only concern. Low-priced material may not be a bargain if it is of

unacceptable quality or if delivery is not reliable.³⁰³ Clearly, the purchasing function involves more than obtaining the best price. It also involves *buying the best value*, which means buying:

- the right quantity and quality
- at the best price
- from suppliers who are reliable and provide good service” (Liraz, 2018, www.bizmove.com/).

Notably the purchasing function is one guaranteed business activity that helps secure a steady inflow of materials/services into the organization and some of the other three functions of purchasing include the following:

- *placing and processing orders* of materials,
- *bargaining for the right price* with suppliers without compromising the organization’s quality requirements/standards,
- *maintaining already existing inbound logistics arrangements* between the organization and its various suppliers in order to ensure that on-time deliveries of the ordered goods/services are efficiently carried-out (Abrahamsson *et al.*, 2008:11). The different job responsibilities found in a purchasing department are discussed in the next section.

8.7 Job responsibilities found in a purchasing department

There are several job titles that are found in a purchasing department today and the incumbents of these job posts are guided by the purchasing policy and the business strategy in their day-to-day purchasing activities of the organization. It is important for entrepreneurs to become fully knowledgeable of all the job titles that are found in the purchasing function and how they contribute to the achievement of the organization’s goals and objectives. The various job titles that are found in the purchasing department are depicted in Figure 8.4 below.

³⁰³ Liraz, M (2018) *The Function of Purchasing in the Organisation*. Available from: <https://www.bizmove.com/general/m6i1.htm> [Accessed 2018, 09 November]

Figure 8.4 Three job titles found in a purchasing department



Source: Modified: (Murphy cited in PurchaseControl™, 2020, www.purchasecontrol.com).

8.7.1 Purchasing manager

The success of an organization centers on the quality, quantity, price and type of materials/services it buys to use to manufacture/process its final products and this is one of the many responsibilities performed by a purchasing manager. Purchasing managers play a vital role in every organization as they are the most senior authority in the function or they can be referred to as the ‘head of the purchasing department’.³⁰⁴“At the top of the purchasing department, there is a purchasing manager who supervises the department staff and works closely with the organization executive do plan and oversee the budget. The purchasing manager has to maintain

³⁰⁴ Murphy, K. cited in PurchaseControl™ (2020) *Purchasing Department: Roles, Duties, and Responsibilities*. Available from: <https://www.purchasecontrol.com/blog/purchasing-department/> [Accessed October 02, 2020]

close communications with department heads to better understand their needs and the role their purchases play in the company. For instance, a purchasing manager for an online retailer needs to have a working knowledge of the way network servers play the company's operational workflow" (Murphy cited in PurchaseControl™, 2020, www.purchasecontrol.com). The key responsibilities of purchasing managers include: (1) forecasting the demand of products/services produced by the organization through using old and current data statistics (*namely; sales units sold in the past 6 months - 2 years or climate seasons, salespeople reports and so on*), (2) they consistently liaise with the marketing department for regular market research results so that they remain up-to-date with the current market trends (*consumer buying patterns & changes in social cultures*) in order for them to implement accurate buying methods, (3) they are responsible for creating long term mutual relationships with suppliers, vendors and other stakeholders of the organization,

8.7.2 Purchasing agent & buyers

"*Purchasing officers, purchasing agents, and buyers* all work under the supervision of the purchasing manager. Their duties and responsibilities may vary depending on an organization's size and priorities"³⁰⁵ (Murphy cited in PurchaseControl™, 2020, www.purchasecontrol.com). The other additional duties of a purchasing agent include the following: (1) they are responsible for carrying-out the administration paperwork such as payment and sending of receipts to vendors, manufacturers or suppliers on time in order to maintain the organization's good working relationships with them, (2) they conduct inventory management systems, monitor inventory levels and they ensure that new stock refills are done on time to avoid inventory shortfalls. The different types of purchasing done in an organization are covered in the next section.

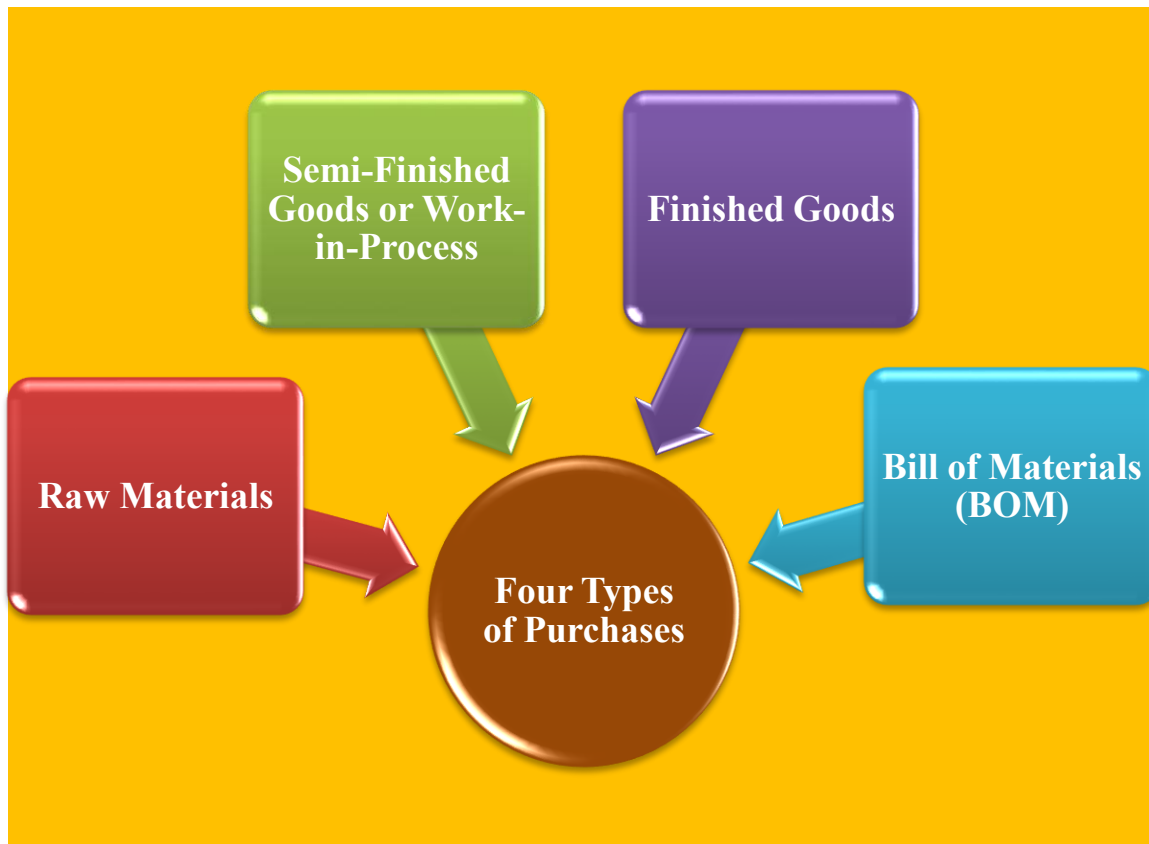
8.8 Types of purchases

The purchasing of supplies is done almost on a daily basis in every organization. A purchasing department of an organization makes different types of purchases from selected suppliers from

³⁰⁵ Murphy, K. cited in PurchaseControl™ (2020) *Purchasing Department: Roles, Duties, and Responsibilities*. Available from: <https://www.purchasecontrol.com/blog/purchasing-department/> [Accessed October 02, 2020]

time to time while maintaining the rules stipulated by the purchasing policy. Thus the common types of purchases that are made by most of the organizations are depicted in Figure 8.5 below.

Figure 8.5 Common types of purchases



Source: Modified: (Australian Government Department of Industry, Innovation and Science, 2020, <https://www.business.gov.au/>; Davis *et al.*, 2003:604).

8.8.1 Raw materials

Goods or items that are delivered to the organization's premises or warehouses in their raw or natural form for use as inputs to produce other goods (*products*) are referred to as *raw materials* (Australian Government Department of Industry, Innovation and Science, 2020, <https://www.business.gov.au/>). Examples of raw materials include: timber delivered at a furniture manufacturing plant in the magnificent city of Toronto, Canada which is later cut into manageable pieces of wood that are used to make kitchen chairs, tables, sofas and other furniture products that are later supplied to furniture retail outlets across various cities in Canada (*namely*:

Vancouver, Toronto, Montreal, Ottawa, Calgary, Edmonton, Quebec City, Regina, Hamilton, Saskatoon and many other cities). “Raw materials inventory are raw materials that your business changes to produce its goods and/or services. For example, if you manage an ice cream business, raw materials inventory could include milk you use to make ice cream” (Australian Government Department of Industry, Innovation and Science, 2020, <https://www.business.gov.au/>).

8.8.2 Semi-finished goods

³⁰⁶Another type of purchase made by organizations includes *semi-finished goods* that have been partially processed despite the fact that they were not fully completed. Therefore, most semi-finished product purchases are also similar to raw materials as they are used as inputs to produce an organization’s final products (Davis *et al.*, 2003:604). Typical examples of semi-finished goods include windscreens, door handles, vehicle seats, rims, lights, seat belts and so on which are used as material component supplies in automobile assembly plants in the United Kingdom, Germany, India, the United States of America and Sweden. “*Work-in-process* inventory is any unfinished goods that your business has made. If your business makes and sells chairs, work-in-process inventory would include any unfinished chairs on hand that your business has made”³⁰⁷ (Australian Government Department of Industry, Innovation and Science, 2020, <https://www.business.gov.au/>).

8.8.3 Finished goods

“*Finished goods* inventory includes any finished goods that are ready to sell. If you have a retail business that buys and sells toys, the toys you buy would be finished goods inventory”³⁰⁸

³⁰⁶ Davis, M., Aquilano, N. and Chase, R. (2003 *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-630.

