6-1 Planning for Business Growth

OBJECTIVES

- ***Examine business growth.***
- ***Learn when to grow a business.***
- ***Explore product life cycles.***

PLANNING FOR BUSINESS GROWTH

To grow a business means to make changes that result in greater sales. A business grows, or expands, in two ways: internally and externally. Organic growth is growth achieved by expanding a business internally-for example, adding new products or services for sale. External growth is achieved by buying other businesses or merging with them. Most small businesses experience organic growth rather than acquiring other companies.

When a business thrives, the owner must eventually decide whether to maintain the original strategy or take a bold step to grow the business. Because entrepreneurs are ambitious by nature, the question is often not whether to grow, but when and how to grow. Growth, like any business move, must be carefully thought out. A smart entrepreneur develops a carefully researched business plan before launching a business. Business growth also requires a great deal of planning. The original business plan should be updated or an entirely new one developed. In either case, the plan should outline steps for implementing the growth strategy and look at the possible consequences on the business.

DECIDING WHEN TO GROW

There are three primary factors that will affect the decision to grow a business: condition of the business, economic climate, and the life goals of the business owner.

Condition of the Business

A business is ready to grow when it has a solid base of customers and makes sales that meet or exceed forecasts and contribute to a satisfactory net profit. The business has become good at what it does. It makes a consistent profit and achieves quality standards and customer-satisfaction targets. The owner does not struggle to keep up with the day-to-day demands of the business but has enough time to devote to growth. Some of the signs you should look for include the following:

- Your business is recognized by your community and industry.
- Your sales are rising.
- You have a customer base that regularly buys from you.
- You are hiring more employees and now have managers.
- You need more space.

Economic Climate

The economic climate in which the business operates is also important. Owners planning for growth must consider economic conditions at the local, national, and perhaps even global levels. Economies tend to follow cycles of upturns and downturns. A downturn is not necessarily a bad time to expand a business. It depends on the business and its markets. You should ask the following questions:

- How is the national economy doing? Are people worried about spending money, or are they spending freely?
- What are the economic conditions in your industry or region?
- Have the demographics of your market changed?
- Is demand for your product or service expected to remain strong?
- Does your business face new competition?

Life Goals of the Business Owner

Growing a business is not only an economic move, it's a personal one as well. An owner who decides to grow a business takes on new pressures and demands. Growth will require more time and money and introduce new risks. Owners who want to grow their businesses should schedule growth with their life goals in mind.

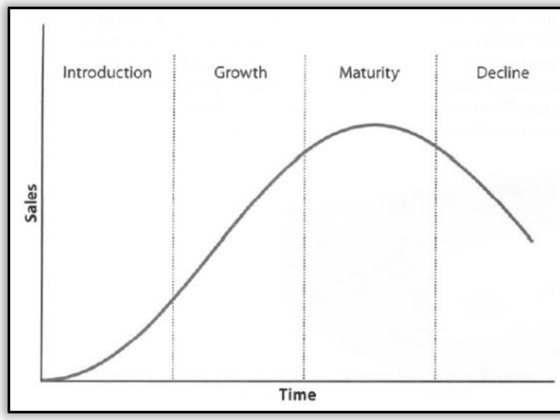
CONTROL YOUR GROWTH

Growing rapidly may sound like a great thing for a business, but uncontrolled growth may be just as bad as no growth at all. Businesses that grow too quickly often find that they don't have the resources to support their growth. They can lack money, employees, supplies, and more. As a result, they often overextend themselves. Sometimes they are even forced to go out of business. To make sure that your business expands successfully, you will have to control its growth. This means you will need to come up with a plan for expansion that includes strategies for the following:

- Attaining measurable objectives and goals (reaching sales goals, increasing customer base, opening another store)
- Hiring managers and supervisors
- Financing expansion
- Obtaining resources for expansion (capital, equipment, inventory, materials, and supplies)

PRODUCT LIFE CYCLE

A product life cycle is a series of stages-introduction, growth, maturity, and decline-that a product may pass through while it is on the market. This concept can be applied to a product type or industry (for example, automobiles), to a specific brand (for example, Ford), and to a particular product (like the Ford Explorer).



Each stage in a product life cycle has specific cost and profit considerations. A conventional product life-cycle curve is shown to the right.

Introduction
When a product is introduced, the marketing effort is devoted to building product awareness-that is, making consumers aware of the product. This is typically an expensive phase with high advertising and promotional expenses. Profits may be low at first.

