MNE 3701 Entrepreneurship and Small Business Management

Video Conference

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Open Rubric

Agenda

- Introduction and general discussions
- Study units 1,2,4,5,6,8
- Break (10 min)
- Study units 9,10,12,13,14

General discussions

- Assignments answered
- Exams:the study units are 1, 2, 4, 5, 6, 8, 9, 10, 12, 13, and 14. The corresponding chapters in the prescribed text book are as follow: 14th edition of the text book chapters 6, 7, 9, 10, 11, 14, 15, 16, 19, 20 and 21

General discussions continue

- In the 15th and 16th editions chapters 6, 7, 9, 10, 11, 12, 15, 16, 17, 20, 21 and 23. The examination paper could also include some of the questions in the assignments.

Creating business plans

Chapter 6 Page 150 (14) and page 148(15)
Page 164 (16)
Topic 1
Study Unit 1

What Is a Business Plan?

Business Plan

A document that sets out the basic idea underlying a business and related startup considerations

- Crystallises the dreams and hopes that motivate and entrepreneur to take the start up plunge
- Identifies factors affecting the venture's success
- Serves as the entrepreneur's tool for raising capital

The business plan is used primarily in two ways:

- To provide a statement of goals and strategies for use by individuals within the firm
- To aid in the development of relationships with outsiders who could help the company achieve its goals (stakeholders)

Objectives of a business plan

Basic objectives of the business plan:

- Outline the nature and context of the opportunity
- Present the approach planned to exploit the opportunity
- Identify the factors most likely to determine venture success/failure

Types of Business Plans

- Summary Plan
  - A short form of a business plan that presents only the most important issues and projections for the business
- Comprehensive Plan
  - A full business plan that provides an in-depth analysis of the critical factors that will determine a firm's success or failure, along with all the underlying assumptions

Types of Business Plans (cont’)

1. The summary plan—short form of a business plan
   - Helps gauge investor interest
   - May be best in uncertain markets
2. The comprehensive plan—provides in-depth analysis of critical factors that will determine the firm’s success or failure

A comprehensive plan is beneficial when:

- Describing a new opportunity
- Facing significant change in the business or environment
- Explaining complex business situations

Features of a Successful Business Plan(important)

- It must be arranged appropriately, with an executive summary, a table of contents, and chapters in the right order.
- It must be the right length and have the right appearance—not too long and not too short, not too fancy and not too plain.
- It must give a sense of what the founders and the company expect to accomplish three to seven years into the future.
- It must explain in quantitative and qualitative terms the benefit to the user of the company’s products or services.
- It must present hard evidence of the marketability of the products or services.

Features of a Successful Business Plan

- It must justify financially the means chosen to sell the products or services.
- It must explain and justify the level of product development which has been achieved and describe in appropriate detail the manufacturing process and associated costs.
- It must portray the partners as a team of experienced managers with complementary business skills.
- It must suggest as high an overall “rating” as possible of the venture’s product development and team sophistication.
- It must contain believable financial projections, with the key data explained and documented.

Features of a Successful Business Plan (cont')

- It must show how investors can cash out in three to seven years, with appropriate capital appreciation.
- It must be presented to the most potentially receptive financiers possible to avoid wasting precious time as company funds dwindle.
- It must be easily and concisely explainable in a well-orchestrated oral presentation.

Deciding on the Content of a Business Plan

- Factors that help determine the content of a business plan for a startup:
  - The entrepreneurial team
  - The opportunity
  - The resources
  - The deal structure
  - The big picture

Good Opportunities Have Good "Fit"

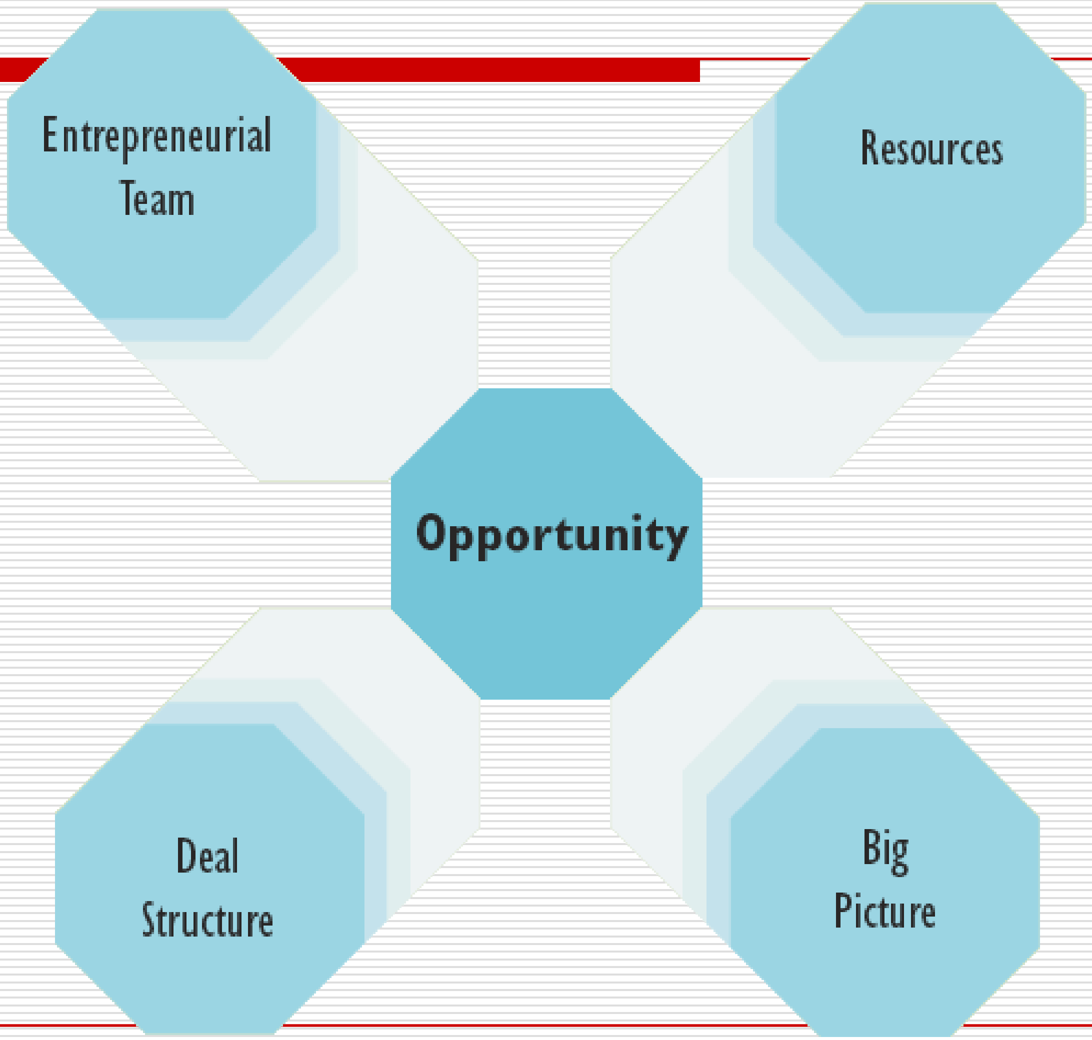


Exhibit 6.4

Contents of a Business Plan(important)

- Title Page
- Table of Contents
- Executive Summary
  - Synopsis
  - Narrative
- Vision and Mission Statement
- Company Overview
- Products and/or Services Plan
- Marketing Plan
- Operating Plan
- Financial Plan
- Appendix of Supporting Documents
- Making an effective written presenation.

Resources for Business Plan Preparation

- Computer-Aided Business Planning
  - Word processors
  - Spreadsheets
  - Specialised business plan software packages
- Professional Assistance
  - Attorneys
  - Marketing specialists
  - Engineering and production experts
  - Accounting firms
  - Incubator organizations
  - Small business development agencies

The Marketing Plan

Chapter 7 Page 180 (14) and page 175(15)
Page 198 (16)

Topic 1

Study Unit 2

What is Small Business Marketing?

- Marketing
  - Activities directing the flow of goods and services from producer to consumer or user
- Small business marketing consists of those business activities that relate directly to:
  - Identifying a target market
  - Determining target market potential
  - Preparing, communicating, and delivering a bundle of satisfaction to

Marketing Philosophies Make a Difference

- Production-Oriented
  - Emphasizes development of the product and production efficiencies over other activities
- Sales-Oriented
  - Favors product sales over production efficiencies and customer preferences
- Consumer-Oriented
  - All marketing efforts begin and end with the customer; focus is on the consumer’s needs—*this philosophy is the most consistent with long-term success of the firm*

Why Firms Fail to Adopt a Consumer Orientation

- The State of Competition
  - With no competition or high demand, firms turn to emphasize on production.
- Production Focus of Small Business Managers
  - Small business managers tend to have strong production skills and weak marketing skills.
- Focus on the Present
  - Small business managers tend to focus on current success which is the result of an overemphasis on selling that favours a sales oriented philosophy and customers' needs are not considered.

The Marketing Plan and Supporting Marketing Activities

Exhibit 7.1

The Formal Marketing Plan

- Market Analysis
  - Customer profile
    - A description of potential customers in a target market
  - Sales forecasts
    - Outlook: “most likely,” “pessimistic,” and “optimistic”
- The Competition
  - Profile of key management personnel
  - Overall strengths and weaknesses
  - Related products being marketed or tested
  - Likelihood of competitors’ entry into target market

The Formal Marketing Plan

- Marketing Strategy
  - Product and/or service section
    - Decisions affecting the total product
  - Distribution section
    - Decisions regarding product delivery to customers
  - Pricing section
    - Setting an acceptable value on the product
  - Promotional section
    - Communicating information to the target market

The Nature of Marketing Research (important)

- Marketing Research
  - The gathering, processing, reporting, and interpreting of market information
- Outside Sources
  - Hiring professional marketing researchers
  - Using the Internet for web-based surveys and online focus gro

Steps In the Marketing Research Process (important)

1. Identifying the informational need
   Why do we need to know this?
2. Searching for secondary data
   Who has researched this topic already?
3. Collecting primary data
   Who do we ask and what do we ask them?
4. Interpreting the data
   Got the information, now what does it mean?