³⁰⁷ Australian Government Department of Industry, Innovation and Science (DIIS) (2020) *Managing your Business Inventory*. Available from: <https://www.business.gov.au/Products-and-services/Inventory-management/Managing-your-business-inventory> [Accessed January 31, 2020] © Commonwealth of Australia

³⁰⁸ Australian Government Department of Industry, Innovation and Science (DIIS) (2020) *Managing your Business Inventory*. Available from: <https://www.business.gov.au/Products-and-services/Inventory-management/Managing-your-business-inventory> [Accessed January 31, 2020] © Commonwealth of Australia

(Australian Government Department of Industry, Innovation and Science, 2020, <https://www.business.gov.au/>). The term ‘finished goods’ refers to the final product that is produced after the transformation/production process of an organization has been done and is currently stored in the organization’s premises. Another good example of finished goods in an automobile assembly plant is a finished new automobile such as a ‘sport utility vehicle’ (SUV) 4 x 4 car model (Davis *et al.*, 2003:604). The organization can also make finished goods purchases from its suppliers. For example, large clothing retailers in the leading fashion hub nations such as France, Germany and the United Kingdom buy finished clothing products from both local & international clothing manufacturers in North America, the European Union, Africa & so on to stock in their retail outlets for example, shirts, blouses, skirts, jeans, tracksuits, sweaters, jackets, hats and so on. Therefore, finished goods are also completely processed products or items that an organization buys from its suppliers as materials or supplies.

8.4.4 Bill of Materials

Generally the *bill of material* is a list that clearly outlines all the parts or semi-finished goods that are used to produce the organization’s final products it sells to its targeted customers in the marketplace. Therefore, it is important for every organization to set clear purchasing objectives so that it properly drafts clear and precise bill of materials. In the next section aspects about the purchasing/buying process will be covered in the following section.

8.9 Purchasing/buying process

Various academics and researchers have established the different steps that must be followed during the purchasing process and in this chapter only six steps will be identified.³⁰⁹ According to Supply Chain Resource Co-operative SME (2003) many organizations are beginning to re-evaluate their purchasing processes, and identify new types of e-procurement tools that will meet their needs. This summer, Karl Mundt and Mark Benson have been working with PPD to map out their purchasing process, and identify discrepancies in the process that may exist:

³⁰⁹ Supply Chain Resource Cooperative SME (2003) *E-Procurement and the Purchasing Process*. Available from: <https://scm.ncsu.edu/scm-articles/article/e-procurement-and-the-purchasing-process>

8.9.1 User need for product or service

The purchasing process begins with identifying or anticipating a material or service needed by a user, and electronic documents may be used in any of the following forms:

- Purchase requisitions from internal users
- Forecasts and customer orders (*electronically*)
- Routine reordering systems (*barcodes*)
- Stock checks
- Material requirements identified during the new product development (Supply Chain Resource Cooperative SME, 2003, www.scm.ncsu.edu/).

8.9.2 “Purchase approval and supplier evaluation

There may be various steps in the process required, depending on the size of the purchase, as well as whether the company has purchased from the supplier before. Once the user need has been recognized, the system will check to see if an approved supplier has already been entered into the database. In many cases, for a repetitive purchase, purchasing may have already negotiated a contract with the supplier, with established terms for delivery, pricing, quality, etc., and the supplier has already been entered into the accounting system. If the purchase requisition requests an item which is a very small dollar amount, the system may allow the user to purchase the item with no approval required through a system such as an e-procurement system, online catalog, or purchasing card. In cases when the dollar amount exceeds the users' permission to generate a purchase order, the purchase must then go through an approval process, to review the requisition, approve it, and allow a purchase order to be created. If the requisition requests an item for a higher dollar amount with no existing supplier, then purchasing may obtain quotes or bids from potential suppliers. Purchasing forwards a request for quotation (RFQ) to suppliers

inviting them to submit a bid for a purchase contract”³¹⁰ (Supply Chain Resource Cooperative SME, 2003, www.scm.ncsu.edu/).

8.9.3 “Bidding, negotiation and supplier selection

Final supplier selection occurs once purchasing completes the activities required during the supplier evaluation process. Selecting suppliers is perhaps one of the most important activities performed by companies. Errors made during this part of the purchasing cycle can be damaging and long-lasting. After bids have been received, and/or the negotiation has taken place, the sourcing team will select a supplier, and then move on to authorize the purchase through the purchase approval process” (Supply Chain Resource Cooperative SME, 2003, www.scm.ncsu.edu/).

8.9.4 “Purchase approval

After the supplier is selected or a requisition for a standard item is received, purchasing grants an approval to purchase the product or service. This is accomplished through an electronic drafting of a purchase order (PO), sometimes called a purchase agreement, after supplier selection is complete. Purchasing must take great care when wording a purchase agreement because it is a legally binding document. Almost all purchase orders include the standard legal conditions that the order (*i.e., the contract*) is subject to on the reverse side of the agreement. The purchase order details critical information about the purchase: quantity, material specification, quality requirements, price, delivery date, method of delivery, ship-to address, purchase order number, and order due date. Note that firms are increasingly using computerized databases to perform these processes, and are moving towards a ‘paperless’ office” (Supply Chain Resource Cooperative SME, 2003, www.scm.ncsu.edu/).

8.9.5 “Release and receive purchase requirements

This phase of the purchasing cycle involves the physical transmittal of purchase requirements. This should be a fairly routine, although not necessarily the most efficient, part of the purchasing

³¹⁰ Supply Chain Resource Cooperative SME (2003) *E-Procurement and the Purchasing Process*. Available from: <https://scm.ncsu.edu/scm-articles/article/e-procurement-and-the-purchasing-process>

cycle. Some organizations transmit orders electronically, while others send material releases through the mail or by fax. Electronic data interchange (EDI), which involves the electronic transfer of purchase documents between the buyer and seller, can help to shorten order cycle time. EDI transactions, particularly through the Internet, will increase over the next several years. The shipping and receiving processes require several other important documents (*which can also be electronic*), including the material packing slip, the bill of lading, and the receiving discrepancy report”³¹¹ (Supply Chain Resource Cooperative SME, 2003, www.scm.ncsu.edu/).

8.9.6 “Continuously measure and manage supplier performance

One way to identify the best suppliers is to track performance after awarding a contract. Supplier measurement and management is a key part of the purchasing cycle. As shown in the exhibit, buyers should not assume that the purchasing cycle ends with the receipt of an ordered item or the selection of a supplier. Continuous measurement is necessary to identify improvement opportunities or supplier nonperformance” (Supply Chain Resource Cooperative SME, 2003, www.scm.ncsu.edu/). It is important for entrepreneurs to ensure that the quality of their materials they purchase is good and this will be covered in the following section.

8.10 Conclusion

Purchasing in an organization is concerned with the buying of materials or supplies from selected suppliers who sell their goods at reasonable prices without compromising on quality. One of the main aims of the purchasing function is to ensure that the organization saves lots of money when buying materials by enjoying economies of scale and choosing suppliers who are accredited by international quality bodies. Some organizational policies require the organization to buy from organizations that produce goods using environmentally friendly materials. Every organization needs supplies or materials and it makes different types of purchases for raw materials, semi-finished goods, finished goods, bill of materials and so on. It is important for organizations to ensure that they buy materials or supplies from carefully selected suppliers who offer the right prices without limiting product quality and who can also deliver on time.

³¹¹ Supply Chain Resource Cooperative SME (2003) *E-Procurement and the Purchasing Process*. Available from: <https://scm.ncsu.edu/scm-articles/article/e-procurement-and-the-purchasing-process>

8.11 Discussion questions

1. Define what is purchasing and explain the functions of the purchasing function in an organization giving examples?
2. Discuss the nine reasons why the purchasing function is important to an organization?
3. Describe a purchasing policy? Discuss the six purchasing process steps?
4. Discuss how an organization can obtain credible quality recognition in this 21st century and ensure that it selects reputable suppliers of quality products?
5. Describe the three job responsibilities of the purchasing department and briefly discuss the four types of purchases commonly done by a purchasing department?

Chapter 9: Inventory management

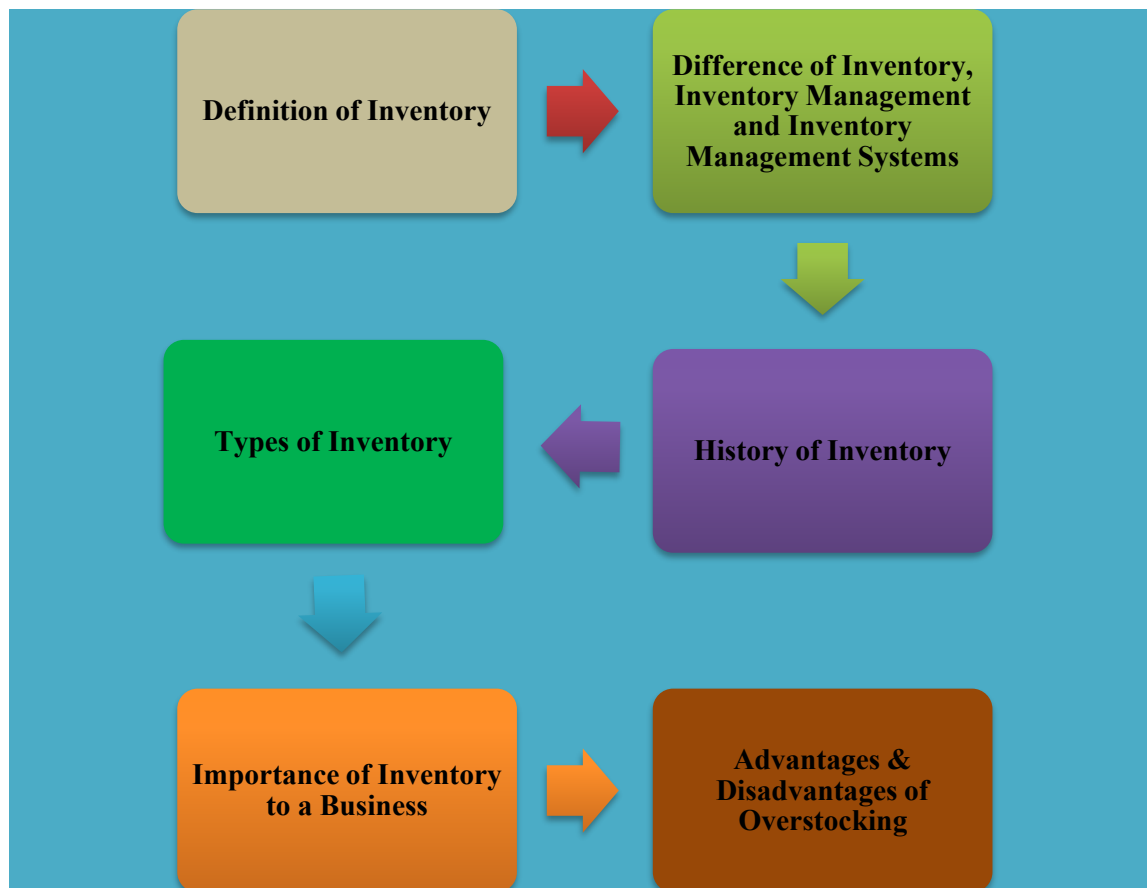
After studying this chapter you should be able to:

- Define the term inventory. Identify the key differences between inventory, inventory management and inventory management systems.
- Highlight the importance of inventory and the history of inventory.
- Explain the different types of inventory and inventory management systems.
- Outline the benefits of barcode inventory systems and radio frequency identification inventory systems.
- Identify the common advantages and disadvantages of overstocking.