Growth
Sales and profit increase steadily as the product is embraced by consumers. Competitors may be few at this stage, allowing the business to expand distribution and take advantage of strong demand.

Maturity
This is the stage during which sales and profits stop growing. They level off and may begin to decline. By now, the product probably faces stiff competition. The business may have to lower prices or enhance the product in some way to give it a new competitive advantage and extend its life.

Decline
During the decline stage, product sales and profits fall steeply and don't recover. The product loses its appeal to consumers. In some cases, the decline is due to technological advances or governmental regulations. For example, the VCR has given way to the digital video recorder.

Product life-cycle curves have many variations. Some products are immensely and immediately popular. Their sales rocket upward but then decline quickly. This cycle is common in the fashion and entertainment industries. Other products endure for long periods. A perpetual life cycle is a product life cycle in which a product never undergoes a final decline, because it remains in the maturity stage forever. Basic food products, such as bread and other items of everyday use, are said to have a perpetual life cycle. However, individual brands and products within the bread industry can certainly decline.

PRODUCT LIFE CYCLE IN GROWTH PLANNING

The product life cycle is a useful concept for planning growth strategy. One way for a business to grow is to provide a product (or service) that it has not offered before. This product will be new to the business but may not be new to the market. It could be similar to other products already being offered. If you want to add a new product to your company's offerings, you must understand the product group's stage in the product life cycle. This knowledge will help you determine the level of competition you will face and the costs and marketing strategies that will be required to make the new offering successful.

The product may be completely new and different, with no competition. This is an introductory stage offering. The product may be similar to others that are in a growth phase. In this case, the new offering probably needs to be innovative to set itself apart from competitors. A business may decide to introduce a copycat product when the overall life cycle for that product group is in the maturity stage. At this point, price or product enhancements may be the competitive advantage. Introducing a product that is part of an existing product group in the decline stage typically wouldn't be a wise business move. However, the decline stage is an excellent time to introduce a replacement product for the one that is in decline.

Businesses also have to consider the costs and risks of introducing a new product that competes against their existing products. For example, a business with an existing product in the maturity stage may find it difficult and expensive to lure customers away from that product to a new, but similar, offering.

NEW PRODUCT DEVELOPMENT

In order to stay competitive in the market, a business must develop new products or services to offer to customers. The business wants to find out early in the development process whether the product is likely to be successful before investing too much money in it. It is also important for the business to determine that the product meets an important market need, can be produced efficiently and at a reasonable cost, and will be competitive with other products in the market.

Soft drink companies introduced more new products during 2000-2002 than were introduced during the entire decade of the 1990s. However, during the economic slowdown that began in 2008, the introduction of new products slowed. As the economy recovers, soft drink manufacturers will begin to look at new markets for existing products.

Product development involves the following steps:

1. idea development
2. idea screening
3. strategy development
4. financial analysis
5. product development and testing
6. product marketing.

SOFT DRINKS INTRODUCED SINCE 2000

Drink	Company
Introduced in 2009	
Pepsi Throwback	PepsiCo
Mountain Dew Throwback	PepsiCo
Introduced in 2007	
Diet Pepsi Max	PepsiCo
Introduced in 2006	
Coca-Cola BlaK	Coca-Cola
Introduced in 2005	
Coca-Cola Zero	Coca-Cola
Coca-Cola with Lime	Coca-Cola
Mountain Dew MDX	PepsiCo
Pepsi Lime	PepsiCo
Introduced in 2004	
Diet Coke with Lime	Coca-Cola
Coca-Cola C2	Coca-Cola
Introduced in 2003	
Mountain Dew Livewire	PepsiCo
Introduced in 2002	
Vanilla Coke	Coca-Cola
Diet Vanilla Coke	Coca-Cola
Dr Pepper Red Fusion	Dr Pepper/Seven UP
dnL	Dr Pepper/Seven UP
Pepsi Blue	PepsiCo
Diet Mountain Dew Code Red	PepsiCo
Sobe Mr. Green	PepsiCo
Introduced in 2001	
Diet Coke with Lemon	Coca-Cola
Fanta (reintroduced in U.S.)	Coca-Cola
Diet Sierra Mist	PepsiCo
Mountain Dew Code Red	PepsiCo
Mountain Dew AMP	PepsiCo
Introduced in 2000	
Pepsi Twist	PepsiCo
Diet Pepsi Twist	PepsiCo
Sierra Mist	PepsiCo
Red Flash	Coca-Cola

Idea Development

The first, and often the most difficult, step in product development is finding ideas for new products. Employees or customers can generate ideas. Many times salespeople will hear wishes and complaints from customers about what they would like to see and not see in products. If the salesperson shares this information with the development department, it can lead to ideas for new products.