Methods for Collecting Primary Data

- Observational Methods
  - Human
  - Mechanical
- Questioning Methods
  - Surveys
    - Mail
    - Telephone
  - Personal interviews
  - Experiments

Designing and Testing a Questionnaire

- Ask questions that relate to the issue.
- Select the form of question that is most appropriate . Open-ended and multiple-choice questions are the most popular.
- Carefully consider the order of the questions to avoid producing biased answers to later questions.
- Ask sensitive questions near the end of the questionnaire.
- Carefully select the words in each question. Questions should be simple, clear, and as objective as possible.
- Pre-test the questionnaire on a small representative sample of respondents.

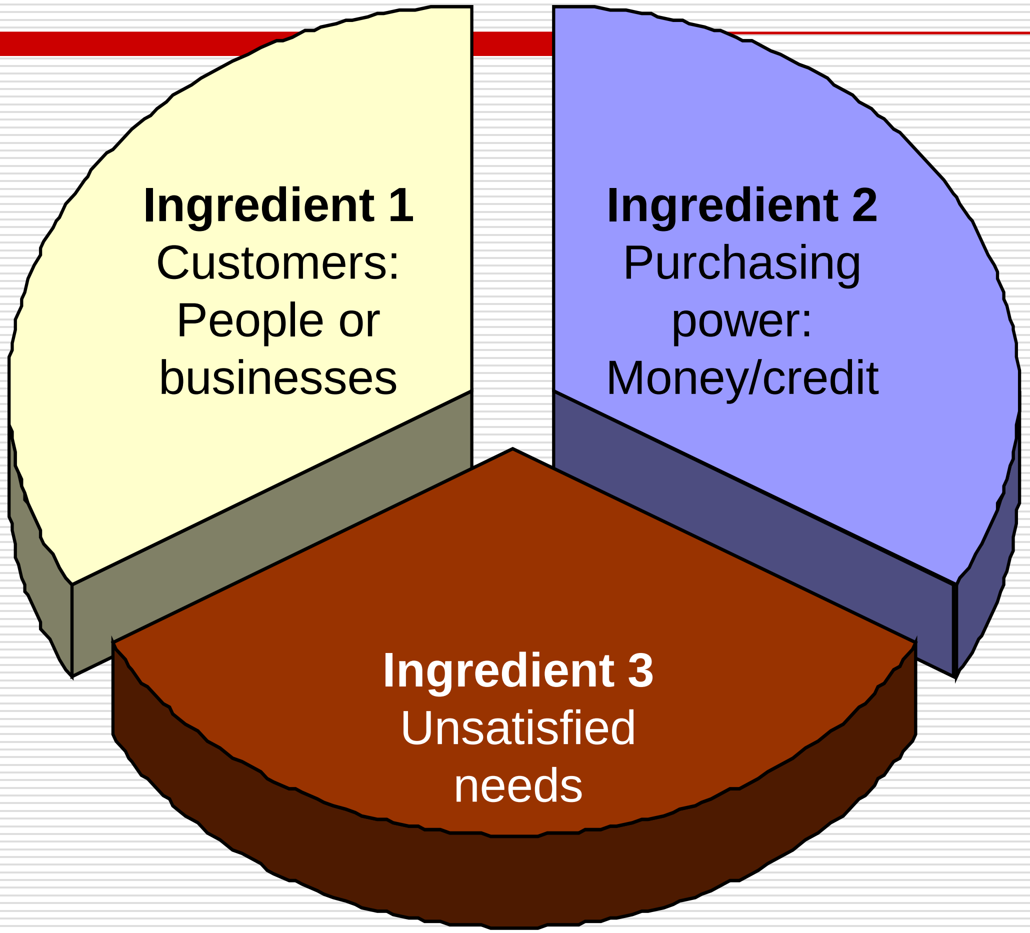
Understanding Potential Target Markets

- Market
  - A group of ***customers*** or potential customers who have ***purchasing power*** and ***unsatisfied needs***
- Market Segmentation
  - The division of a market into several smaller groups with similar needs
- Market Segmentation and its variables

  - benefit variables- specific characteristics that distinguish market segments according to the benefits sought by customers

  - demographic variables- specific characteristics that describe customers and their purchasing power

Ingredients of a Market



Types of Market Segmentation Strategies (important)

- Unsegmented Strategy (Mass Marketing)
  - A strategy that defines the total market as the target market
- Multisegment Strategy
  - A strategy that recognizes different preferences of individual market segments and develops a unique marketing mix for each
- Single-Segment Strategy
  - A strategy that recognizes the existence of several distinct segments but focuses on only the most profitable segment

Estimating Market Potential

The Sales Forecast

A prediction of how much (in units and/or dollars) of a product or service will be purchased within a market during a specified period of time

-Assesses the new venture's feasibility

- Assists in planning for product scheduling, setting inventory levels, and personnel decisions

Limitations to Forecasting (for Entrepreneurs)

-New business circumstances are unique

-Lack of familiarity with quantitative methods

-Lack of familiarity with the forecasting process

The Forecasting Process: Two Dimensions of Forecasting

- The Starting Point
  - Breakdown process (chain-ratio method)
    - Forecasting begins with macro-level variable and works down to the sales forecast (top-down).
  - Buildup process
    - All potential buyers in vari submarkets are identified, then the estimated deman added up (bottom-up).

The Location Plan

CHAPTER 9 page 236 (14 th) ,page 230 (15 th) page 260 (16th)

Topic 1

Study Unit 4

The importance of the location decision(important)

An entrepreneur should always realise that customers continuously analyse the following variables:

- Convenience
- Cost
- Reliability
- Quality
- Parking facilities

Key Factors in Selecting a Good Location (important)

Customer Accessibility

-Customer convenience (high traffic)

-Access by targeted customers (niche market)

-Avoidance of shipping costs (local markets)

Business Environment Conditions

-Climate-related factors

-Business environment factors

- Presence of established competitors
- Regulations, legal requirements, and restrictions
- Tax structure, exemptions, and incentives

Key Factors in Selecting a Good Location

- Availability of Resources
  - Nearness to raw materials
  - Availability of a suitable labor supply
  - Access to adequate and reliable transportation
- Personal Preference of the Entrepreneur
  - Familiarity with home community environment
  - Support of entrepreneur by the community
  - Desire for a particular lifestyle
  - Contribution to the community

Key Factors in Selecting a Good Location

- Site Availability and Costs
  - Difficulty of locating a good site
    - *Business incubator:* provides shared space, services, and management assistance for new businesses
  - Buying: large costs and commitment required to purchase site outright
  - Advantages of leasing:
    - Avoids a large cash outlay
    - Allows the owners to postpone committing to the site before the business becomes a success

Locating the business in the Entrepreneur's Home (important)

- Home-Based Business
  - A business that maintains its primary facility in the residence of its owner
- Attraction of a Home-Base Business
  - Low start-up and overhead costs
  - Convenience for family and lifestyle
  - Technology
    - Advances in office equipment allow home-based business to compete with commercial sites.

Home-Based Businesses

- Challenges
  - Business image of a home-based business
    - Professional image is difficult to maintain in a home environment.
  - Family and business conflicts
    - There is a need to observe regular business hours and establish spatial boundaries (specific work areas) to avoid distractions.
  - Legal considerations
    - Local laws and zoning ordinances prohibit many types of home-based businesses.

Locating the Startup on the Internet

- E-Commerce
  - The paperless exchange of business information via the Internet
- Internet
  - A huge, loosely connected computer network that links smaller netw
the world
- World Wide Web (WWW)
  - A system of Internet servers accessible with browsers, which navigate via hypertext lin

Benefits of E-Commerce to Small Firms

- Provides small businesses with the opportunity to compete with larger firms in larger markets
- Helps with cash flow problems by compressing the sales cycle most sales are credit card sales ensuring the immediate flow of money
- Builds better customer relationships through better service
  - Electronic Customer Relationship Marketing (eCRM)
    - An electronically based system that emphasizes customer relationships

E-Commerce Business Models

- Business Model
  - A group of shared characteristics, behaviors, and goals that a firm follows in a particular business situation such as the following

Types of customers served:

- Business-to-Business (B2B) Model
  - A business model based on selling to business customers electronically
- Business-to-Consumer (B2C) Model
  - A business model based on selling to final customers electronically
- Auction Sites
  - Web-based businesses offering participants the ability to list products for bidding

Degree of Online Presence

Two models

- Content/Information-Based Model
  - A business model in which the Web site provides information but not the ability to buy or sell products and services
- Transaction-Based Model
  - A business model in which the Web site provides a mechanism for buying or selling products or services
    - *24/7 E-Tailing:* electronic retailing providing round-the-clock access to products and services

Designing and Equipping the Physical Facilities

- Design Requirement Challenges
  - Physical facilities should be of adequate size and accommodation; not too large or too luxurious.
  - Considerations
    - Age and condition of building
    - Heating and air conditioning
    - Lighting and restroom facilities
    - Fire hazards
    - Entrances and exits
  - The ideal building meets the functional requirements of the business and projects the appropriate image to customers and the

Equipping the Physical Facilities
Manufacturing Equipment

General purpose equipment

- Machines that serve many functions in the production system

Using General-Purpose Equipment results in:

- Low purchase cost
- Flexible production
- Good resale value

Special-purpose equipment

- Machines designed to serve specialised functions in the production process

Using Special-Purpose Equipment results in:

- Low labor cost per unit of product
- High hourly output
- Limited resale value

Retail Store and Office Equipment

- Retail
  - Display racks
  - Sales counters
  - Cash registers/ POS systems
- Image
  - Luxury/utilitarian customer furnishings
  - Lighting
  - Displays
  - Signage
- Office Equipment
  - Computers
  - Fax machines
  - Copiers and printers
  - Telephone systems
  - Filing cabinets

The Financial Plan
Topic 1: Projecting Financial Requirements

Chapter 10 page 260 (14th), page 286 (15th) and page 330 (16th)

Topic 1

Study Unit 5

Understanding Financial Statements (important)

- Financial Statements (Accounting Statements)
  - Reports of a firm's financial performance and resources, including an income statement and a balance sheet
    - Helps determine a startup's financial requirements
    - Assesses the financial implications of a business plan

Understanding Financial Statements

- Income Statement
  - A report showing the profit or loss from a firm's operations over a given period of time.
  - "How profitable is the business?"