9.1 Introduction

In general entrepreneurs as human beings often succumb to false misleading information or assumptions about inventory and in most instances they end up seeing it as something that they think of when it is needed or as a low level priority task. Today businesses can only succeed if they effectively manage four assets namely; people, the corporate image, inventory and business innovation. Inventory is a critical ingredient to the reduction of costs, enhanced quality control of products, increased profitability and high sales revenue. Continuous innovation has become the norm in the management of a small business today as entrepreneurs are now placing more emphasis on adopting inventory management systems that quickly push-out slow moving inventory merchandise from their shelf spaces or warehouses to save costs and boost sales revenue levels. Small businesses that spend money buying inventory tend to be doing the right thing but they must first conduct market research in order to avoid buying outdated materials and overstocking their warehouses. The components of inventory management that will be covered in this chapter are depicted in Figure 9.1 below.

Figure 9.1 Six components of inventory management



A manufacturing industry requires high inventory management systems than the services industry. There are several definitions of inventory and these will be covered in the following section.

9.2 Definition of inventory

There is a plethora of definitions of inventory that have been developed by leading business gurus in the field of purchasing, supply chain and operations management in different parts of the world today. It is important for entrepreneurs to be fully aware of the fact that the terms ‘inventory’ and ‘inventory management’ are completely different irregardless of the fact that they are interrelated. ³¹²“*Inventory* can best be described as any materials or goods that pass through or are held in your business and are necessary in order to carryout your trade (O’Byrne,

³¹² O’Byrne, R. (2017) *What is Inventory*. Available from: <https://www.logisticsbureau.com/what-is-inventory/>

2017, www.logisticsbureau.com). *Inventory* is defined as stock of materials, goods, components and supplies the organization uses to produce finished goods or for reselling³¹³ (Davis *et al.*, 2003:604). “*Inventory management* is the activity involved in making sure your inventory works for your business as cost-effectively as possible”³¹⁴ (O’Byrne, 2017, www.logisticsbureau.com). It is important to know about the differences of inventory and inventory management systems and this will be covered in the following section.

9.3 Difference between inventory, inventory management and inventory management systems

It is very common for entrepreneurs to fail to identify the difference between the terms inventory, inventory management and inventory management systems. The differences between the three terms are highlighted in Table 9.1 below.

Table 9.1 Key difference between inventory, inventory management and inventory management systems

Inventory	Inventory management	Inventory management systems
<ul style="list-style-type: none"> • ³¹⁵“Inventory is an asset that is sold throughout the ordinary course of business. It is often one of the main sources of a company's revenue” (Debitoor, 2020). • Inventory includes goods ready for sale as well as any physical resources used in the production of 	<ul style="list-style-type: none"> • “<i>Managing inventory</i>. Sometimes referred to as stock, inventory represents tied-up capital. It is therefore important to implement effective stock management in order to free-up capital” (Debitoor, 2020). • However, another notable difference is that inventory 	<ul style="list-style-type: none"> • “An <i>inventory management system</i> is the combination of technology (hardware and software) and processes and procedures that oversee the monitoring and maintenance of stocked products, whether those products are company assets, raw materials and supplies, or

³¹³ Davis, M., Aquilano, N. and Chase, R. (2003) *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-670.

³¹⁴ O’Byrne, R. (2017) *What is Inventory*. Available from: <https://www.logisticsbureau.com/what-is-inventory/>

³¹⁵ Debitoor (2020) *Inventory - What is Inventory?* Available from: <https://debitoor.com/dictionary/inventory>

<p>the finished products” (Debitoor, 2020).</p> <p>Inventory should be reported as a short-term or <u>current asset</u> as it is usually liquidated (turned into cash) within a year” (Debitoor, 2020).</p>	<p>management is the task of determining projections and the restocking of materials while focusing on the timeline to place new orders including: (1) accurately determining the adequate volumes of inventory and (2) determining the right supplier to use to deliver the goods.</p> <ul style="list-style-type: none"> • Thus, by doing so the organization will consistently have adequate inventory that meets the required quality standards, at the appropriate time and place. • Inventory management puts more emphasis on the creation and maintenance of strong mutual working relationships between the organization and all the intermediaries involved in the supply chain of its inventory or goods as they all play a critical role in the producing or delivery of inventory of the right quality, at the right time and place. 	<p>finished products ready to be sent to vendors or end consumers”³¹⁶ (Pontius, 2018).</p>
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Source: Modified (Debitoor, 2020, <https://debitoor.com>; Pontius, 2018, www.camcode.com).

It is important for entrepreneurs to be fully knowledgeable about the origins of inventory management and this will be covered in the following section.

³¹⁶ Pontius, N. (2018) *What is an Inventory Management System*. Available from: <https://www.camcode.com/asset-tags/what-is-an-inventory-management-system/>

9.4 History of inventory

Historically ancient people were the first people to engage in the buying and selling of goods for the last 100-300 years or more thus making inventory management one of the oldest business practices still being applied today. The technology revolution has extensively improved inventory management over the past three decades especially ‘the arrival of computers and integrated software inventory management systems’ which have made it easier for entrepreneurs to monitor their inventory efficiently. The origins of inventory vary amongst different academics and researchers. ³¹⁷According to Dolinsky (2014) titled: ‘**inventory accounting, memory, and the birth of writing**’ - some of the world's earliest known writing systems - early Dynastic Egyptian hieroglyphs, Mycenaean and Knossian Linear-B, Babylonian cuneiforms, and Chinese pictographs - are heavily represented in the archeological record by long lists of bins of grain, jars of oil, weapons and armor, and other common goods of these first civilizations. The urge to make the flow of goods and services more efficient is perhaps identical with the urge of civilization itself. Inventory control goes back further than writing, however. Even before systems of representing specific sounds by specific pictures arose - the systems that let you look at a letter "s" and associate it with the hissing sound one makes by pressing the tongue lightly behind the upper teeth and squeezing air out of the lungs, for example - there were simpler inscriptions in Egyptian and Babylonian warehouses and granaries, with pictures that represented the inventory owner and numbers representing amounts in stock and taxes due. Writing probably arose from the desire to enhance administrative efficiency, and only then went on to bloom into the vast gardens of literature, poetry, and descriptive writing that we think of today when we hear the word "writing". These gardens had the chance to bloom only after inventory writing helped to turn the flow and regulation of civilization-critical goods and taxes into a science in each of the major early civilizations. The urge that created the early inventory records of Egypt, Greece and Babylon has kept going strong even up to our own time. The progression of inventory records shows a drive for greater and greater durability, accuracy, and level of convenience. The desire for reliable, accurate, and fast inventory accounting has led to the development of inventory accounting software, a mechanized version of the ancient record-keeping scribe who

³¹⁷ Dolinsky, A. (2018) *Inventory Management History, Part One*. Available from:

http://www.almyta.com/Inventory_Management_History_1.asp

once scratched IDs into bits of bone to assist with a task human memory was unable to handle. Barcode standardization was one of the most significant events in the entire history of logistics. With every major grocer's studies showing that barcoding would lead to great savings in just a matter of years, and with computer prices coming down to affordable levels, the door opened to a great surge forward - to an information technology that would tie not only businesses, but entire industries together. By the 1980s the first inventory control computer programs that could run on a PC were starting to see use. But that is another story. As we have said above, the revolution that was barcode standardization is still not played out, and we do not mean that specific technologies such as RFID are on the rise, but rather that the possibility of a single standardized electronic language that represents every inventory item in the entire commercial world and allows companies to communicate in a standard and efficient way still hangs in the air. The implications of the barcode revolution will be seen by the present generation to have been more momentous than ever expected (Dolinsky, 2014, www.almyta.com).³¹⁸ ““It is easy to believe that mechanized inventory control is inextricably tied to the computer revolution. Computers themselves evolved partly from the advanced mechanical calculator designed by Charles Babbage in the 1820s, however, and theoretical forbears of modern checkout systems existed at least as early as the 1930s. Forty years passed between these forbears and the advent of standardized barcode reading for inventory control. During these years electronic technology caught up with the projects and dreams of specialists in the field of inventory control and what is now called Point of Sale. In 1932 a Harvard University Business Administration team led by Wallace Flint came up with the first known automatic checkout/inventory control design”” (Dolinsky, 2014, www.almyta.com). The importance of inventory will be discussed in the following section.

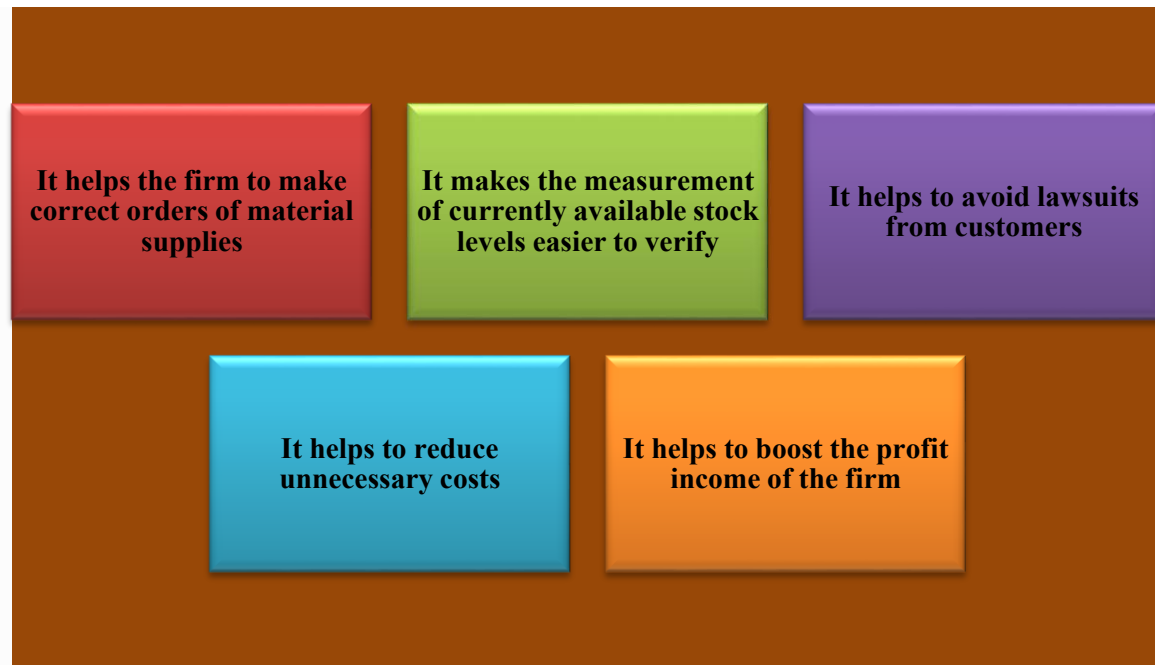
9.5 Importance of inventory to a business

In general there are many reasons why small businesses must keep inventory. It is essential that small businesses must effectively manage their inventory management systems carefully. The importance of inventory will be depicted in Figure 9.2 below.