Idea Screening

Once ideas have been developed, they are screened to select the ones that have the greatest chance of being successful. Questions to be answered during the screening process include the following:

- Has a market been identified for the product?
- Is the competition in the market reasonable?
- Are resources available to produce the product?
- Is the product legal and safe?
- Can a quality product be produced at a reasonable cost?

Strategy Development

Once an idea has been determined to be reasonable, the business will create and test a sample marketing strategy. The business performs research to identify the appropriate target market and to be sure that there are customers with adequate income who are looking to satisfy a need that the product meets. Questions asked during this stage include the following:

- What is the likely demand for the product?
- How would the introduction of the product affect existing products? Would the new product take away market share from existing products the company produces?
- Would current customers benefit from the product?
- Would the product enhance the image of the company's overall product mix?

Financial Analysis

If a new product idea is determined to meet a market need and can be developed, the company will perform a financial analysis. Spreadsheet programs are often used in this step. Costs of production and marketing, sales projections for the target market, and resulting profits are calculated. Questions to be answered at this stage include the following:

- What impact could the new product have on total sales, profits, market share, and return on investment?
- Would the new product affect current employees in any way? For example, would it require people with different skills, the hiring of more people, or a reduction in the size of the workforce?
- What new facilities, if any, would be needed?
- How might competitors respond?
- What is the risk of failure? Is the company willing to take the risk?

Product Development and Testing. When a manufacturer sees a market opportunity and decides to develop a new product, it makes a prototype which is a full-scale model of a new product. After testing the prototype in the laboratory and making final adjustments, the company designs the production process, obtains needed equipment and materials, and trains production personnel. The product is then test marketed in selected areas. If it receives a positive response, the manufacturer places the product into full production. If not, the manufacturer drops it.

Product Marketing. Introduction of the product into the target market is the last step in the product development cycle and the first step of the product's life cycle. Before this takes place, many other things must be done. The marketing mix elements must be planned, and there must be an adequate supply of the product on hand to meet the target market's needs.

Once the product has been introduced into the market, the company will have to monitor its life cycle. Many new products fail even though the product development steps have been followed carefully. Products may not match the needs of customers, or customers may not see what differentiates the product from other products on the market. The product may be priced too high or too low, poorly distributed, or improperly promoted .

6-2 Growth Strategies

OBJECTIVES

- ***Investigate business growth strategies.***
- ***Explain the importance of planning for growth.***

GROWTH STRATEGIES

Businesses can follow many growth strategies when they wish to expand. These strategies typically focus on new products and/or new markets. (In this discussion, services are referred to as the products of a service business.) Three broad categories of growth strategies are:

- Intensive growth strategies
- Integrative growth strategies
- Diversification growth strategies

INTENSIVE GROWTH STRATEGIES

An intensive growth strategy is a growth strategy that focuses on cultivating new products or new markets, and sometimes both. Businesses use an intensive growth strategy when they believe they haven't fully realized their strengths or their markets. This strategy is best described as "doing more of what you are good at doing." The three most common types of intensive growth strategies are:

- Market penetration
- Market development
- Product development

Market Penetration

Market penetration is an intensive growth strategy that emphasizes more intensive marketing of existing products. This strategy has two goals: sell more to existing customers and sell to new customers in existing markets. Both goals require extensive, and expensive, marketing (advertising, promotions, and so on). However, market penetration is a way for a business to increase its profits by taking advantage of its existing skills, experience, and knowledge about its target markets. It is a popular growth strategy for small businesses.

Existing customers may be convinced to buy more of a product if the business advertises new uses for that product. The makers of dry soup mixes could, for example, publish recipes for party dips made from their products. Businesses can also try to convince existing customers to buy a product more often. Toothbrush manufacturers advertise that dentists recommend replacing a toothbrush every three months. Existing customers may also buy more and buy more often if they are offered incentives, such as frequent-buyer programs.

Market penetration can also involve pursuing new customers in current target markets. Basically, the business uses marketing tactics to try to gain customers from its competitors. This increases a business's market share. Market share is the percentage of the total sales captured by a product or a business in a particular market. In other words:

$$(\text{Sales by Business} \div \text{Total Sales in Market}) \times 100 = \text{Market Share}$$

If a company sells $1,000 worth of tennis rackets in a town where total sales of tennis rackets are $5,000, the company has a one-fifth, or 20%, market share: ($1,000 ÷ $5,000) x 100 = 20%. Once a business has the largest market share it believes it can capture, the next step is usually to find new markets.