  Sales – Expenses = Profits
    - Revenue from product or service sales
    - Costs of producing product or service (cost of goods sold)
    - Operating expenses (marketing, selling, general and administrative expenses, and depreciation)
    - Financing costs (interest paid)
    - Tax payments

Sections of the Income Statement

- Cost of goods sold
  - The cost of producing or acquiring goods or services to be sold by a firm
- Gross profit
  - Sales less the cost of goods sold
- Operating expenses
  - Costs related to marketing and selling a firm's product or service, general and administrative expenses, and depreciation
- Operating income
  - Earnings before interest and taxes are paid

Sections of the Income Statement

- Financing Costs
  - The amount of interest owed to lenders on borrowed money
- Net income available to owners (Net income)
  - Income that may be distributed to the owners or reinvested in the company
- Depreciation expense
  - Costs related to a fixed asset, such as a building or equipment, distributed over its useful life

The Balance Sheet

- Balance Sheet
  - A report showing a firm's assets, liabilities, and owners' equity at a specific point in time

Total Assets = Outstanding debt + Owner's equity

Balance Sheet: Current Assets

Current Assets (Working Capital)

Assets that can be converted to cash within the firm's operating cycle

Cash: Currency and negotiable instruments

Accounts receivable: the amount of credit extended to customers that is currently outstanding

Inventory: raw materials and products held in anticipation of eventual sale

Balance Sheet: Fixed Assets

- Fixed assets
  - Relatively permanent resources intended for use in the business (not for resale)
- Depreciable assets
  - Assets whose value declines (depreciates) over time
- Gross fixed assets
  - Original cost of depreciable assets before any depreciation expense has been taken
- Accumulated depreciation
  - Total depreciation expense taken over the assets' life

Balance Sheet: Fixed Assets (cont'd.)

- Net fixed assets
  - Gross fixed assets less accumulated depreciation
- Other assets
  - Assets other than current assets and fixed assets, such as patents, copyrights, and goodwill that have an estimated value

The Balance Sheet: Debt

- Debt
  - Business financing provided by a creditor
- Current (Short-term) debt
  - **Accounts payable**: outstanding credit payable to suppliers
  - **Accrued expenses**: short-term liabilities that have been incurred but not paid
  - **Short-term notes**: Cash amounts borrowed from a bank or other lending sources that must be repaid within a short period of time
- Long-term debt
  - Loans and mortgages from banks and other lenders with maturities greater than one year

The Balance Sheet: Debt

- Long-term debt
  - Loans and mortgages from banks and other sources with repayment terms of more than 12 months
- Mortgage
  - A long-term loan from a creditor for which real estate is pledged as collateral

Financial Forecasting

- Pro Forma Financial Statements
  - Statements that project a firm's financial performance and condition
  - Purposes of pro forma statements:
    - How profitable can the firm be expected to be, given the projected sales levels and the expected sales expense relationships?
    - What will determine the amount and type of financing (debt or equity) to be used?
    - Will the firm have adequate cash flows? If so, how will they be used; if not, where will the additional cash come from?

Forecasting Profitability

- Net Income Depends On:
  - Amount of sales(the price of the product times the number of units sold)
  - Cost of goods sold and operating expenses(fixed and variable costs)
  - Interest expense(cost of capital)
  - Taxes(a percentage of taxable income)

Determining Financing Requirements (important)

- Liquidity
  - The degree to which a firm has working capital available to meet maturing debt obligations
- Current Ratio
  - The firm's relative liquidity, determined by dividing current assets by current liabilities
- Debt Ratio
  - Debt as a fraction of assets; total debt divided by total assets
  - Spontaneous financing—debts such as accounts payable that increase as the firm grows

Sources of Equity Capital(important)

- External Equity
  - The owners' original investment
- Profit Retention
  - The reinvestment of profits in a firm
- Internal Equity
  - Capital from retaining profits within the firm
- Forecasting financial requirements (in total):

Total asset requirements = **Total sources of financing** = **Spontaneous financing** + **Profits retained within the business** + **External sources of financing**

Good forecasting requires sound judgment.(important)

- Develop realistic sales projections
- Projections from assumptions about marketing and pricing plans
- Use realistic profit margins
- Don’t limit projections to income statement.
- Provide monthly data for upcoming year and annual data for succeeding years.
- Avoid providing too much information
- Be certain about the numbers
- Follow the plan.

The Financial Plan: Finding Sources of Funds

Chapter 11 in 14th page 298 chapter 12 in 15th page 309 and page 356 in 16th

Topic 1

Study Unit 6

The Nature of a Firm and Its Financing Sources (important)

Factors That Determine Financing

- Firm’s economic potential
  - Growth prospects and long-term profitability
- Company size and maturity
  - Life-cycle position in business
- Types of assets
  - Tangible or intangible
- Owner preferences for debt or equity
  - Tradeoffs required for debt and equity

Debt or Equity Financing?(important)

- Potential Profitability
  - Borrowing increases potential for higher rates of return on owners' equity; exposes firm to more financial risk
- Return on Assets
  - Rate of return earned on a firm's total assets invested, computed as operating income ÷ total assets
- Return on Equity
  - Rate of return earned on the owner's equity investment, computed as net income ÷ owner's equity investment

Debt or Equity Financing? (cont'd.)

- Financial Risk
  - Investing more owner equity limits potential return on equity; lowers financial risk for firm.
- Voting
  - Increasing equity through borrowing requires owners to share control with external investors.

Sources of Funds

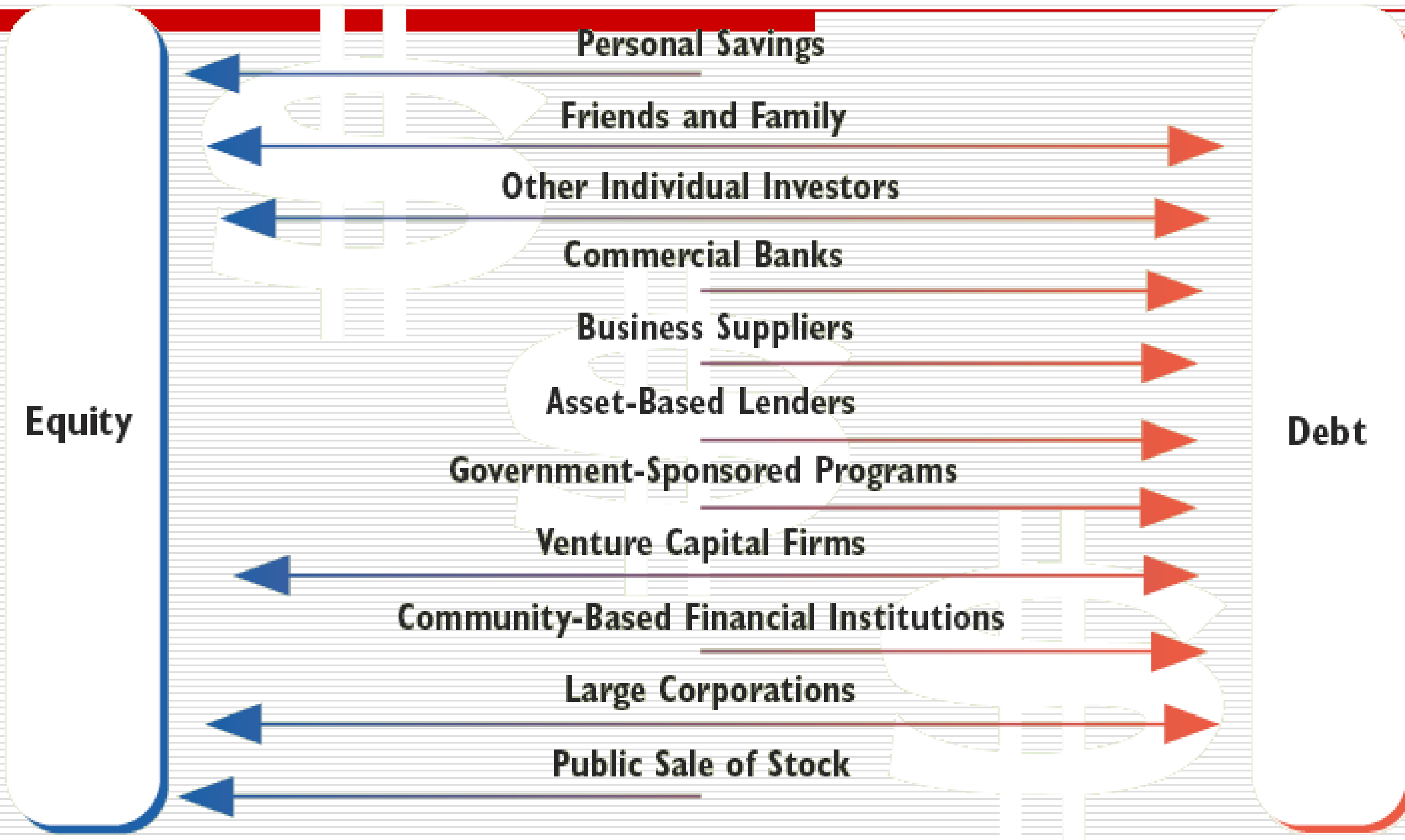


Exhibit 11.3

Debt or Equity Financing? (cont'd.)

- Sources Close to Home
  - Personal savings
    - Owner equity is expected by other investors.
  - Family and friends
    - Borrowing puts personal relationships at risk.
  - Credit cards
    - Provides immediate access to funds and assets; cards should be method of payment and not a source of credit.

Sources of financing available in South Africa

Individual investors

- Entrepreneurs have access to the following sources of early financing:
- personal savings --- the most frequently used source of equity in start-up firms
- friends and relatives --- a convenient source of finance, but also frequently a dangerous and stressful option
- other individual investors --- for example, retired people with long-term business experience (business angels are investors in the informal capital market and are normally self-made millionaires as a result of their own entrepreneurial endeavours)

Sources of financing available in South Africa

Business suppliers and asset-based lenders

- Entrepreneurs can make use of the following three types of credit:

(1) Accounts payable (trade credit). This form of lending is based on short-term funds in the form of accounts payable. The term of payment varies between 30 and 120 days.