³¹⁸ Dolinsky, A. (2018) *Inventory Management History, Part One*. Available from:

http://www.almyta.com/Inventory_Management_History_1.asp

Figure 9.2 The importance of inventory in a business



As depicted in Figure 9.2 above the reasons why inventory management is important are many and these are further explained as follows:

9.5.1 It helps the firm to make correct orders of material supplies – an extensive amount of time is put in assessing the quantity of goods that must be re-ordered and also planning is simultaneously carried-out thus making inventory management a useful tool for determining accurate order placements in the organization.

9.5.2 It makes the measurement of currently available stock levels easier to verify – it is very difficult to determine the exact quantities of goods that are available in the warehouse if the firm does not have a well devised stock list of items or an inventory management system it uses to monitor the quantity levels of stock. Thus inventory management is a useful tool that helps to simplify the flow of goods from suppliers to the firm’s warehouses until they reach the final consumers.

9.5.3 It helps to avoid lawsuits from customers – inventory management helps firms to avoid lawsuits from customers by keeping accurate records of delivery and expiry dates of products so

that harmful expired products are easily disposed-off and new stock orders are placed inside the retail outlet's shelves so that they may be offered to customers. In addition inventory management helps customers to receive their orders on time since inventory management consistently monitors stock levels. Any stock reduction results in new orders being placed by the firm.

9.5.4 It helps to reduce unnecessary costs – inventory management helps the firm to avoid ordering excessive inventory which may end up expiring or becoming outdated whilst it is in the hands of the firm. Furthermore, inventory management can also help the firm to avoid experiencing inventory shortfalls during its production schedules.

9.5.5 It helps to boost the profit income of the firm – certain inventory management strategies such as the ordering of the goods 'just in time' for production helps the firm to avoid costs such as pilferage (*theft in the warehouse facilities*) and storage costs therefore this automatically increases the profit income of the firm. The different types of inventory will be covered in the following section.

9.6 Types of inventory

³¹⁹According to O'Byrne (2017) however, inventory management is easier if we also consider the discrete stages inventory goes through in the supply chain, so we typically refer to business inventory in terms of "types". The main inventory types are:

- *Raw materials*: The ingredients or components from which your business manufactures or produces the products it sells.
- *Work in progress*: Any inventory in the process of being transformed from one or more raw materials into a finished product.
- *Finished goods*: This is what we call the inventory that's ready to be passed on to customers. You may also hear two other types of inventory being talked about from time to time"
- *Service inventory*: comprises spare parts and tools used after the sale or in service businesses.
- *In-transit inventory*: which is inventory being moved from one point to another by road, rail, sea, or air (*as opposed to riding a conveyor between adjoining warehouses for example—this*

³¹⁹ O'Byrne, R. (2017) *What is Inventory*. Available from: <https://www.logisticsbureau.com/what-is-inventory/>

would not be classed as in-transit inventory) (O’Byrne, 2017, www.logisticsbureau.com). There are numerous benefits and types of inventory management systems and these will be covered in the following section.

9.7 Benefits & types of inventory management systems

³²⁰According to Pontius (2017) an *inventory management system* is the combination of technology (*hardware and software*) and processes and procedures that oversee the monitoring and maintenance of stocked products, whether those products are company assets, raw materials and supplies, or finished products ready to be sent to vendors or end consumers. Overall, a comprehensive inventory management system offers [countless benefits](#) to companies including:

- Improved cash flow
- Better reporting and forecasting capabilities
- Reduction in storage costs (*overhead*)
- Reduced labor costs
- Reduction in dead stock
- Better organization
- Enhanced transparency
- Improved supplier, vendor, and partner relationships³²¹ (Pontius, 2017, www.camcode.com/).

9.7.1 Best practices for inventory management systems

There are several good practices that can be adopted by firms as inventory management systems. According to Pontius (2017) [Clearly Inventory](#) explains that a good inventory management system can help to enhance productivity, but only if you set it up with some basic essentials including:

- Location names
- Easy-to-read location labels

³²⁰ Pontius, N. (2017) *What is an Inventory Management System? Definition of Inventory Management Systems, Benefits, Best Practices & More*. Available from:

<https://www.camcode.com/asset-tags/what-is-an-inventory-management-system/>

³²¹ Campbell, C. (2018) *You’re Probably Losing Money By Not Using These 8 Inventory Management Techniques*.

Available from: <https://www.shopify.com/blog/inventory-management>

- Unique item identification numbers
- Units of measure
- A starting count
- A software solution that effectively monitors and tracks activity
- Clear, company-wide policies and processes
- People who know how to support these policies and processes^{322 323}(Pontius, 2017, www.camcode.com/).

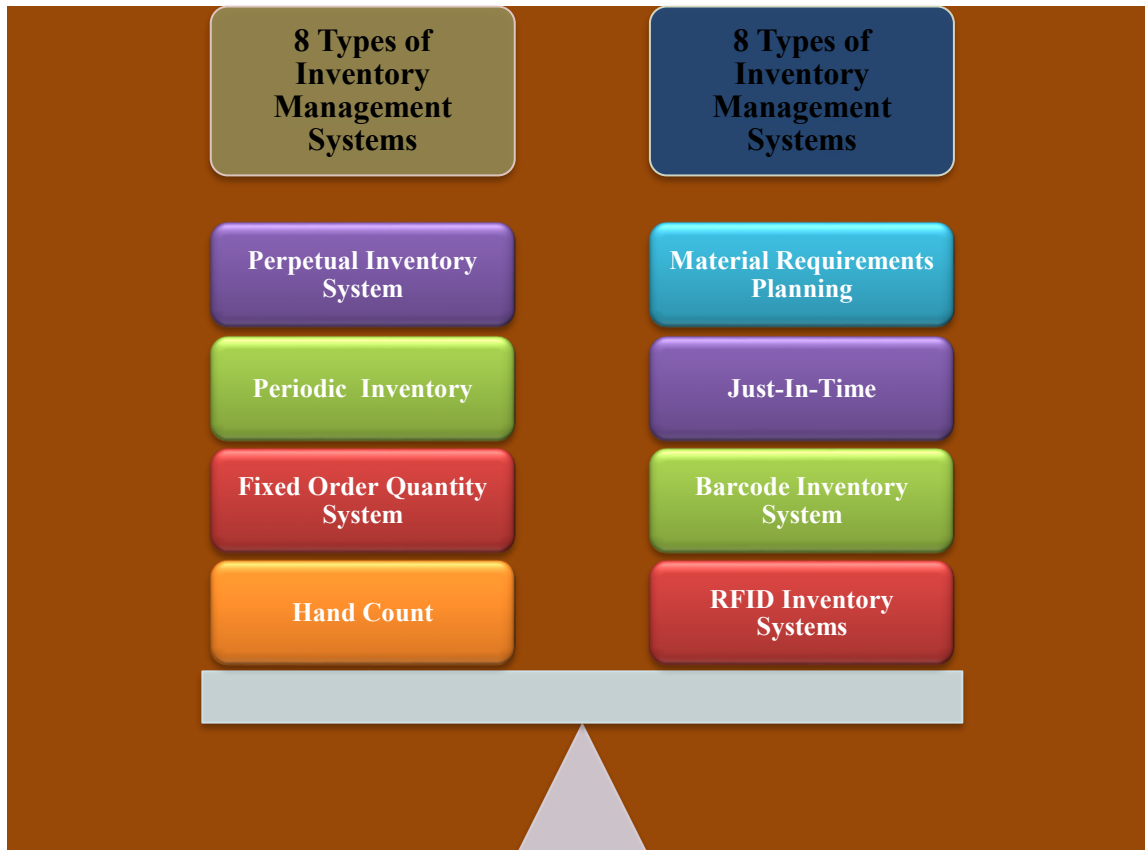
9.7.2 Eight types of inventory management systems

The eight types of inventory management systems that can be adopted by an organization are depicted in Figure 9.3 below.

³²² Pontius, N. (2018) *What is an Inventory Management System? Definition of Inventory Management Systems, Benefits, Best Practices & More*. Available from: <https://www.camcode.com/asset-tags/what-is-an-inventory-management-system/>

³²³ Clearly inventory (2017) *Inventory Basics*. Available from: <https://clearlyinventory.com/resources/inventory-basics/>

Figure 9.3 Types of inventory management systems



Source: Modified: (Miller, J. G. & Sprague, L. G., 1975; Chary, 2004:37.1; Chan, M., 2017; Davis *et al.*, 2003:638; Pontius, 2018, Corporate Finance Institute, 2020)

9.7.2.1 Perpetual Inventory System

“The *perpetual inventory system* involves tracking inventory after every, or almost every, major purchase. In perpetual inventory systems, the cost of goods sold (COGS) is updated in accounting records to ensure that the number of goods in a store or in storage is accurately reflected by the books. The perpetual inventory system is the opposite of the periodic inventory system, where a company maintains its inventory through physical counts on a definite scheduled and reoccurring basis. The *major difference between perpetual and periodic inventory systems* is that the former is done in real-time while the latter shows the COGS in-between physical inventories. *Increased Usage of a Perpetual Inventory System.* Perpetual inventory systems are not widely used by major companies because they are time-consuming and take time

away from employees who may otherwise be actively engaging in sales. In recent years, however, as technology begins to take over every part of business and [accounting practices](#), and inventory can be calculated through the use of computers and [scanners](#), perpetual inventory tracking is becoming less burdensome³²⁴ (Corporate Finance Institute, 2020, <https://corporatefinanceinstitute.com>).