Market Development

Market development is an intensive growth strategy that focuses on reaching new target markets, such as customers in another geographic area or customers who have different demographics from current customers. A retail store might open a branch in a new city or develop a Website to sell its products online.

Product Development

Product development is an intensive growth strategy in which businesses develop new products or enhance their existing products. Enhancements may include bonus features or new packaging for products. For example, they could add small toys as extras to cereal boxes. Product development is typically costly for a business but can be a successful means of growth if the new or enhanced offering is popular with customers.

INTEGRATIVE GROWTH STRATEGIES

An integrative growth strategy is a growth strategy that emphasizes blending businesses together through acquisitions and mergers Integrative growth strategies are typically more expensive than intensive growth strategies and are usually practiced by mature businesses with large cash flows. There are two types of integrative growth strategies:

Vertical Integration

An integrative growth strategy in which one business acquires another business in its own supply chain, but not at the same supply chain level) is a vertical integration strategy. An example of this type of growth strategy is when a retail store buys a wholesaler. Another example is when a manufacturing business buys a retail store in which its products are sold.

Horizontal Integration

An integrative growth strategy in which one business acquires another business at the same supply chain level as itself is a horizontal integration strategy. When one manufacturing company buys another manufacturing company, that's a horizontal integration strategy. The acquired business may be a competitor or a business in a completely different industry.

DIVERSIFICATION GROWTH STRATEGIES

Every business has a core business, which is the most important focus of the business. For example, the core business of McDonald's is selling fast food. A diversification growth strategy is a growth strategy in which a business grows by offering products or services that are different from its core business. There are two types of diversification growth strategies:

Synergistic Diversification

A growth strategy in which a business adds new products or services that are related to its existing products or services is a synergistic diversification. A clothing store that begins selling shoes practices this type of growth. So does an event-planning business that begins to offer catering services.

Horizontal Diversification

A growth strategy in which a business adds new products or services that are not related to its existing products or services but appeal to its existing target market is called horizontal diversification. Recently some large grocery stores have begun offering credit cards to their customers. This is an example of horizontal diversification. Another example would be a gas station that sells food.

6-3 Challenges of Growth

OBJECTIVES
- ***Examine how personal feelings affect business growth.***
- ***Study the practical challenges of growing a business.***
- ***Investigate the chances for business growth.***

CHALLENGES OF GROWTH

Entrepreneurs excel at identifying business opportunities and finding resources to transform innovative ideas into reality. An entrepreneurial mindset is the mental attitude common to entrepreneurs. It typically includes an optimistic, can-do outlook and the personal ambition necessary to create a business. This is ideal for starting a business but may not be as useful when it comes to growing the business.

PERSONAL FEELINGS ABOUT BUSINESS GROWTH

Business growth often requires the owner to give up some personal control over the business. This may be difficult for someone who has been the driving force and creative center of the business and largely responsible for its success. A micromanager is an individual who interferes too much in the decisions and tasks of associates or employees. He or she constantly scrutinizes and criticizes everything they do, or automatically dismisses their ideas and opinions as inferior. A micromanager does not trust others to get things done or do them right. A business owner prone to micromanagement, or reluctant to delegate responsibilities, may become overwhelmed by the added demands of business growth. Entrepreneurs must truthfully examine their personal feelings about giving up some control for the chance to grow the business.

Also, business growth increases risk. The growth effort may fail; it may even put the overall business in jeopardy. Entrepreneurs who are considering growth should carefully examine the risks involved and weigh them against their personal capacity for taking on that risk.

Obviously there are personal challenges and potential negative consequences associated with business growth. However, growth that is successful can be rewarding to a business owner. It will probably bring greater personal income and financial stability and a sense of accomplishment. Business owners must ultimately make the decision about whether to grow or not, based on their life goals.

PRACTICAL CHALLENGES OF GROWING A BUSINESS

Growing a business involves six practical challenges. Each should be addressed in the revised business plan you will develop.

Space. A growing business usually requires more physical space. If the existing building or rooms are not large enough to handle the expansion, you will have to find additional space.

Business Structure. You may need to change the organizational structure of your business-for example, from a sole proprietorship to a limited liability company or corporation.

Materials and Equipment. Growth may require you to purchase more materials, equipment, and office furniture and supplies. A manufacturing business that wants to grow must be sure the supply chain will be able to accommodate the new demands.