The Banker’s Perspective

- Bankers’ Concerns
  - How much the bank will earn on the loan?
  - What is the likelihood that the lender will be able to repay the loan?
- The Five Cs of Credit
  - Character of the borrower
  - Capacity of the borrower to repay the loan
  - Capital invested in the venture by the borrower
  - Conditions of the industry and economy
  - Collateral available to secure the loan

Questions Lenders Ask

- Lender's Questions
  - Do the purpose and amount of the loan make sense, both for the bank and for the borrower?
  - Does the borrower have strong character and reasonable ability?
  - Does the loan have a certain primary source of repayment?
  - Does the loan have a certain secondary source of repayment?
  - Can the loan be priced profitably to the customer and to the bank, and are this loan and the relationship good for both the customer and the bank?
  - Can the loan be properly structured and documented?

The Banker’s Concerns

How much money is needed?

What is the venture going to do with the money?

When will the money be needed?

When and how will the money be paid back?

Financial Information Required for a Bank Loan

- Three years of the firm's historical statements
  - Balance sheets, income statements, and statements of cash flow
- The firm's pro forma financial statements
  - The timing and amounts of the debt repayment included as part of the forecasts
- Personal financial statements
  - The borrower's personal net worth (assets – debts) and estimated annual income

Additional requirements to secure a loan

- Foster a personal relationship with the banker.
- Provide accurate information in support of the loan request.
- Submit a well-prepared written presentation.
- Select a bank depending on the basis of its range of services available, location and lending policies.

Loan terms on which to agree

When negotiating a loan, the parties involved need to agree on the following four loan terms:

(1) the interest rate --- a negotiable variable

(2) the loan maturity date --- depends on the need

(3) the repayment schedule --- either equal or decreasing monthly or annual payments

(4) the loan covenants --- restrictions to ensure loan repayment such as

- provision of monthly statements
- limitation on managers' salaries
- limitation on financial ratios
- personal guarantee of the loan

Government/nongovernmental sponsored programmes and agencies

The South African government grant loans through the following financing vehicles:

- Khula Enterprises provide 80% of the collateral required by the bank for the loans needed. For the collateral provided by Khula they charge additional interest, as arranged with them. Khula further specialises in providing small loans which are not profitable for or popular with South African banks.
- The Industrial Development Corporation (visit its website at www.idc.org.za).

  The Southern African Enterprise Development Fund
- See also the government's other entrepreneurship-support programmes at www.dti.gov.za

Government/nongovernmental sponsored programmes and agencies

- The Small Business Development Corporation (SBDC) has been replaced by Business Partners, an organisation that offers various investment and loan options to the entrepreneur. Visit its website at www. businesspartners.co.za to see the ways in which it services the entrepreneurial sector.
- other sources of finance

Private Equity Investors

- Informal Venture Capital
  - Funds provided by wealthy private individuals (business angels) to high-risk ventures
- Formal Venture Capitalists
  - Individuals who form limited partnerships for the purpose of raising venture capital from large institutional investors
    - The firm's expected profits in future years
    - The venture capitalist's required rate of return

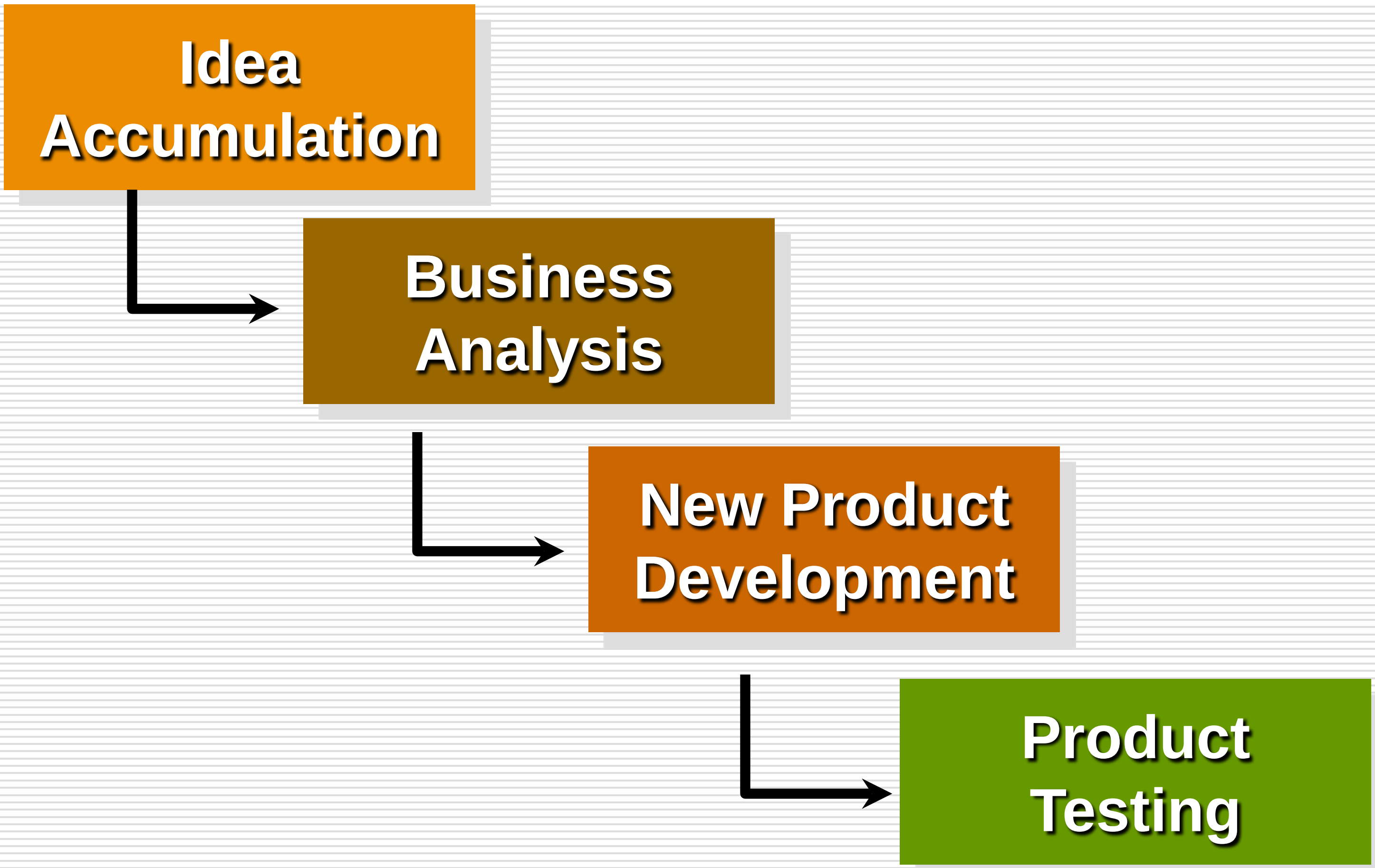
Product and Supply chain Management

Chapter 14 in 14th page 370, chapter 15 in 15th page 389 and page 438 in 16th.

Topic 2

Study Unit 8

New Product Development Process



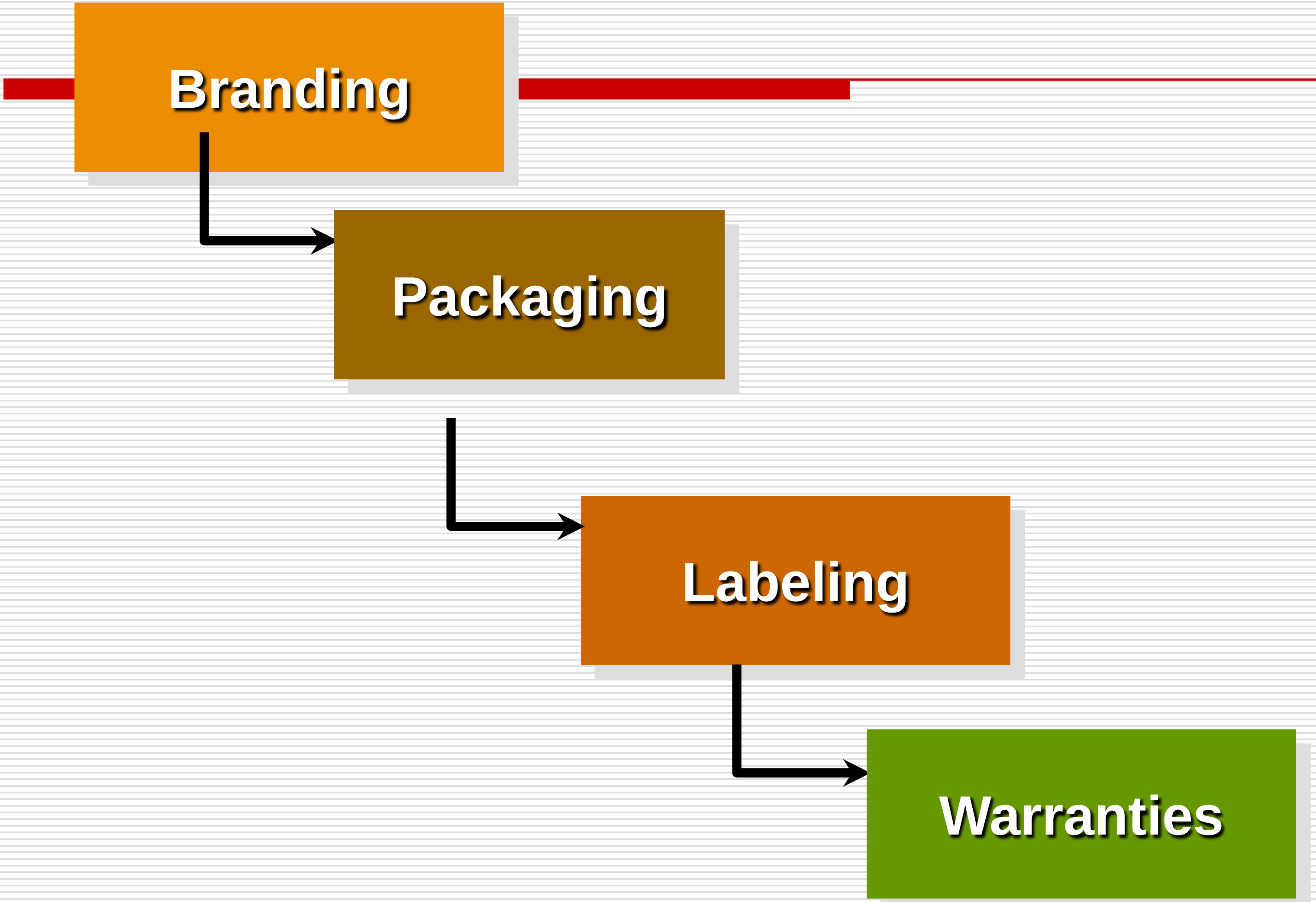
New Product Development Process (important)

- Idea Accumulation
  - Increasing the number of ideas under consideration
  - Sources for ideas
    - Sales, engineering, or other personnel within the firm
    - Government-owned patents, which are generally available on a royalty-free basis
    - Privately owned patents listed by the U.S. Patent Office
    - Other small companies that may be available for acquisition or merger
    - Competitors' products and advertising
    - Requests and suggestions from customers

New Product Development Process (cont'd.)