9.7.2.2 Periodic Inventory System

According to Pontius (2018) [Periodic inventory systems](#) do not track inventory on a daily basis; rather, they allow organizations to know the beginning and ending inventory levels during a certain period of time. These types of inventory control systems track inventory using physical inventory counts. When physical inventory is complete, the balance in the purchases account shifts into the inventory account and is adjusted to match the cost of the ending inventory. Organizations may choose whether to calculate the cost of ending inventory using LIFO or FIFO inventory accounting methods or another method; keep in mind that the beginning inventory is the previous period's ending inventory³²⁵ (Pontius, 2018, www.camcode.com/).

9.7.2.3 Fixed order quantity system

The *fixed order quantity* is when the organization places an order for inventory at its suppliers because its inventory would have reached the minimal levels needed to re-order new inventory. It only occurs when inventory drops to the re-order point³²⁶ (Davis, Aquilano and Chase, 2003:607).

³²⁴ Corporate Finance Institute (2020) *What is the Perpetual Inventory System?* Available from: <https://corporatefinanceinstitute.com/resources/knowledge/accounting/perpetual-inventory-system/> [Accessed February 04, 2020]

³²⁵ Pontius, N. (2018) *4 Types of Inventory Control Systems: Perpetual vs. Periodic Inventory Control and the Inventory Management Systems That Support Them*. Available from: <https://www.camcode.com/asset-tags/inventory-control-systems-types/>

³²⁶ Davis, M., Aquilano, N. and Chase, R. (2003) *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-670.

9.7.2.4 Hand count

Inventory control can also be done through carrying-out physical hand counting and it is an effective method that can be used by the firm to keep an accurate record of the current stock levels in the warehouses. However, hand counting is subject to human error but it is a popular cheap method of conducting inventory control that is used by most of the small businesses. Hand count inventory control system can be used to support other inventory management systems such as the perpetual system.

9.7.2.5 Material requirements planning (MRP)

“So the prospect of you running into an MRP system is growing: many of your suppliers may now be explaining to your purchasing department changes in their delivery promising procedures because they are on MRP; your customers may be insisting on new ways of setting delivery schedules because they are on MRP”³²⁷ (Miller, J. G. and Sprague, L. G., 1975. Behind the Growth in Material Requirements Planning. *Harvard Business Review*, September Issue). Today the popularity of MRP has enormously grown to both small and large businesses. Interestingly, the concept of MRP is ancient and has been in existence for many years from the time the Romans built their mega unique architectural building structures. Therefore, it is a well known logical fact that whenever a major project of any kind is being carried-out especially construction projects (*of buildings or even shipbuilding*) a lot of planning takes place (Davis, Aquilano and Chase, 2003:641). ³²⁸According to Miller and Sprague (1975) Behind the Growth in Material Requirements Planning. *Harvard Business Review*, September Issue, ““MRP is a new name applied to an old concept, but it is a concept that has come of age with currently available data processing capabilities. This synthesis of modern computers and some old (and some new) concepts has resulted in a system that can be used effectively to both plan and control production and materials flows. The logic of MRP is based on the fact that the demand for materials, parts, and components depends on the demand for an end product. This distinction is vital since it

³²⁷ Miller, J. G. and Sprague, L. G., 1975. Behind the Growth in Material Requirements Planning. *Harvard Business Review*, September Issue.

³²⁸ Joseph Orlicky, *Materials Requirements Planning. The New Way of Life in Production and Inventory Management* (New York: McGraw-Hill, 1975), for an exposition of dependent versus independent demand.

explains both the behavior of parts orders and, ultimately, inventories. The four central elements in an MRP system: the master production schedule that “drives” the system, the bill of materials file, the inventory status file that provides the necessary data, and the materials requirements planning package that contains the necessary logic” (Miller, J. G. and Sprague, L. G., 1975. Behind the Growth in Material Requirements Planning. *Harvard Business Review, September Issue*). There are several advantages of using MRP that can be enjoyed by a firm today. In general MRP has the advantage of ensuring that the organization orders the accurate materials, in the correct numbers, the re-order dates are prioritized and preparations are done to ensure that there is adequate capacity to produce products to satisfy customer demand. MRP also helps to allow capacity planning as the owner-manager of the business can view the production in advance whilst orders of supplies have not yet been placed giving them the chance to adjust or cancel orders³²⁹ (Davis *et al.*, 2003:641). “The rapid update capability of computers, coupled with the MRP logic and the appropriate data, makes it possible for managers to cope intelligently with the thousands of changes that inevitably occur between the planning and execution of primary tasks”³³⁰ (Miller, J. G. and Sprague, L. G., 1975. Behind the Growth in Material Requirements Planning. *Harvard Business Review, September Issue*). Over the past number of years material requirements planning has evolved and diversified to become an enterprise resource planning system (*ERP*). Nowadays a material requirements planning system involves the entire organization. An enterprise resource planning system integrates all the organization’s functions (*marketing, human resources, finance, research and development, operations or production MRP, the information and technology*) (Davis *et al.*, 2003:638).

³²⁹ Davis, M., Aquilano, N. and Chase, R. (2003 *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-670.

³³⁰ Miller, J. G. and Sprague, L. G., 1975. Behind the Growth in Material Requirements Planning. *Harvard Business Review, September Issue*.

9.7.2.6 Just-in-time (JIT)

³³¹The Just-In-Time production system was developed in Japan at a leading automobile plant and today the Just-In-Time production system has been adapted by several manufacturing industries around the world. A typical good scenario is whereby a manufacturing facility produces the right quantity of goods (*either semi-finished or finished goods*) that are needed at a particular right time. Therefore, this type of scenario if it is implemented properly there will be zero inventories of both the finished goods and work-in-process at the manufacturing facility. Furthermore, if the manufacturing business proceeds to negotiate with its suppliers of raw materials that they must only transport their raw materials or goods to the manufacturing facility's premises in the right quantities at the right time (*when they are needed*) this must result in the manufacturing facility having zero inventory levels of raw materials and this is commonly referred to as the 'Just-In-Time (JIT) production system'. Historically in the United States of America most of the supermarkets were already implementing the system of Just-In-Time by simply ensuring that items on their shelves that have been purchased by customers are the ones that are only replaced and nothing else. The JIT theory is believed to have been borrowed from the retail sector of the United States of America (Chary, 2004:37.1). ³³²According to Chan, M. (2017) in inventory management, the Just-In-Time or JIT system reduces wastage, improves efficiency and productivity, and contributes to smoother production flows. A shorter production cycle can decrease financial costs, inventory costs and labour costs. Below, we summarise the key features of the JIT approach:

Smooth production flow

One of the key features of the JIT system is a uniform production process. From the arrival of materials from suppliers to the delivery of goods to customers, the JIT system aims to prevent fluctuating production rates, which can result in delays and excess work-in-process inventories.

³³¹ Chary, S. N. (2009) *Production and Operations Management*. 4th Edition, New Delhi: Tata McGraw-Hill Education Private Limited, 29.4 – 37.1.

³³² Chan, M. (2017) *The Benefits of the Just-In-Time Approach*. Available from:

<https://www.unleashedsoftware.com/blog/benefits-jit-system-approach>

Pull-method

The pull-method contributes to this smooth production process, and it is a key feature of the JIT system. Under the pull-method, goods are produced in each stage only as they are needed at the next stage. This system eliminates work-in-process inventory between production steps, thereby reducing waiting times and associated non-value-added costs. The pull-method also prevents wastage due to the production of defective products, since the output at every stage of production is inspected before passing on to the next stage.

Reduction in storage and waiting time

Under the JIT system, materials are purchased and goods produced only as required, rather than to build up stocks for future use. This alleviates the need to make space for holding products and materials, and results in less time wasted waiting for large amounts of materials and products. Relatedly, the JIT system encourages faster setups of production machinery. Producing small lots of product only as required demands a faster set up of machinery, resulting in more efficiency and reduced costs. The result is higher quality raw materials and finished products.

Maintenance of equipment

The JIT system requires strict adherence to routine maintenance schedules. Effective, preventive maintenance of equipment will allow the company to avoid costly down time from machine breakdowns³³³ (Chan, M, 2017, <https://www.unleashedsoftware.com/blog/benefits-jit-system-approach>). The following section will cover aspects about barcode inventory systems.

9.7.2.7 Barcode Inventory Systems

According to Pontius (2018) inventory management systems using barcode technology are more accurate and efficient than those using manual processes. When used as part of an overall inventory control system, barcode systems update inventory levels automatically when workers

³³³ Chan, M. (2017) *The Benefits of the Just-In-Time Approach*. Available from: <https://www.unleashedsoftware.com/blog/benefits-jit-system-approach>

scan them with a barcode scanner or mobile device. The benefits of using barcoding in your inventory management processes are many^{334 335}(Pontius, 2018, www.camcode.com/).

9.7.2.8 Radio Frequency Identification (RFID) Inventory Systems

According to Pontius (2018) radio frequency identification (*RFID*) inventory systems use active and passive technology to manage inventory movements. Active RFID technology uses fixed tag readers throughout the warehouse; RFID tags pass the reader, and the movement is recorded in the inventory management software. For this reason, active systems work best for organizations that require real-time inventory tracking or where inventory security has been an issue. Passive RFID technology, on the other hand, requires the use of handheld readers to monitor inventory movement. When a tag is read, the data is recorded by the inventory management software. RFID technology has a reading range of approximately 40 feet with passive technology and 300 feet with active technology (Pontius, 2018, www.camcode.com/). Today there are many pros that are being enjoyed by businesses that adopt RFID inventory management system. “Radio frequency identification offers small businesses increased supply chain and inventory visibility for greater operational efficiency, with reduced inventory and out-of-stocks. Key business drivers for implementing RFIDs include:

- Revenue growth through increased order fill rate, greater product availability and decreased retailer out-of-stocks.
- Lower costs through operational and labor efficiencies, with a decrease in shrink and nonworking inventory.
- Reduced invested capital through inventory reduction and better on-hand data decreases the need for safety stock and increased turns.