Information Technology (IT). This is the use of computer systems, hardware, and software to store and manage information. IT demands for accounting, purchasing, inventory, payroll and other operations will increase as the business grows and expands its recordkeeping.

People and Skills. A growing business almost always needs more employees, especially at the management level. Existing staff may have to be trained in new skills that will be necessary to make the growth effort successful.

Money. Business growth requires financing. This money may come from the company itself or from outside sources. Self-financing means obtaining the funds for growth from existing operations, for example, by reinvesting cash reserves (profits). External sources of money include debt capital, which is money obtained by a business through a loan, and equity capital, which is money obtained by a business from an investor in exchange for a share of ownership (equity) in the business. Whatever the source, you must carefully consider the financial risks and obligations as part of your strategy for growth.

SWOT ANALSIS FOR GROWTH

The success of business growth will be more certain if you follow a strategic plan. It is also important to know as much as possible about your business: what works well, what could be improved, what drives profitability, and so forth. An effective tool for accomplishing this task is a SWOT analysis.

The SWOT analysis that we discussed a few weeks ago was used for evaluating the prospects of starting a business. A SWOT analysis assesses strengths, weaknesses, opportunities, and threats for a start-up company. However, a SWOT analysis is also useful for established businesses when analyzing growth opportunities. An established business that keeps good records should be well aware of its strengths and weaknesses. Customer surveys can also provide valuable feedback. The threat component of the SWOT analysis is, in large part, the competition. Business owners need to learn as much as possible about the strengths and weaknesses of potential competitors and the market share their actual competitors have. It's also important to be aware of any new or potential regulations that may impact growth.

When you know your business's capabilities, limitations, and threats, you can better select an appropriate growth opportunity. Many small businesses choose to grow by opening a new location that offers the same products or services as their original location. But the factors that made one location successful may not work in another location. A business owner with multiple locations must also be careful that the original customers are not ignored during the growth process. Another possible choice is to expand the product offerings in the existing location. No matter what strategy a business owner selects, a completely new business plan should be prepared to assess all aspects of the situation.

6-4 Global Trends and Opportunities

OBJECTIVES

- ***Discuss the reasons and methods for participating in the global economy.***
- ***Determine whether international business is right for you.***

EXPORTS AND IMPORTS

The global marketplace has dramatically changed the way businesses operate. It has made business more competitive, and it has opened new opportunities for companies, including small entrepreneurial businesses. As the global marketplace continues to expand, entrepreneurs can take advantage of even more opportunities. International trade is one way you can become part of the global marketplace. This means you would export or import the products or services you sell or use in your business.

EXPORTING

Products and services that are produced in one country and sent to another country to be sold are exports. The United States exports agricultural products, automobiles, machinery, computers, and more. These products are shipped to countries all over the world.

Direct Exporting. You can find buyers or distributors in foreign markets and ship your products to them. This is called direct exporting. For direct exporting, you may need to hire salespeople who live in or travel to the foreign countries. Tiffany Wilson owns a mid-sized printing company. Last year, Tiffany decided to expand her business internationally. She hired a Dutch sales representative, Mieta Van Praag, to market her business in Europe. Mieta calls on customers in the Netherlands and France.

Indirect Exporting. It can be difficult to make contacts with buyers in other countries. Some businesses use commissioned agents who act as brokers to find foreign buyers for products and services. Exporting through commissioned agents is indirect exporting.

Selling Worldwide Through The Web. Another way to get involved in exporting is through the Internet. Businesses translate and modify their websites to appeal to foreign customers. They fill individual orders and ship them directly to the foreign customer's address. Shahid Mahmoud's business manufactures puzzles. He recently began promoting his products abroad over the Internet because research showed that Japanese buyers like puzzles. To target that market, he created an e-commerce website written in Japanese.

IMPORTING

Products and services that are brought from another country to be sold are imports. The United States imports many products, such as automobiles from Europe, Japan, and Korea and oil from the Middle East. Entrepreneurs may decide to import products to sell or to use in the production of their product. Price and quality are usually factors in their decision to import. Consumers like low prices and demand high quality. James Sutton owns a business that makes African-style clothing.
He imports all of his fabrics from West Africa because of their unique colors, designs, and textures. James's customers appreciate his attention to detail in creating authentic African clothing.

IS INTERNATIONAL BUSINESS RIGHT FOR YOU?

Not every business can succeed internationally. You need to consider the pros and cons of competing globally. Then you must determine whether there is a market for your business in other countries and write an international business plan.