- Business Analysis
  - Product's relationship to the existing product line
  - Cost of development and introduction
  - Available personnel and facilities
  - Competition and market acceptance
- Development of the Product
  - Branding, packaging, pricing, and promotion
- Product Testing
  - Proving the product design through consumer reaction to the product

Building The Total Product (important)



Building the Total Product

- Branding
  - A verbal and/or symbolic means of identifying a product
- Brand Name
  - A brand that can be spoken (tangible)
- Brand Mark
  - A brand that cannot be spoken (tangible)
- Brand Image
  - Symbolic (Intangible)

Building the Total Product (cont'd

- Branding
  - A verbal and/or symbolic means of identifying a product
- Rules for Naming a Product:
  - Select a name that is easy to pronounce and remember.
  - Choose a descriptive name.
  - Use a name that can have legal protection.
  - Select a name with promotional properties.
  - Select a name that can be used on several product lines of a similar nature.

Building the Total Product (cont'd.)

- Designing a Logo:
  - *Be simple*.
  - *Leave it open to interpretation*.
  - *Be relentlessly consistent*.
  - *Don't be embarrassed about design*.
  - *Get good advice*.
  - *Don't expect miracles*.

Protecting the Product Offering

- Trademark
  - An identifying feature used to distinguish a manufacturer's product
- Service Mark
  - A legal term indicating the exclusive right to use a brand to identify a service

Building the Total Product (cont'd.)

- Packaging
  - Color, design, and protection for the product
- Labeling
  - Shows the brand and informs the consumer about product features and care
- Making Warranties
  - A promise that the product will perform at a certain level or meet certain standards
    - Implied and written warranties
    - Policy considerations: Cost, service capability, competitive practices, customer perceptions, legal implications

Product Strategy

- Product Strategy
  - The way the product component of the marketing mix is used to achieve a firm's objectives
  - Product item
    - The lowest common denominator in the product mix—the individual item
  - Product line
    - The sum of the related individual product items
  - Product mix
    - A firm's total product lines
  - Product mix consistency
    - The similarity of product lines in a product mix

Product Strategy (cont'd)

- Product
  - A total bundle of satisfaction—a service, a good, or both—offered to consumers in an exchange transaction
  - Includes both the main element (physical product or core service) and complementary components (features)

The Legal Environment (important)

- Consumer Protection
  - Labeling
    - Nutrition Labeling and Education Act of 1990
    - Listing of contents
    - Proper care and use
  - Product safety
    - Consumer Product Safety Act of 1972
    - Packaging
    - Use instructions
    - Disposal
- Patent Protection
  - The registered, exclusive right of an inventor to make, use, or sell an invention
  - Utility patent
    - Registered protection for a new process or product's function
  - Design patent
    - Registered protection for the appearance of a product and its inseparable parts
  - Plant patent
    - Registered protection for any distinct and new variety of plant

Protecting a Product Offering (cont'd.)

- Copyright
  - The exclusive right of a creator to reproduce, publish, perform, display, or sell his or her works
  - Copyright notice
    - The copyright symbol ©
    - The year the work was published
    - The copyright owner's name
- Trade Dress
  - Elements of a firm's distinctive image ("look") not protected by a trademark, patent, or copyright

Supply Chain Management

- Supply Chain Management
  - A system of management that integrates and coordinates the means by which a firm creates or develops a product or service and delivers it to customers
- Distribution
  - Physically moving products and establishing intermediary relationships to support such movement
- Physical Distribution (Logistics)
  - The activities of distribution involved in the physical relocation of products
- Channel of Distribution
  - The system of relationships established to guide the movement of a product

Supply Chain Management (cont'd.)

- Functions of Intermediaries
  - Perform the marketing function better
  - Provide efficient distribution of the product
  - Merchant middlemen
    - Intermediaries that take title to the goods they distribute
  - Agents/brokers
    - Do not take title to the goods they distribute

- Channels of Distribution
  - Direct channel
    - A distribution system without intermediaries
  - Indirect channel
    - A distribution system with one or more intermediaries
  - Dual distribution
    - A distribution system with more than one channel

Building a channel for distribution

- Important Factors in Building a Distribution Channel
  - Costs associated with establishing a direct channel distribution
  - Coverage is increased through the use of indirect channels of distribution
  - Control is enhanced using a direct distribution channel

The Scope of Physical Distribution (important)

- Transportation—Which Mode to Use?
  - Common carriers
    - Transportation intermediaries available for hire to the general public
  - Contract carriers
    - Transportation intermediaries that contract with individual shippers
  - Private carriers
    - Lines of transport owned by shippers
- Storage
  - Lack of storage space is a common problem
- Materials Handling
  - Protecting the firm's output during warehousing
- Specifying Responsibility for Delivery Terms
  - Paying freight costs (F.O.B.)
  - Selecting the carriers
  - Bearing the risk of damage
  - Selecting the modes of transport

The Scope of Physical Distribution (cont'd.)

- Logistics Companies
  - Firms which specialize in providing cost-effective transportation, storage, and distribution services to small companies
    - Trucking
    - Packaging
    - Warehousing

Pricing and Credit Decisions

Chapter 15 in 14th page 396, chapter 16 in 15th page 418 and page 472 in 16th.

Part 2

Study Unit 9

Setting a Price

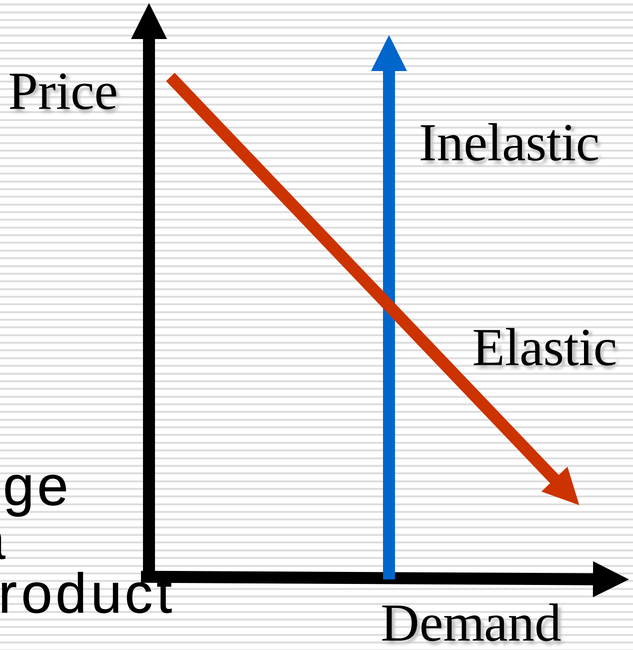
- Price
  - A specification of what a seller requires in exchange for transferring ownership or use of a product or service
    - Prices set too low, loss in revenue
    - Price set too high, loss in revenue
    - Price and demand are related for many goods and services
- Credit
  - An agreement between a buyer and a seller that provides for delayed payment for a product or service

Cost Determination for Pricing

- Total Cost
  - The sum of cost of goods sold, selling expenses, and overhead costs
- Total Variable Costs
  - Costs that vary with the quantity produced or sold
- Total Fixed Costs
  - Costs that remain constant as the quantity produced or sold varies
- Average Pricing
  - An approach in which total cost for a given period is divided by quantity sold in that period to set a price

How Customer Demand Affects Pricing

- The Elasticity of Demand
  - The degree to which a change in price affects the quantity demanded
  - Elastic Demand
    - Demand that changes significantly when there is a change in the price of the product
  - Inelastic Demand
    - Demand that does not change significantly when there is a change in the price of the product



Pricing and a Firm’s Competitive Advantage

- Pricing and Competitive Advantage
  - Customers will demand and pay more for a product or service that they perceive as important to their needs.
- Prestige Pricing
  - Setting a high price to convey an image of high quality or uniqueness (competitive advantage)
    - Customers associate price with quality.
    - Markets with low levels of product knowledge are candidates for prestige pricing.

Applying a Pricing System

- Break-Even Analysis
  - A comparison of alternative cost and revenue estimates in order to determine the acceptability of each price
  - Steps in the analysis
    - Examining revenue-cost relationships: the quantity at which the product will generate enough revenue to start earning a profit
    - Incorporating actual sales forecasts into the analysis

Applying a Pricing System (cont'd.)

- Examining Cost and Revenue Relationships
  - Breakeven Point
    - The sales volume at which total sales revenue equals total costs (fixed and variable)
    - The point at which profitability starts and losses cease
- Incorporating Sales Forecasts
  - Adjusted Break-Even Analysis
    - Price has a variable impact and influence on demand.
    - Adjusting for the indirect effect of price allows for a more realistic profit area to be identified.

Applying a Pricing System (cont'd.)

- Markup Pricing
  - Cost plus pricing system that adds a markup percentage to cover:
    - Operating expenses
    - Subsequent price reductions
    - Desired profit

Applying a Pricing System (cont'd.)