³³⁴ Pontius, N. (2018) *What are RFID Tags? Learn How RFID Tags Work, What They're Used for, and Some of the Disadvantages of RFID Technology*. Available from: <https://www.camcode.com/asset-tags/what-are-rfid-tags/>

³³⁵ Murphy, F. (2010) *Inventory Management: The Benefits of Bar-Coding Technology*. Available from: <https://www.facilitiesnet.com/materialhandling/article.aspx?id=11513> [Accessed February 04, 2020]

- Better utilization of fixed assets, resulting in lowered capital asset requirements.
- Gaining favor with retailers to better position products on shelves”³³⁶ (Gilbert, 2005). The advantages and disadvantages of understocking are covered in the following section.

9.8 Advantages & disadvantages of overstocking

There are several advantages and disadvantages of overstocking that are experienced in the management of inventory by an organization. It is critical for entrepreneurs to be fully knowledgeable of both the advantages and disadvantages so that they make proper factual based decisions when managing inventory.

³³⁶ Gilbert, G. (2005) RFID and Small Business. *RFID Journal*. Available from:

www.rfidjournal.com/articles/view?2002

Figure 9.4 Common advantages & disadvantages of overstocking



9.11 Conclusion

In conclusion inventory encompasses the materials or supplies an organization buys from its suppliers for the purpose of reselling or to use during the transformative process to produce finished products that will be sold to its targeted consumers. Today most businesses keep inventory to avoid running out of stock during the production process. It is costly for businesses to keep excessive inventory and some of the costs of keeping high levels of inventory include warehousing costs and pilferage. There are different types of inventory a business buys every year such as raw materials, semi-finished or finished goods, material components and supplies.

Businesses are able to ensure that they avoid running out of stock and order the right quantities of materials if they use the economic order quantity formula, just-in-time and perpetual inventory management systems. It is important for businesses to avoid unnecessary waste of materials through implementing just-in-time.

9.12 Discussion questions

1. Define the term inventory and explain the key difference between inventory, inventory management & inventory management systems?
2. Discuss the history of inventory?
3. Describe the eight types of inventory control/management systems and provide relevant examples?
4. Outline four types of inventory? Describe the advantages & disadvantages of overstocking?
5. Explain the difference that exists with material requirement planning, enterprise resources planning and just-in-time using current examples?

Chapter 10: Facility location & layout

After studying this chapter you should be able to:

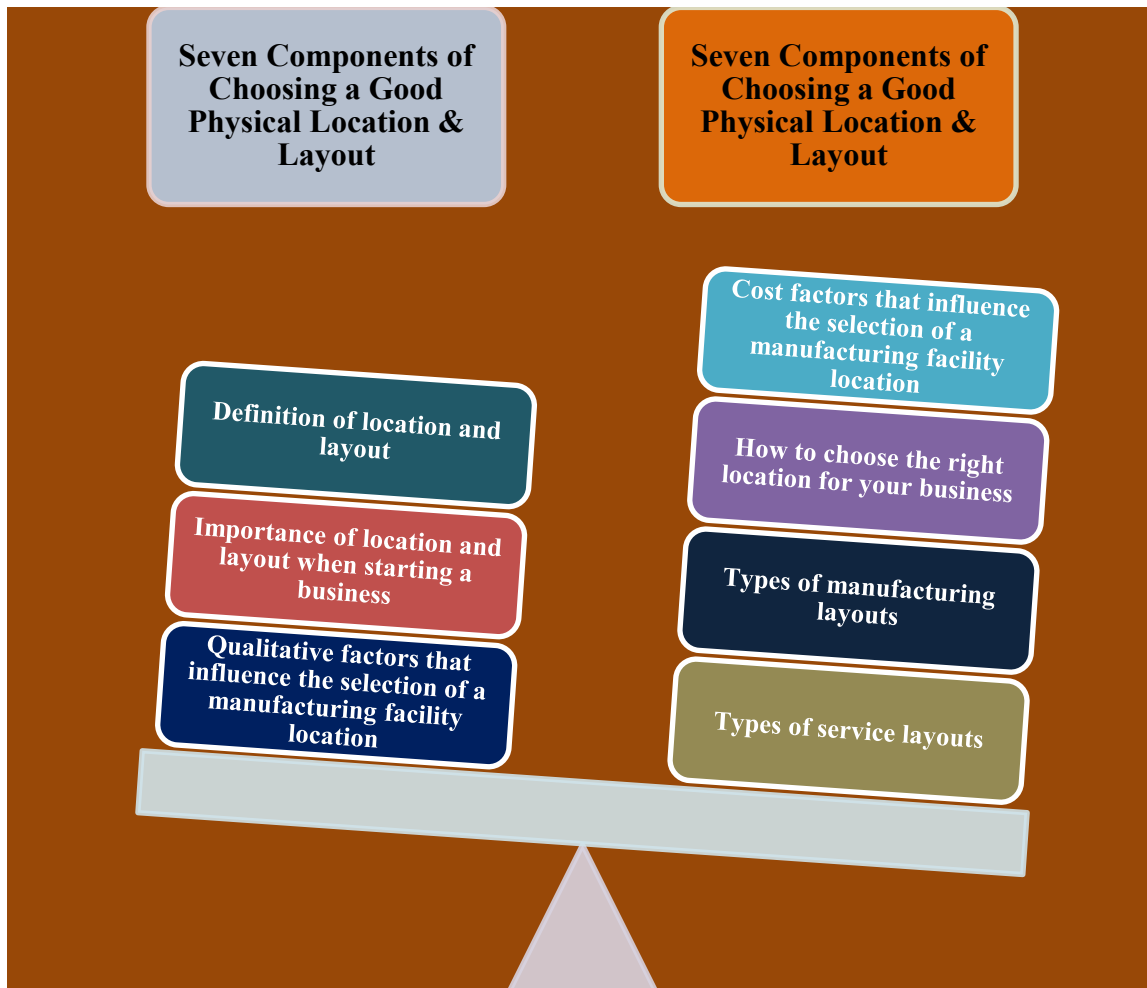
- Define the term location and layout.
- Explain the importance of location and layout when starting a business. Discuss how location and layout are important to a business.
- Describe the qualitative factors that influence the selection of a manufacturing facility.
- Outline the cost factors that influence the selection of a manufacturing business.
- Discuss the different types of manufacturing layouts
- Explain the types of service layouts

10.1 Introduction

In general the location and layout of a business (*whether it is a manufacturing, retail or service*) determines its level of success, profitability, costs and corporate image. However, it is important to note that to a certain extent the location of your business does not matter when the entrepreneur is starting a specific type of business. A typical good example of a business where its location does not matter is an online service company due to the fact that the physical location of this type of business does not have a significant impact on its level of success. Online businesses rarely conduct face-to-face interactions with their customers therefore they can be located anywhere where there is a good Internet network connection for example Silicon Valley, California in the United States of America has one of the world's greatest Internet network. In-depth analysis and market research must first be carried-out by the entrepreneur before he/she decides to locate their business at a particular site location. The process of choosing a business location and layout is basically covered in the business plan thus the entrepreneur's strategic thinking skills play a significant role when implementing the steps of choosing a prime business location. Some of the entrepreneurs often falsely assume that they can simply open their business anywhere and start making money as soon as they open their doors for business and unfortunately this assumption is very wrong. In general it requires sufficient time for an entrepreneur to be able to properly decide or choose a site location for their business. Notably, in certain instances the proposed new business may be located in a foreign country where various aspects need to be first taken into consideration before making a decision relating to its physical

location at a particular site so that it starts operating. The components involved in the selection of a good physical location and layout of a business by entrepreneurs are many and some of the components that will be covered in this chapter are depicted in Figure 10.1 below.

Figure 10.1 Seven components of choosing a good physical location and layout



The definition of location and layout will be discussed in the following section.

10.2 Definition of location and layout

The physical site where a firm is situated and conducts its everyday business operational activities is called its *physical location* and it can be called a *prime location* if it is close to qualitative factors such as high customer traffic, market and good infrastructure. The amount of sales revenue that is generated by a business is significantly influenced by the place it chooses to

do business. For instance most of the global high-tech giants are physically located in Silicon Valley in San Francisco Peninsula in the State of California in the United States of America due to the fact that it has one of the largest Internet fibre-optic cable connection in the world, state-of-the-art infrastructure (*roads, airports and railway networks*), it has access to highly skilled labour and a reliable affordable power supply. *Layout* in the manufacturing sector refers to the way the criterion of the business facility is arranged to minimize confusion or delays and also to ensure the simple flow of people, materials or equipment. For instance, a manufacturing business layout strategy will focus on how similar equipment is grouped close together in order to accelerate the speed in an assembly line³³⁷ (Chary, 2004:29.4; Davis, Aquilano and Chase, 2003:324). While on the other hand *layout* in a service sector business refers to the way the criterion of the business premises is arranged to minimize confusion or delays in terms of its equipment, machinery, furniture design, office spaces (*open plan or separate offices*), shelf spaces and display walking area. The type of business greatly influences the physical layout of a business. For example in a retail business shelf space or display is important³³⁸ (Chary, 2004:29.4; Davis, Aquilano and Chase, 2003:324). One of the key indicators of an effective layout in both manufacturing and service businesses is the availability of a good spatial system (Chary, 2004:29.4). The importance of location and layout when establishing a new business is highlighted in the following section.

10.3 Importance of location and layout when starting a business

Location is a key element in the profitability of a business and generally layout helps the business to process its work activities in a cost-effective and much faster way. The reasons why the location and layout of a business is very important is depicted by Table 10.1 below.

³³⁷ Chary, S. N. (2009) *Production and Operations Management*. 4th Edition, New Delhi: Tata McGraw-Hill Education Private Limited, 29.4

³³⁸ Davis, M., Aquilano, N. and Chase, R. (2003) *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-670.