REASONS FOR COMPETING GLOBALLY

There are many risks associated with competing in the global marketplace. There are also many benefits that international business can provide, including increased profits. There are at least three good reasons to expand into other countries:

1. Increased sales You will attract new buyers and broaden your customer base. You may also import unique products that local customers can buy.
2. Reduced costs Manufacturers in other countries can produce goods less expensively because of low labor costs or availability of raw materials. This can mean a savings for you in the form of a lower price.
3. Decreased dependence on current markets and suppliers If economic conditions in the United States suddenly worsen, foreign markets and suppliers might help keep your profits high. Selling products and services abroad can also help you stabilize seasonal market fluctuations.

ANALYZE THE MARKET

Analyzing whether there is an international market for your product will be very similar to how you analyzed your current target market and target customers. You will need to consider political, economic, social, and cultural issues. Additional taxes and regulations are also things to research and consider. There are many online resources are available that can help you learn about doing business abroad.

Mark Milowski owns a business that processes payroll records. He recently met with several Hong Kong business owners who wanted Mark's company to handle their payrolls. Mark liked the idea of expanding globally, but he had many questions. He contacted the U.S. Department of Commerce to get information on doing business in Hong Kong. In addition, he referenced Dun & Bradstreet's “Exporters Encyclopedia” to learn about the regulations he would face.

WRITE AN INTERNATIONAL BUSINESS PLAN

An international business plan is an extension of your business plan. It sets forth your goals for international expansion and defines the strategies for achieving those goals. Your plan should indicate the following:

- Why you want to expand your business into the global marketplace
- Which foreign markets you plan to enter and why
- What revenues your venture is expected to earn
- How you plan to finance your global expansion
- What costs (travel, shipping, marketing) you expect to have
- How you plan to market and sell your products or services abroad
- How you plan to deliver your products or services to foreign markets
- What legal requirements you will need to meet to sell your products or services abroad

6-5 Franchising and Licensing

OBJECTIVES

- ***Investigate franchising a business***
- ***Examine the advantages and disadvantages of being a franchisor.***
- ***Explore brand licensing.***

FRANCHISING A BUSINESS

A franchise is a business arrangement in which an established company sells others the right to use the company's name and operating plan to sell the products or services in other locations. The franchisor is the owner of the established company. A franchisee is an individual who uses the company's name and operation to run the same business in another location. The franchisee pays the franchisor for this privilege. These payments typically include a Franchise Fee, a Franchise Royalty, and a Franchise Advertising Fee.

ADVANTAGES AND DISADVANTAGES FOR FRANCHISORS

A business can expand geographically in two ways: either by opening multiple company-owned units or by franchising the business. Franchising represents a great opportunity for business owners who want to
expand their business but lack the money, time, or personnel to open numerous company-owned units.

Advantages for Franchisors. Franchising provides five major advantages to a franchisor:

- Increased Revenue. The franchisor earns a substantial upfront fee and regular royalty payments from each franchise.
- New Locations without Financial Responsibility. The franchisee, not the franchisor, takes on the financial responsibilities for loans, leases, and other expenses needed to get a franchise unit up and running.
- Franchisee Investment. Because franchisees invest their own money, they are highly motivated to make their franchise units profitable. This may not be the case for company-hired managers who run company units. Also, company-hired managers may quit at any time. A franchise agreement requires a franchisee to commit to a specific number of years.
- No Liability. A franchisor is not directly liable (legally and financially responsible) for the acts of the franchisee's employees, or accidents that take place on franchisee premises.
- Builds Brand Awareness. Franchising builds brand awareness for the franchisor's products or services.

Disadvantages for Franchisors. Franchising has five major disadvantages for a franchisor:

- Regulatory and Legal Requirements. There are substantial government regulations and legal restrictions.
- Extensive Preparation. Preparing a business for franchise, assembling the needed documents, and finding and training qualified franchisees can be time-consuming and expensive. Many franchisors hire professionals to help with the legal and accounting matters associated with franchising.
- Substantial Upfront Investment. All of the expenses involved in setting up a franchise have to be made before a single franchise fee is ever earned. This represents a substantial investment from the franchisor.
- Time-Consuming. Franchising is also time-consuming. The franchisor must prepare a thorough and detailed operations manual and provide technical, marketing, and other forms of support throughout the franchise arrangement. Franchisors risk spending so much time and money on their franchising activities that they neglect their original business. An established business should have more than one company-owned location before attempting to franchise. This helps prove to potential franchisees that the business concept and operations are repeatable.
- Requires Certain Types of Businesses. Franchising can only be successful for businesses that are in solid financial condition, easily duplicated, and not dependent on the personal characteristics of their owners. A business owner with a struggling business shouldn't consider franchising.