- Markup Pricing
  - Cost plus pricing system that adds a markup percentage to cover:
    - Operating expenses
    - Subsequent price reductions
    - Desired profit

$$\frac{Markup}{Selling\ Price} \times 100 = Markup\ as\ a\ percentage\ of\ selling\ price$$

$$\frac{Markup}{Cost} \times 100 = Markup\ as\ a\ percentage\ of\ cost$$

Selecting a Pricing Strategy (important)

- Penetration Pricing
  - Setting lower than normal prices to hasten market acceptance of a product or service or to increase market share
- Skimming Pricing
  - Setting very high prices for a limited period before reducing them to more competitive levels
- Follow-the-Leader Pricing
  - Using a particular competitor as a model in setting prices

Selecting a Pricing Strategy (cont’d.)

- Variable Pricing
  - Setting more than one price for a good or service in order to offer price concessions to certain customers
- Dynamic Pricing
  - Charging more than the standard price when the customer’s profile suggests that the higher price will be accepted
- Price Lining
  - Setting a range of several distinct merchandise levels

Selecting a Pricing Strategy (cont'd.)

- What the Market Will Bear
  - A strategy of charging the highest prices that customers will pay; used only when the seller has little or no competition.
- Setting Prices: Controls and Situations
  - The Sherman Antitrust Act prohibits competitors from conspiring to fix prices
  - The effect of the introduction of new products into an established product line
  - Offering discounts to match the needs of customers

Offering Credit (important)

- Benefits of Credit to Borrowers
  - Provides working capital
  - Ability to satisfy immediate needs and pay later
  - Better records of purchases on credit billing
  - Better service and greater convenience when exchanging purchased items
  - Establishment of credit history
- Benefits of Credit to Sellers
  - Facilitates increased sales volume
  - Brings a closer association with customers
  - Fosters easier selling through telephone, mail, and Internet
  - Helps smooth sales demand since purchasing power is always available
  - Provides easy access to a tool with which to stay competitive

Offering Credit (cont'd.)

- Factors That Affect Selling on Credit
  - Type of business
    - Durable goods retailers offer more credit.
  - Credit policies of competitors
    - Competitors are expected to match other competitors' credit offerings.
  - Income level of customers
  - Availability of working capital
    - Credit sales increase the amount of working capital.

Types of Credit(important)

- Consumer Credit
  - Financing granted by retailers to individuals who purchase for personal or family use
- Trade Credit
  - Financing provided by a supplier of inventory to a given company which sets up an account payable for the amount
    - Terms of sale may be 2/10, net 30—two percent discount on the invoice amount if paid in full within 10 days of the invoice

Types of Consumer Credit Accounts

- Open Charge Account
  - A line of credit that allows the customer to obtain a product at the time of purchase
- Installment Account
  - A line of credit that requires a down payment, with the balance paid over a specified period of time
- Revolving Charge Account
  - A line of credit on which the customer may charge purchases at any time, up to a pre-established limit

Types of Credit Cards

- Bank Credit Cards
  - Credit cards issued by banks that are widely accepted by retailers who pay a fee to the banks for handling their credit transactions
- Entertainment Credit Cards
  - Business credit cards originally used to purchase services, now widely accepted for merchandise
- Retailer Credit Cards
  - Credit cards issued by firms for specific use in their outlets or for purchasing their products or services

Managing the Credit Process (important)

- Evaluation of Credit Applicants
  - Can the buyer pay as promised?
  - Will the buyer pay?
  - If so, when will the buyer pay?
  - If not, can the buyer be forced to pay?
- The Traditional Five Cs of Credit
  - Character
  - Capital
  - Capacity
  - Conditions
  - Collateral

Managing the Credit Process Continue (important

- Sources of credit information
- Aging of accounts receivable
- Billing and collection procedures
- Credit regulation.

Sources of Credit Information

- Individuals
  - Customer's previous credit history
  - Dun & Bradstreet Business Information Reports
- Businesses
  - Financial statements of the firm
  - Other sellers to the firm
  - Firm's banker
  - Trade-credit agencies
  - Credit bureaus
  - Online credit data

Promotional Planning

Chapter 16 in 14th page 420, chapter 17 in 15th page 440 and page 496 in 16th

Study Unit 10

Focusing on the Customer: Marketing Growth Strategies

The Communication Process in Promotion

- Communication Process Components
  - Source—the message sender
  - Channel—the path the message travels
  - Receiver—the recipient of the message
- Forms of Promotional Communication
  - Nonpersonal—advertising
  - Personal—personal selling
  - Special forms—sales promotion

Promotional Communications

- Promotional Mix
  - A blend of nonpersonal, personal, and special forms for communication techniques aimed at a target market
  - Makeup of the mix is determined by:
    - Geographical nature of target market
    - Size of promotional budget
    - Product's characteristics

Determining the Promotional Budget (important)

- How much should a small business spend on promotion?”
  - Allocating a percentage of sales
  - Deciding how much can be spared
  - Spending as much as the competition
  - Determining what it takes to do the job

Personal Selling in the Small Firm

- Personal Selling
  - A sales presentation (promotion) delivered in a one-on-one manner
  - Requires:
    - Product knowledge
    - Well-prepared sales presentation
    - Ability to build good will

Importance of Product Knowledge

- Salespersons use product knowledge to:
  - Successfully educate customers about the product's advantages, uses, and limitations.
  - Answer customer questions and counter customer objections.

Personal selling becomes order-taking when a salesperson lacks product knowledge

The Sales Presentation: Prospecting

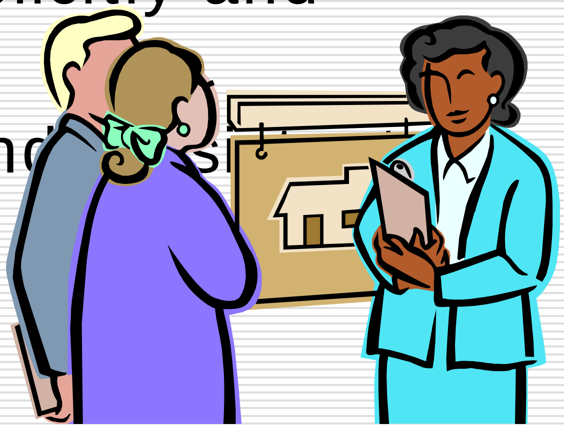
- *Prospecting*
  - *A systematic process of continually looking for new customers*
- Prospecting Techniques
  - Personal referrals
    - Salesperson initiates customer contact through referral by another party known to the customer
  - Impersonal referrals
    - Information on potential new customers developed from public records and published sources
  - Marketer-initiated contacts
    - Market surveys are used to identify prospects.
  - Customer-initiated contacts
    - Potential customers are identified through their contacts with the firm.

Practicing the Sales Presentation

- Improves the salesperson’s success rate
- Prepares salesperson for objections related to price, product, timing, service, or need
- Techniques for dealing with objections:
  - Direct denial
  - Indirect denial
  - Boomerang technique
  - Compensation method
  - Pass-up method

Making the Sales Presentation

- Adapting the sales approach to the customers' needs:
  - Avoid a "canned" sales talk.
  - Speak the customer's "language."
  - Answer every objection explicitly and adequately.
  - Be enthusiastic, friendly, and
  - Be personally supportive of the customer.



Customer Goodwill and Relationship Selling

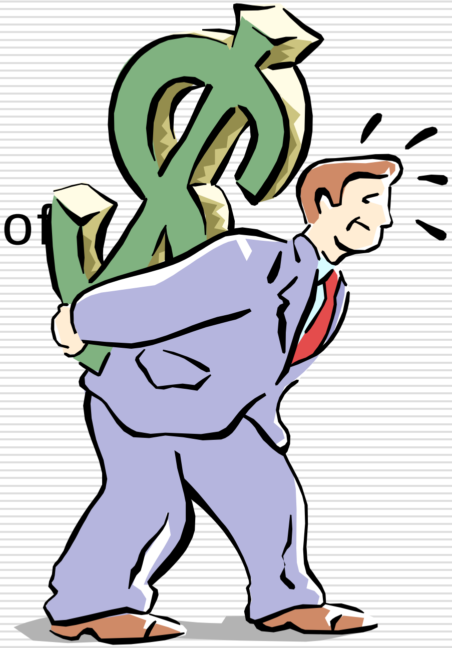
- Relationship Selling
  - Building customer goodwill for future sales to satisfied customers through:
    - Maintaining a good personal appearance
    - Having a pleasant personality
    - Using professional etiquette in all customer contacts
    - Understanding the customer's point of view
    - Maintaining high ethical standards in the customer relationship

The Compensation Programme for Salespeople (important)

- Nonfinancial Rewards
  - Personal recognition of employees by the firm
    - Plaques and “Employee of the Month” awards
    - Providing “perks” to superior performers
  - Personal satisfaction drawn by salespersons from doing their work well

Compensating Salespeople

- Financial Rewards
  - Commissions
    - Compensation paid as percentage of sales productivity
    - Strong sales motivator
  - Straight Salary
    - Compensation paid regardless of sales made
  - Combination of Commissions and Salary
    - Balance of two compensation forms is adjusted to provide an increasing proportion of commission as salesperson gains experience



Advertising Practices for Small Firms

Advertising

– The impersonal presentation of a business idea through mass media

Advertising Objectives

– To sell by informing, persuading, and reminding
– To serve as a complement to product quality and efficient service
– To properly reflect changes in customer needs and preferences

Types of Advertising

- Product Advertising
  – The presentation of a business idea designed to make potential customers aware of a specific product or service and create a desire for it
- Institutional Advertising
  – The presentation of information about a particular firm, designed to enhance the firm's image

Obtaining Assistance with Advertising

- Advertising Agencies
  - Furnish design, artwork, and copy for ads
  - Evaluate and recommend media with greatest "pulling power"
  - Evaluate the effectiveness of advertising appeals
  - Advise on promotion and merchandise displays
  - Conduct market sampling studies
  - Furnish mailing lists
- Other Sources
  - Suppliers
  - Trade Associations

Advertising Decision Factors

- Frequency of Advertising
  - With regularity for effectiveness and continuity
    - Introduction of new uses for established products
    - Introduction of new products and services
- Where to Advertise
  - Appropriate media mix is determined by:
    - Geographical area for target market coverage
    - Customer type targeted by advertising campaign
    - Advertising media customarily used by industry
    - By type of business
    - Web advertising: advertising appearing on the World Wide Web

Advantages and Disadvantages of Traditional Advertising Media (important)

Medium	Advantages	Disadvantages
Newspapers	Geographic selectivity and flexibility; short-term commitments; short lead time; immediacy; year-round readership	Little demographic selectivity; limited color capabilities; low pass-along rate; may be expensive
Magazines	Good reproduction; demographic and regional selectivity; relatively long life; high pass-along rate	Long-term commitments; slow audience buildup; long lead time
Radio	Low cost; immediacy; highly port able; short-term commitments; entertainment carryover	No visual treatment; short message life; commercial clutter
Television	Wide, diverse audience; creative opportunities for demonstration; immediacy; entertainment carry-over	Short message life; high campaign cost; long-term commitments; long lead times; commercial clutter
Outdoor media	Repetition; moderate cost; flexibility; geographic selectivity	Short message; lack of demo-graphic selectivity; distracting noise levels

Exhibit 16.3 F. Hair, Jr., and Carl McDaniel, *Marketing* (Cincinnati: South-Western, 2004), p. 505.