Table 10.1 Reasons why location & layout are important in choosing a business

Location	Layout
<p><i>It determines the number of customer traffic</i> - businesses that are strategically located at a site where a lot of people pass through everyday tend to attract high customer traffic therefore location is a critical component towards business success.</p>	<p><i>It helps to ease the flow of goods during the production process</i> – the way the machines and workspaces are arranged in a manufacturing layout facility helps to quicken the movement of materials from Point A to Point B until a finished product is finally produced thus layout is important to enhancing a business’s efficiency.</p>
<p><i>It helps to boost the image of the business</i> – the reputation of a business is highly influenced by its physical location for instance businesses that are located in high crime areas are negatively affected by the bad environment therefore they also suffer from bad publicity.</p>	<p><i>It helps to reduce the lead time of customer orders</i> – the fact that layout helps to ease the flow of materials from one workstation to another ultimately reduces the time it takes for a customer to wait for their order to be processed/produced in the firm’s manufacturing facility until it is delivered to a customer.</p>
<p><i>It helps to promote brand recognition</i> – a business that chooses a prime strategic location such as modern shopping mall (<i>for instance a clothing store or supermarket</i>) increases its brand awareness and it is more likely to enjoy positive word-of-mouth which is a form of free advertising from customers and this significantly boosts the business’s brand power/recognition.</p>	<p><i>It helps to improve the quality of products produced by the firm</i> – when a facility is divided into different work sections it allows specialization. Therefore, each employee during the production process of a product he or she will focus on their area of specialty thus this enormously improves the quality levels of a product.</p>

<p><i>It helps the business to be located at a site that offers customers convenience – a good physical location is a place that offers customers convenience in the form of good parking spaces, walking pavements, access to clean toilets/water, high security and so on.</i></p>	<p><i>It helps to attract high customer traffic if it is a service business for instance a retail outlet – in a service business the décor, shelves and merchandise must be arranged in such a way that allows easy movement of people inside the retail outlet while also allowing customers to have easy access to the goods being sold. Therefore, layout in a service business is a critical component of business success.</i></p>
<p><i>It helps a business to choose a site that is closer to good infrastructure – location is one factor that enables a business to choose a site that offers proximity to infrastructure such as good road networks (for easy delivery of goods and easy customer access) (Davis et al., 2003:290)</i></p>	<p><i>It facilitates the specialization of skills – layout assists to separate work stations based on specialty therefore it promotes high productivity levels and the specialization of skills.</i></p>

There are several non-financial factors that influence the selection of a manufacturing facility location when starting a new business and these will be covered in the following section.

10.4 Non-financial factors that influence the selection of a manufacturing facility and services businesses location

³³⁹“When building a manufacturing facility, getting the plant operational and producing products can seem like the end game. But the key to a project’s long-term success is that it fulfills its function for many years to come” (Gallagher, 2017, www.globaltrademag.com/). Generally most of the manufacturing facilities need to be physically located close to a steady labour supply and raw materials due to the following: (1) size of the manufacturing facility, (2) type of operations, (3) huge appetite for labor and input materials. For example, a coal mining company is more likely to prosper beyond expectations if it is physically located in a small town rich with coal deposits, well developed railway lines, road infrastructure, schools and universities/colleges. Entrepreneurs when selecting and analyzing the site to locate their manufacturing facilities they should evaluate both non-financial and financial factors. These will be discussed in-depth as follows:

³³⁹ Gallagher, B. (2017) *Choosing a Site for a Manufacturing*. Available from: <https://www.globaltrademag.com/choosing-site-manufacturing-facility-3/>

10.4.1 Non-financial factors

There are several non-financial factors that influence the selection of a physical location by entrepreneurs and some of these factors will be depicted in Figure 10.2 below.

Figure 10.2 Four non-financial factors to consider when choosing a physical location of a business



Source: Modified (Davis *et al.*, 2003:291; Kaelble, 2011; Gallagher, 2017, www.globaltrademag.com/)

10.4.1.1 Availability of adequate labour supply

As previously mentioned in Chapter 6 that people are the most important asset in a business and this generally applies to all forms of businesses (*whether they are either profit-making/nonprofit organizations and or large/small in size*). Generally the key ingredient behind the effective and efficient operation of a business facility or plant is adequate labor supply of the right caliber. The availability of an adequate labor supply is critical since the manufacturing facility will easily

source its much needed skilled and nonskilled human resources from the closest labour market in order for it to achieve its operational goals. In general manufacturing facilities require high amounts of labour therefore a physical location that offers much more affordable labor is the best place to operate such a business.³⁴⁰“Labor availability for a given site may not remain consistent as time goes by. A site selection team should look at details such as demographic shifts – for example, is the population of an area aging? If demographic research shows that there is an adequate population to sustain a future workforce, the next step is to look at the local educational and training landscape. Opportunities for local businesses to partner with colleges, vocational schools and other institutions are critical not only for training the current cohort of workers, but will remain vital throughout the facility’s existence” (Gallagher, 2017, www.globaltrademag.com/).

10.4.1.2 Availability of good infrastructure

In general the location of certain types of businesses is critical and one important aspect that influences business location is the availability of good infrastructure. Manufacturing businesses rely on the availability of good infrastructure networks in a chosen area. This is due to the fact that they need to be located in an area with good railway, road, sea and air transport networks for their raw material suppliers to have easy access to bulk deliveries of goods to their warehouses/premises. Manufacturing businesses that produce high volume and low value products need to be located close to railway, sea and road networks in order to incur low transport costs³⁴¹ (Davis *et al.*, 2003:290). Nowadays modern infrastructure is now needed for high-tech firms in the information, technology and communication (*ICT*) sector which is comprised of electricity, data connectivity, satellite communication systems infrastructure and so on³⁴² (Kaelble, 2011). A good example of how infrastructure influences location decisions of an

³⁴⁰ Gallagher, B. (2017) *Choosing a Site for a Manufacturing*. Available from:

<https://www.globaltrademag.com/choosing-site-manufacturing-facility-3/>

³⁴¹ Davis, M., Aquilano, N. and Chase, R. (2003) *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-670.

³⁴² Kaelble, S. (2011) *Infrastructure and Logistics Advantages Drive Facility Location Decisions*. Available from:

www.areadevelopment.com/logisticsInfrastructure/July2011/evolving-infrastructure-factors-facility-location-535356.shtml?Page=1

organization's facility is when several of the largest Silicon Valley, California high-tech firms based in the United States of America decide to open new facilities in Maiden, North Carolina (Kaelble, 2011). North Carolina has a well developed power supply infrastructure that enables the state to enjoy affordable electricity charges thus this advantage can enable a high energy consuming data center or facility to operate cost-efficiently thereby enabling the state of North Carolina to attract several of these high-tech giants (Kaelble, 2011).

10.4.1.3 Availability of raw materials

Proximity to raw materials is one of the factors that significantly influences the physical location of a manufacturing business. The need to enjoy reduced transport costs makes this factor an important one. In addition when the manufacturing facility is located closer to raw materials this often reduces the amount of time it takes for materials to be delivered to the business's premises. For example, a sugar manufacturing plant is generally located close to a sugar plantation so that the bulk deliveries of sugarcane can easily be done (Davis *et al.*, 2003:290).

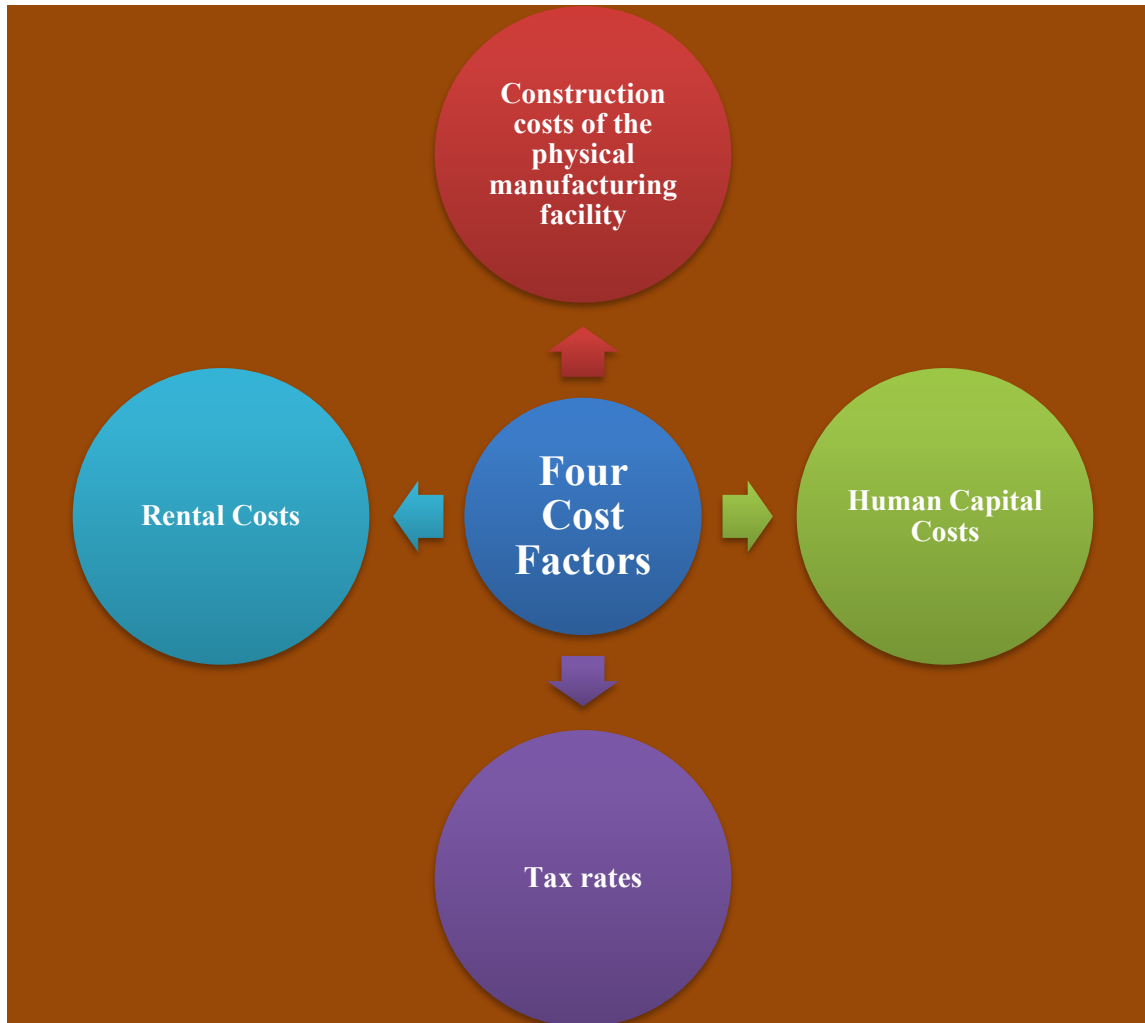
10.4.1.4 Closeness to markets

The global economy has been very dynamic over the past several years and today consistent increases in the price of fuel continue to have a negative impact on the operational costs of many businesses today. A business must make an effort to locate its manufacturing facility closer to the market in order to significantly reduce its transport costs mainly product distribution costs. Today there are many cost factors that significantly influence the selection of a manufacturing facility location (Davis *et al.*, 2003:290).