LICENSING A BRAND

A brand is more than a name. It's a name with a specific worth in the marketplace. It has this worth because of the reputation of the product, company, or individual associated with the brand. Brand equity is the perceived monetary value of a brand. Entrepreneurs who build brand equity can benefit financially by selling the right to use their brand name to other businesses. This is referred to as licensing a brand, or brand licensing. Brand licensing is granting permission to some person or company to use your brand. The purpose of brand licensing is to associate a new product with an existing and popular brand name.

The company or person who owns the brand is the brand licensor. The company or person who is granted permission to use the brand is the brand licensee. A brand licensee pays the brand licensor for the privilege of using the brand name. The licensee is then responsible for producing and marketing the branded product. The licensee may pay an upfront fee and then pay regular royalties based on sales of the branded product. The licensor retains control over how the licensee can use the brand name and image.

Brand licensing has been popular for years in the entertainment and sports industries. Marketing new products can be expensive and time-consuming for companies. Associating a new product with the name or image of celebrities past or present (Babe Ruth and Michael Jordan are good examples), fictional characters (such as Mickey Mouse), or company brands (Harley-Davidson, Levi, Caterpillar) helps gain recognition and acceptance in the marketplace. Basically, licensees are renting brand names to give their products a particular image and a marketing advantage. Licensees hope that customers who are already familiar with an existing brand will have positive feelings toward new products bearing the same brand.

ADVANTAGES AND DISADVANTAGES OF LICENSING

Successful companies that have worked hard to build a positive brand name or image in the marketplace can benefit greatly from licensing. The two biggest advantages are:

- Increased Revenue. The licensor typically receives substantial upfront fees and royalties from licensees.
- Brand Enhancement. Ideally, the branding process should increase customer awareness and enhance the positive reputation of the original brand.

These advantages will only be realized if the licensor chooses reliable licensees and makes wise decisions about which products to license. Some of the potential problems with licensing are: Misbranding, Over-Branding, Risk to the Brand, Lack of Marketing, and Expense.

6-6 Exit Strategies

OBJECTIVES

- ***???***
- ***???***

WHEN TO LEAVE A BUSINESS

One of the goals of owning a business is to build personal wealth. In fact, business ownership provides a unique opportunity for doing so. Regular profits earned during the lifetime of a business can provide a very good income and a comfortable living for the owner. But when an entrepreneur leaves his or her business, a much more valuable asset is involved. It's the accumulated and potential worth of the business itself.

Liquidity is the ease of converting a non-cash asset (such as a business) into cash. A successful business is a very valuable asset, but actually selling it is not always an easy process and must be timed carefully. The owner should consider three factors when deciding to sell a business:

1. personal considerations
2. condition of the business
3. condition of the economy.

Entrepreneurs thrive on creating and growing innovative businesses. However, there may come a time when a business owner decides to sell the business. This decision is often prompted by personal reasons. The entrepreneur may wish to retire or pursue other business opportunities, or may have health or family issues. Selling a business can take months or even years. The new owner may insist that the old owner stay for a while after the deal is closed to help smooth the transition process. A business owner must consider these possibilities when selling a business.

The condition of the business and the economy are also important in timing when to sell. The business will be worth more if it's growing and thriving when it goes up for sale. It needs to be operating smoothly and should not be dependent on the owner's extensive day-to-day involvement. Overall economic conditions are also important. A business will probably sell more quickly and for more money when the national and local economies are doing well.

HOW TO VALUE A BUSINESS

Determining the value of a business can be difficult. You need to consider such factors as the business type, the length of time the business has been operating, its sales and profits, its cash flow, its liabilities or debts, its tangible assets (such as buildings, furniture, inventory, and equipment), and its reputation and prospects for growth. Obviously some of these factors are easy to express in numbers, but others, such as reputation, are not as easy to calculate. There are no simple formulas for calculating the value of a business. There are, however, methods for calculating amounts that are considered benchmarks or reference points in the valuation process.

- Book Value Method. This business valuation method is based on the book value of the business. Book value (also known as the net worth or owner's equity) is an accounting term that means the total assets minus the total liabilities according to a company's balance sheet.
- Multiple of Earnings Method. The multiple of earnings method is a method of valuing a business in which the amount of business earnings over a specific time period (usually one year) is multiplied by a number, typically 3 to 5, to determine a reasonable sales price for the overall business. The actual multiple used will depend upon the type of business you are selling.