Sales promotional Tools

- Specialities
- Trade show exhibits
- Publicity

When to use sales promotional tools.

Managing Human Resources

Chapter 19in 14th page 500 and chapter 20 in 15th page 521 and page 580 in 16th

Topic 3

Study Unit 12

Recruiting Personnel

- The Need for Quality Employees
  - Employee performance directly or indirectly affects the capability of the firm to service customer needs.
  - Employee performance affects profitability.
  - Payroll costs affect the firm’s bottom line.
  - Quality of employees determines the long-term competitive potential of the firm.

The Lure of Entrepreneurial Firms

Advantages of Employment in Small Firms

- Creative options for recruitment
- The questions arises: "How can small businesses compete for employees?"

Smaller enterprises can decide on the following options:

- Freedom and flexibility versus the bureaucracy of corporates
- Compensation packages
- The flexibility of working schedules
- Creative challenges

Sources of Employees (important)

Sources of Employees		
Help-Wanted Advertising	Walk-ins	Schools
Public Employment Offices	Private Employment Agencies	Executive Search Firms
Employee Referrals	Internet Recruiting	Temporary Help Agencies

Diversity in the workforce

Workforce Diversity

- Differences among employees in terms of such dimensions as gender, age, and race
- Increasing with higher proportions of women, older workers, and racial minorities entering

The South African situation should be mentioned here because of the complex diversity of our work environment. The following Acts should be analysed before any form of recruitment can start:

- the Labour relations Act 66 of 1995
- the Basic Conditions of Employment Act 75 of 1997
- the Employment Equity Act 55 of 1998
- the Skills Development Act 97 of 1998
- the Skills Development Levies Act 9 of 1999

The government's long-term plan regarding employment equity is to ensure that the work force will represent the demographic composition of the country. Hence the challenge facing entrepreneurs is to adapt to and accept the benefits of diversity.

Job Descriptions(important)

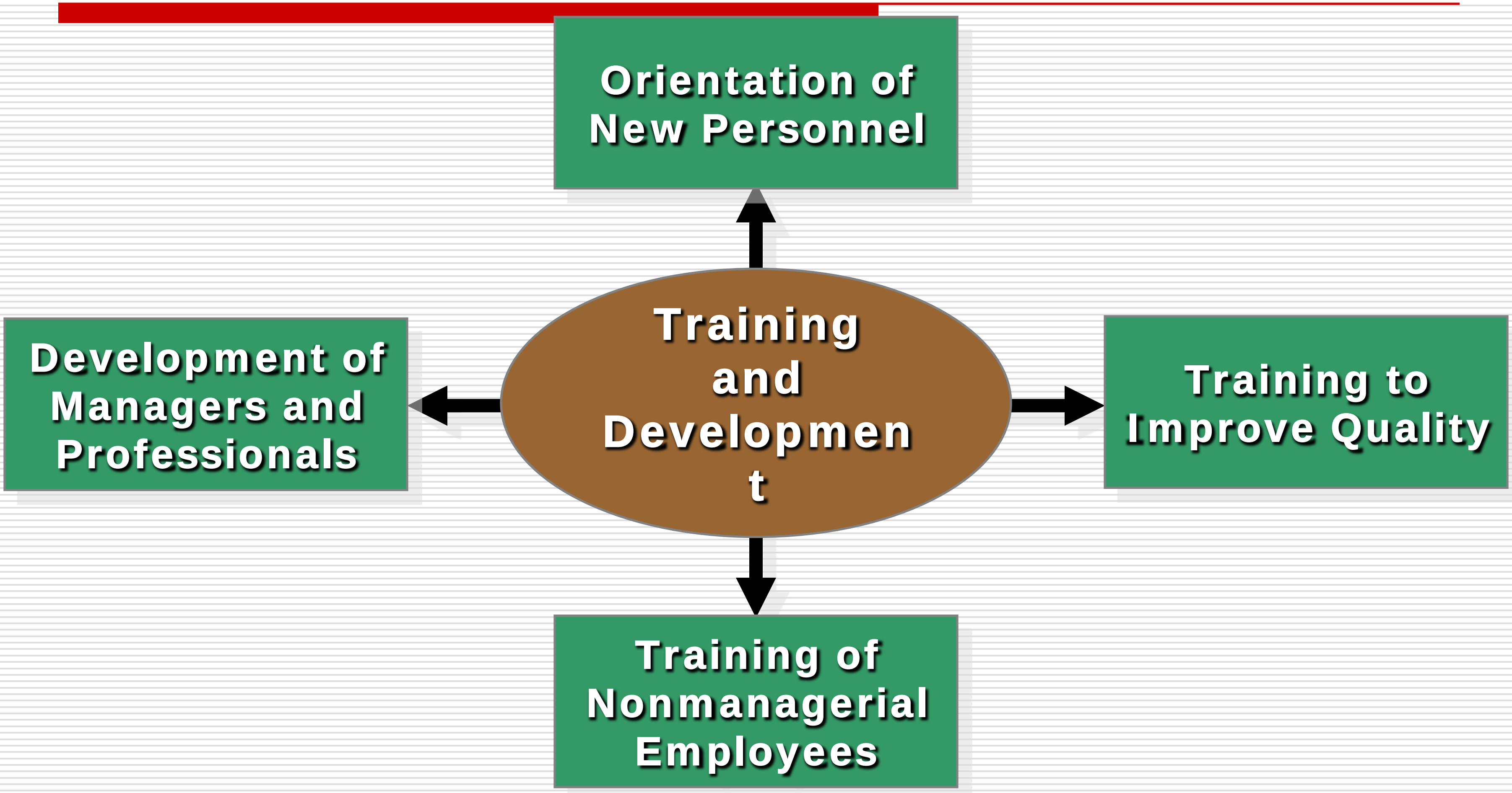
- Job Description
  - A written summary of the essential duties required by a specific job
    - Aids in personnel recruitment
    - Helps focus employees on their work
    - Provides direction in training
    - Serves as the basis for performance review
- Job Specification
  - A list of the skills and abilities needed by the job holder to successfully perform a specific job
    - Aids in selecting the most qualified job applicant

Evaluating Prospects and Selecting Employees (important)

Steps in Recruiting Employees

Step	Issue
Application Forms	Legal questions and applicant privacy
Applicant Interview	Interviewer skills and potential biases
Reference Checking	Difficulties in obtaining useful information
Applicant Testing	Validity and reliability of testing procedures
Physical Examination	ADA requires reasonable adaptations for disabled

Types of Training and Development (important)



Training and Developing Employees

- Purposes of Training and Development
  - Prepare new recruit to perform the duties of the job
  - Improve the performance of current employees
  - Prepare employees for career advancement
  - Improve morale of current employees
  - Serve as an inducement to potential applicants

Training and Developing Employees (cont'd.)

- Development of Managerial and Professional Employees
  - Determining the need for training
  - Creating a plan for training
  - Setting a timetable for training
  - Providing employee counseling

Training and Developing Employees (cont'd.)

- Development of Managerial and Professional Employees
  - Determining the need for training
  - Creating a plan for training
  - Setting a timetable for training
  - Providing employee counseling

Compensation and Incentives for Employees (important)

- Wage or Salary Levels
  - Competitive compensation
  - Time- or output-based compensation
- Financial Incentives
  - Stock options
  - Commission systems
  - Piecework
  - Group incentives and team awards
  - General bonus and profit-sharing plans
- Performance-Based Compensation Plans
  - Keys to developing an effective bonus plan:
    - Set attainable goals.
    - Include employees in planning.
    - Keep updating goals
- Fringe Benefits
  - Supplements to compensation designed to be attractive and beneficial to employees
    - Benefits are a substantial portion of payroll costs.
    - Small firms tend to provide fewer benefits.
    - Small firms are increasingly outsourcing the administration of their benefits programs.
- Employee Stock Ownership Plans (ESOPs)
  - Plans through which a firm is sold either in part or in total to its employees
    - Employees' performance is motivated by their sharing of ownership in the firm.
    - Owners can cash out and withdraw without selling to outsiders.
    - ESOPs offer tax advantages to owners and employees.

Managing Operations

Chapter 20 in 14th page 524, chapter 21 in 15th page 547 and page 610 in 16th

Topic 3

Study Unit 13

Quality Goals of Operations Management

- Quality as a Competitive Tool
  - Quality is a must in international competition
- Quality
  - The features of a product or service that enable it to satisfy customers’ needs
  - A perception of the customer as to the suitability of the product or service of a firm
- Total Quality Management (TQM)
  - An aggressive, all-encompassing management approach to providing high-quality products and services

Customer Focus of Quality Management

- Customer Expectations
  – Quality is the extent to which a product or service satisfies customer's needs and expectations.
    - Product quality
    - Service quality
    - Product and service quality combinations
  – "The customer is the focal point of quality efforts."
- Customer Feedback
  – Customers are the eyes and ears of the business for quality matters.