10.5 Cost factors that influence the selection of a manufacturing and a service business facility location

There are several cost factors that influence the decision to choose a location site for a business to start carrying out its operational activities. Some of the cost factors that influence the selection of a manufacturing facility are depicted in Figure 10.3 below.

Figure 10.3 Four cost factors that influence the selection of a manufacturing facility location



Source: Modified: (Davis *et al.*, 2003:293).

10.5.1 Construction costs of the physical manufacturing facility

Nowadays construction costs are high in many countries as a result of the consistent rise in land prices including building materials and labour costs. Generally land is extremely expensive in developed countries whilst on the other hand it is much cheaper in less developed countries. Therefore, this comparison leads to many businesses opting to open subsidiary manufacturing facilities in less developed countries where land is much cheaper. ³⁴³The decision to choose a

³⁴³ Davis, M., Aquilano, N. and Chase, R. (2003 *Fundamentals of Operations Management*. 4th Edition, New York: McGraw-Hill Incorporation, p18-670.

good physical location of a new manufacturing facility is enormously influenced by the construction costs of the facility (Davis *et al.*, 2003:293). However, globally many of the small businesses often face the challenge of limited financial capital and entrepreneurs who intend to start their new businesses in areas where land and construction labour are highly expensive it is more economically viable for them to rent the facility or outlet in order to save money.

10.5.2 Human capital costs

The most highly successful businesses employ the best employees in the labour market and they adopt good talent retention strategies in order to keep them working for the organization for a much longer time period. In certain parts of the world the cost of labour is cheaper whilst in other parts labour costs consume a significant proportion of the firms' operational budget (Davis *et al.*, 2003:293). Manufacturing businesses are labour intensive by nature thus entrepreneurs tend to choose countries or areas with reasonable labour costs to locate their manufacturing facilities.

10.5.3 Tax rates

Every business strives to operate profitably and a guaranteed way of doing so is through selecting a place where the business will operate whilst enjoying reduced corporate tax rates. Today numerous countries around the world offer extremely high corporate tax rates whilst other countries apply investor friendly tax systems in order to attract foreign investors. Therefore, tax rates greatly influence the selection of a manufacturing facility's location site (Davis *et al.*, 2003:293).

10.5.4 Rental costs

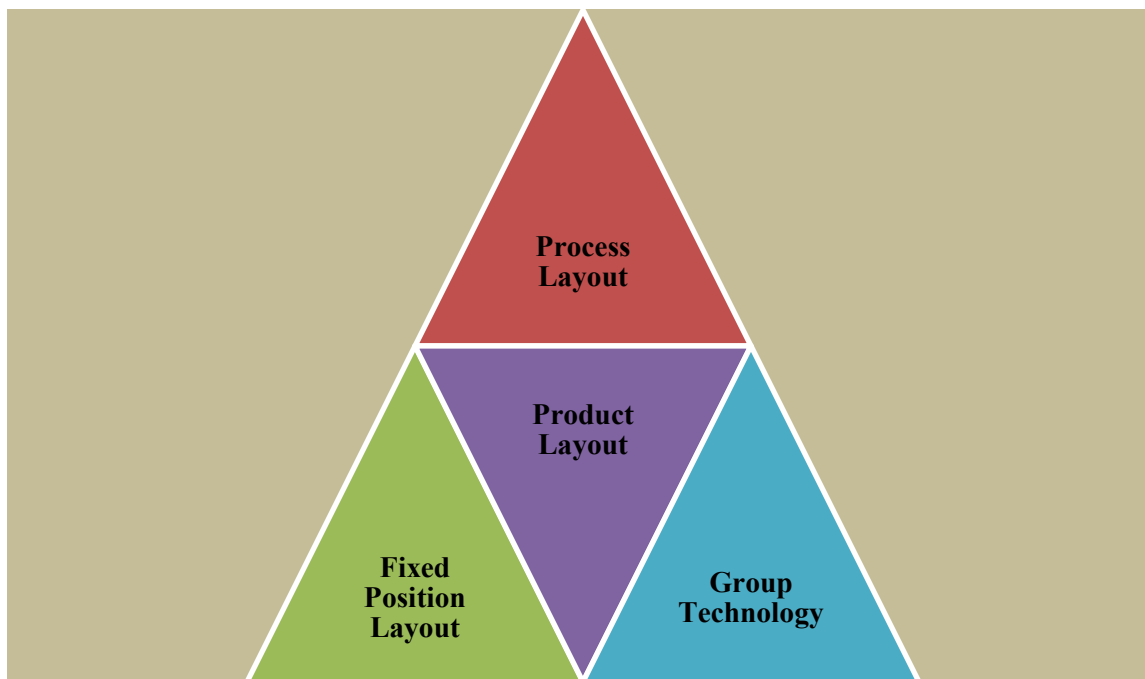
Nowadays a common phenomenon that is often associated with small businesses is that they often lack adequate startup capital to buy business premises (*land, buildings or a plant*) of their own to use to carryout their operational activities. Therefore, the only cheaper alternative they are left with is to find rental business premises they can afford. In general various factors significantly influence rental costs namely: (1) the physical appearance and condition of the building available for rental, (2) while on the other hand if the business premises that are

available for rental are physically located in high customer traffic areas it becomes more likely that their rental costs will be high and vice versa. There are many types of manufacturing layouts and these are covered in the following section.

10.7 Types of manufacturing layouts

A manufacturing layout is one of the most critical part of preparing to start a new business and it is important for new businesses to choose the right manufacturing layout before they open their doors for business in order to operate cost-efficiently. The four types of manufacturing layouts are depicted in Figure 10.4 below.

Figure 10.4 Four types of manufacturing layouts



Source: Modified: (Saxena, 2009:55).

10.7.1 Process layout

The *process layout* is also commonly known as the functional layout and it is commonly utilized in manufacturing facilities that do not have standardized movements of work from one work station to the next for each unit of product or goods manufactured. Generally facilities that manufacture an assortment of products that share certain commonalities are often characterized by a random output. In some instances a few of the processes can actually be used for all the

products while on the other hand certain processes are specifically used for a few selected products (Saxena, 2009:55). A typical example of a process layout is that of a shoe manufacturing plant that produces different types of shoes such as casual shoes, high cut winter boots, athletic trainers or sneakers and so on. Thus different shoes such as athletic trainers or sneakers and casual shoes are made using totally different raw materials and this automatically makes the use of a different layout a necessity since the process cannot be standardized. Furthermore, a typical good example of a process layout in the service industry is a university³⁴⁴ (Saxena, 2009:55).

10.7.2 Product layout

A *product layout* is utilized to manufacture mass quantities of a single form and standard product. This is easily achieved since all the individual units of products are moved from one point of production to another through following a standard sequence of operations or flow of jobs as work stations including machinery is completely organized following a line layout in order to easily facilitate the quick continuous flow of work. A typical good example of a manufacturing facility that uses the product layout is an automobile assembly plant and for a service facility a typical example will be that of a canteen (Saxena, 2009:57).

10.7.3 Fixed-position layout

The fixed-position layout is often considered to be the most suitable type of manufacturing layout to use for products that are categorized as bulky or fragile in terms of both weight and size. In addition the fixed-position layout is considered to be highly suitable to use for products that cannot be easily moved from one point to another during the production process. Therefore, since it is unfeasible to move the bulky or fragile product from one point to another in the production line the only option that is left is for: (1) labour or skilled personnel, (2) machinery and (3) tools to be moved to its physical location or work site in the plant in order for work to

³⁴⁴ Saxena, J.P. (2009) *Production & Operations Management*. 2nd Edition, New Delhi: Tata McGraw-Hill Education Private Limited, p55-60.

commence. A typical good example of a manufacturing facility that uses fixed-position layouts include: aircraft manufacturing facilities, shipyards and so on³⁴⁵ (Saxena, 2009:57).

10.7.4 Group technology

According to the Harvard Business Review article by Hyer and Wemmerlöv (1984) *group technology* is an approach to manufacturing that seeks to maximize production efficiencies by grouping similar and recurring problems or tasks. Through a careful examination of the many applications of GT, the authors show how it saves time, avoids duplication, and facilitates easy and timely information retrieval and use. The essence of GT is to capitalize on similarities in recurring tasks in three ways:

- By performing similar activities together, thereby avoiding wasteful time in changing from one unrelated activity to the next.
- By standardizing closely related activities, thereby focusing only on distinct differences and avoiding unnecessary duplication of effort.
- By efficiently storing and retrieving information related to recurring problems, thereby reducing the search time for the information and eliminating the need to solve the problem again³⁴⁶ (Hyer, N. and Wemmerlöv, U., 1984. Group Technology. *Harvard Business Review July Issue*). The types of service layouts that can be used by entrepreneurs starting their new service businesses will be covered in the following section.

10.8 Types of service layouts

Interestingly, service businesses also use different types of layouts. The three types of layouts used in service businesses include: the process layout, product layout and the fixed position layout similar to the manufacturing layout previously mentioned. In general manufacturing and service layouts only differ in terms of the type of business (*a service business and a manufacturing business*).

³⁴⁵ Saxena, J.P. (2009) *Production & Operations Management*. 2nd Edition, New Delhi: Tata McGraw-Hill Education Private Limited, p55-60.

³⁴⁶ Hyer, N. and Wemmerlöv, U., 1984. Group Technology. *Harvard Business Review July Issue*).

10.9 Conclusion

Location is therefore the place or area where the business will conduct its day-to-day operations or open its doors for business for its customers. While on the other hand layout is concerned with how the merchandise, equipment and décor inside the business building is arranged. The location site of a business is critical therefore entrepreneurs of manufacturing businesses should use both non-financial and financial factors to choose the right location site. Service businesses deal with customers directly therefore entrepreneurs should ensure that they choose location sites that offer easy access to public services and high customer traffic. Building layouts are now important nowadays therefore entrepreneurs should ensure that their manufacturing layouts allow the easy flow of goods in or out of the facility and retailers should ensure that their layouts allow customers to easily locate products. It can therefore be concluded that the different types of layouts entrepreneurs can use for their manufacturing activities include the fixed position, process and product.

10.10 Discussion questions

1. Define the terms location and layout? Discuss the importance of location & layout when starting a business?
2. Describe the non-financial factors that influence the selection of a manufacturing facility?
3. Discuss the cost factors that influence the selection of a manufacturing facility location?
4. Describe how businesses choose the right location to carryout their operational activities?
5. Outline the *four* types of manufacturing layouts and the *three* service business layouts? Please provide relevant examples?

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Chapter 1

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