EXIT STRATEGIES

Planning how to sell a business is just as important as planning how to start a business. The process of exiting a business and gaining the value of the business in cash when you leave is referred to as harvesting the business. It's sometimes called cashing in or cashing out because it involves turning a non-cash asset (the business) into cash.

An exit strategy should be part of an entrepreneur's initial business plan. Thinking about exiting a successful business someday helps entrepreneurs focus on their goals for the business and determines the measures they will use to define business success. Potential investors will be keenly interested in an entrepreneur's exit strategy. It represents a future opportunity for them to recoup their investment and potentially gain additional profit beyond their initial investment.

HARVESTING VALUE FROM A BUSINESS

Several methods exist for harvesting value from a successful and growing business. Most methods account not only for the past success of the business but also for its future potential to make money. For most entrepreneurs, the desired exit strategy is selling the business, or at least selling their ownership interest in the business.

Sale of Business. Some successful business owners choose to sell their business to another company, merging it into the other company in the process. Often, competing businesses have an interest in such sales. The terms acquisition and merger are often used interchangeably to describe the financial union of two companies. However, an acquisition indicates the outright purchase of one company by another, and a merger is a mutual decision by two companies to join together.

Management Buyout. A management buyout is an exit strategy in which a business owner sells his or her ownership shares to the business's managers. The managers then take over ownership of the business. The management buyout is popular with entrepreneurs who wish to transfer business ownership to people they already know and trust to lead the company in the future.

Employee Stock Ownership Plan (ESOP). An employee stock ownership plan (ESOP) is a fund established when a business owner sells his or her ownership shares to a retirement fund for the employees. Although an ESOP can offer substantial tax benefits to an exiting owner, the plans are expensive to establish and subject to many legal regulations.

Initial Public Offering (IPO). An initial public offering (IPO) is the first sale of shares of stock to the general public by a privately held company. IPOs are not always exit strategies. Sometimes they are undertaken to raise money for business expansion. In either case, an IPO can be risky. The stock may be popular with the general public, or it may not. There's no way to tell until the IPO is actually executed. An exiting business owner is also bound by government regulations that restrict company executives from selling their shares within a certain time period after an IPO is initiated.

Chapter Summary

- **Growing a business means making changes that are expected to result in increased sales. Growth should be well planned and timed based on the condition of the business, the overall economy, and the life goals of the business owner. When introducing a new product to the market, it is important to know the product's life-cycle stage for the product group.**
- **Growth strategies fall into three broad categories: intensive, integrative, and diversification. Intensive growth strategies include market penetration, market development, and product development. Integrative growth strategies include horizontal and vertical integration. Diversification growth strategies may be synergistic or horizontal.**
- **Growing a business poses both personal and practical challenges to the business owner. The personal challenges include less control but more risk for the entrepreneur as a business grows. Any plans for growth must be carefully timed with the entrepreneur's life goals in mind. Practical challenges relate to space, organizational structure, materials and equipment, information technology, people and skills, and money. The funds needed for growth can be raised through internal or external means-from cash reserves (profits) or by borrowing or selling equity. A SWOT analysis should be performed to assess the strengths and weaknesses of the business, the threat posed by competitors, and the growth opportunity.**
- **Entrepreneurs participate in the global marketplace through direct and indirect exporting, importing, and selling through the Web. To determine if international business is right for you, consider the pros and cons of competing globally and write an international business plan.**
- **Setting up and running a franchise operation is expensive for the franchisor but can provide significant benefits if the franchise units are successful. The franchisor earns cash from fees and royalties paid by the franchisees, and benefits from wider brand awareness in the marketplace. Franchising does pose substantial legal, accounting, and regulatory challenges to the franchisor. Brand licensing is the granting of legal permission to others to use your brand name to sell something. The licensor maintains ownership over the brand name but earns income by leasing its use to other companies that wish to take advantage of the brand's existing public name awareness and good reputation.**
- **Exit strategies are ways of leaving a business and harvesting as much cash as possible. You should include an exit strategy in your original business plan. Exit timing will be governed by personal considerations and the state of the individual business and the economy as a whole. The value of a business can be roughly estimated by using financial records, such as the income statement or balance sheet. The actual evaluation should take into account the intangible, goodwill aspects of the business. Owners often exit unsuccessful businesses by selling off tangible assets. Possible exit strategies for owners of thriving businesses include acquisitions and mergers, management buyouts, establishing employee stock ownership plans, or making an initial public offering of stock. When you invest money, it compounds and builds wealth. The future value of money is the amount to which it will increase over time.**