Organisational Culture and TQM

- Organisational Culture
  - The behavior, beliefs, and values that characterize a particular firm
- Continuous Quality Improvement
  - A constant and dedicated effort to improve quality
  - The ultimate goal is zero defects—a goal popularized by many quality improvement programs
- Benchmarking
  - The process of studying the products, services, and practices of other firms and using the insights gained to improve quality internally

Tools and Techniques of TQM

- Employee Participation
  - Employee performance is a critical quality variable
  - The implementation of work teams and empowerment of employees to build workplace involvement
  - Quality circle
    - A group of employees who meet regularly to discuss quality-related problems

- The Inspection Process
  - The examination of a product to determine whether it meets quality standards
  - Inspection standard
    - A specification of a desired quality level and allowable tolerances
  - Attribute inspection
    - The determination of product acceptability based on whether it will or will not work
  - Variable inspection
    - The determination of product acceptability based on a variable such as weight or length

Statistical Methods of Quality Control

- Acceptance Sampling
  - The use of a random, representative portion to determine the acceptability of an entire lot
- Statistical Process Control
  - The use of statistical methods to assess quality during the operations process
- Control Chart
  - A graphic illustration of the limits used in statistical process control

International Certification for Quality Management

- ISO 9000
  - The standards governing international certification of a firm's quality management procedures
    - Documentation of the firm's operations in compliance with its quality management procedures
  - A requirement before becoming a supplier to larger U.S. and overseas firms

Quality Management in Service Businesses

- Opportunities for Small Service Companies
  - Providing an excellent combination of tangible products and intangible services
  - Providing personalized, high contact services
  - Providing service quality without regard to the profitability of the customer
  - Developing good measures to control service quality

Competitive Strength Through Improved Productivity (cont'd.)

- Reengineering for Improved Productivity
  - Reengineering
    - Fundamental restructuring to improve the operations process
    - Involves asking why a function is done the way it is done
    - Requires rethinking and radically redesigning basic processes that create value for the customer
- Upgrading Information Systems
  - Management information systems
    - Paper-based processes for tracking orders, work in progress, and inventory have been replaced by computerized data management systems

Competitive Strength Through Improved Productivity (cont’d.)

- Operations Analysis
  - Analyses of work flow, equipment, tooling, layout, working conditions, and individual jobs
    - Laws of motion economy: guidelines for arranging work in the most cost-effective and efficient manner possible
- Methods of Work Measurement
  - Motion Study
    - Analysis of all the motions a worker makes to complete a job
  - Time Study
    - Determination of the average time it takes to complete a task

Purchasing Policies and Practices (important)

- The importance of purchasing
- Purchasing practices and cost management
- Relationship with suppliers

Inventory Management and Operations (cont'd.) (important)

- Inventory Cost Control
  - Economic order quantity (EOQ)
    - The quantity to purchase in order to minimize total inventory costs

Total inventory costs	**=**	**Total carrying costs**	**+**	**Total ordering costs**

Inventory Management and Operations (cont'd.)

- ABC Inventory Analysis
  - A system of classifying items in inventory by relative value
  - **Category A** (close/continuous control)
    - High-value or critical production component items
  - **Category B** (moderate control)
    - Less costly, secondary importance items
  - **Category C** (periodic control)
    - Low-cost and noncritical items

Inventory Management and Operations (cont'd.)

- Just-In-Time Inventory (JIT) System, also Kanban
  - A method of reducing inventory level to an absolute minimum
    - New items arrive at the same time that the last inventory item is placed in service
  - JIT promotes:
    - Closer coordination with suppliers
    - Consistent quality production
    - Lower safety stock levels

Inventory Management and Operations (cont'd.)

- Inventory Record-Keeping Systems
  - Physical inventory system
    - A method that provides for periodic counting of items in inventory
  - Cycle counting
    - A system of counting different segments of the physical inventory at different times during the year
  - Perpetual inventory
    - A method for keeping a running record of inventory
    - Does not require a physical count except to

Managing Risk

Chapter 21in 14th page 550 and chapter 23 in 15th page 601 and page 670 in 16th

Topic 4

Study Unit 14

What is Risk?

- Risk
  – A condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for
- Market Risk
  – The uncertainty of a gain or a loss associated with an investment decision
- Pure Risk
  – The uncertainty associated with a situation where only loss or no loss can occur—there is no potential for gain (only downside)

Risk Management (important)

- Risk Management
  - Ways of coping with risk that are designed to preserve assets and the earning power of a firm
- The Process of Risk Management

Step1: Identify risks.

Step 2: Evaluate risks.

Step 3: Select methods to manage risk.

Step 4: Implement the decision.

Step 5: Evaluate and review.

Methods to Manage Risks

- Risk Control
  - Minimizing potential losses by preventing, avoiding, or reducing risk
- Loss Prevention
  - Stopping loss from happening
- Loss Avoidance
  - Avoiding loss by choosing not to engage in hazardous activities
- Loss Reduction
  - Lessening the frequency, severity, or unpredictability of losses
- Risk Financing
  - Making funds available to cover losses that cannot be managed by risk control
- Risk Transfer
  - Buying insurance or making contractual agreements with others to transfer risk
- Risk Retention
  - Choosing—whether consciously or unconsciously, voluntarily or involuntarily—to manage risk internally
- Self-Insurance
  - Designating part of a firm's earnings as a cushion against possible future losses

Tools For Managing Risk

	High Frequency	Low Frequency
High Severity	• Loss prevention • Loss avoidance • Loss reduction	• Self-insurance • Contractual agreements
Low Severity	• Loss reduction • Risk retention	• Risk retention

Note: To find a listing of the risk management tools appropriate for dealing with a potential loss, see the box corresponding to the severity and frequency of the potential loss.

Exhibit 21.1

Risk Management and the Small Firm

- Risk Management Differences from Large Firms:
  - It is more difficult for small firms to get insurance coverage.
  - Large firms can assign responsibilities for risk management to a specialized staff manager.
  - Risk management is not something that requires immediate attention.

Property Risks

- Real Property
  - Land and anything physically attached to the land, such as buildings
- Personal Property
  - Machinery, equipment, furniture, fixtures, stock, and vehicles
- Replacement Value of Property
  - The cost to replace or replicate property at today's prices
- Actual Cash Value (ACV)
  - An insurance term that refers to the depreciated value of a property
- Direct Loss
  - A loss in which physical damage to property reduces its value to the property owner
- Indirect Loss
  - A loss arising from inability to carry on normal operations due to a direct loss of property

Liability Risks: Statutory Liability

- Workers' Compensation Legislation
  - Laws that obligate the employer to pay employees for injury or illness related to employment, regardless of fault
- Contractual Liability
  - Performance or financial obligations (risks) that firms assume when entering into contracts with other parties
- Torts
  - Wrongful acts or omissions for which an injured person can take legal action against the wrongdoer for monetary damages
- Establishing Negligence
  - A legal duty to act (or not to act) to cause injury (damage)
  - A failure to provide the appropriate standard of care
  - The presence of actual injury or damages
  - Action was the proximate cause of injury or damages

- Reasonable (Prudent Person) Standard
  - The typical standard of care based on what a reasonable or prudent person would have done under similar circumstances
- Compensatory Damages
  - Economic or noneconomic damages intended to make the claimant whole, by indemnifying the claimant for any injuries or damage arising from the negligent action

Types of damages

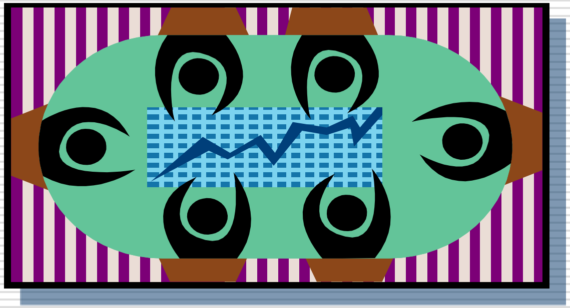
- Economic Damages
  - Compensatory damages that relate to economic loss such as medical expense, loss of income, or the cost of property replacement/restoration
- Noneconomic Damages
  - Compensatory damages for such losses as pain and suffering, mental anguish, and loss of consortium
- Punitive Damages
  - A form of punishment that goes beyond compensatory damages, intending to punish wrongdoers for gross negligence or a callous disregard for the interests of others and to have a deterrent effect

Sources of Tort Liability

Premises Liability

Professional Liability

Employee Liability



Vehicular Liability

Product Liability

Directors and Officers Liability

Business Personnel

- Personnel Risks
  - Risks that directly affect individual employees, but may have an indirect impact on a business as well

Premature Death

Poor Health

Insufficient Retirement Income

Insurance for Small Business (important)

- Basic Principles of a Sound Insurance Program
  - Identifying insurable business risks
    - Workers' compensation and automobile liability insurance are required by law.
  - Limiting coverage to major potential losses
    - Avoid overspending insurance resources.
  - Relating premiums to probability of loss
    - Insure most improbable but critical losses first.

Requirements for Obtaining Insurance (important)

- The risk must be calculable so that premiums can be calculated.
- The risk must exist in large enough numbers to allow the law of averages to work.
- The insured property must have commercial value.
- The policyholder must have an insurable interest in the property or person insured.

Common Types of Insurance

- Business Owner's Policy (BOP)
  - A business version of a homeowner's policy, designed to meet the property and liability insurance needs of small business owners
- BOP Coverage Approaches
  - Named-peril approach
    - An approach that identifies the specific perils covered
  - All-risk approach
    - An approach that defines the perils covered by stating that all direct damages to property are covered except those caused by perils specifically excluded

Insurance: Valuation

- Valuation
  - Both real and personal property are valued on a replacement-cost basis such that all property damage and loss will be reimbursed at the rate required to rebuild or replace the property
- Insurance to Value Provision
  - Requires the insured to carry a minimum policy limit relative to the actual value of the property
  - Not contained in most BOPs
  - Coinsurance provision
    - Requires that property be insured for at least 80 percent of its value or a penalty will be applied to any covered loss

Additional BOP Coverage

- Business Interruption Insurance
  - Reimburses a business for the loss of anticipated income plus continuing expenses that cannot be met because of the negative impact of a direct loss on business revenues
- Commercial General Liability (CGL) coverage
  - Covers bodily injury and property damage for which the business is liable
- Medical Payments Coverage
  - Covers injuries of customers and the general public, with no fault required on the part of the insured

Life and Disability Insurance

- Key-Person Insurance
  - Coverage that provides benefits upon the death of a firm's key personnel
- Disability Insurance
  - Coverage that provides benefits upon the disability of a firm's partner or other key employee

I thank you.