Chapter 1

Preparing for Business

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Would you go into the jungle without carrying out some pretty rigorous preparation? You'd need to know something about the terrain and how to navigate it, as well as the temperature, rainfall, and food supply. You would also be keen to know what predators you might meet on the way and how to defend yourself against them. When you're starting a business, particularly your first business, you need to carry out the same level of preparation as you would for crossing the Gobi desert or exploring the jungles of South America. You are entering hostile territory.

Your business idea may be good, it may even be great, but such ideas are two a penny. The patent office is stuffed full of great inventions that have never returned tuppence to the inventors who spent so much time and money filing them. It's how you plan, how you prepare, and how you implement your plan that makes the difference between success and failure. And failure is pretty much a norm for business start-ups. Tens of thousands of small firms fail, some disastrously, every year. Most are perfectly ordinary enterprises – catastrophe is not confined to brash Internet whiz kids entering markets a decade or so ahead of the game.

This chapter sets the scene to make sure that you are well prepared for the journey ahead.

Getting in Shape to Start Up

You need to be in great shape to start a business. You don't have to diet or exercise, at least not in the conventional sense of those words, but you do have to be sure that you have the skills and knowledge you need for the business you have in mind, or know how to tap into sources of such expertise.

The following sections help you through a pre-opening check-up so that you can be absolutely certain that your abilities and interests are closely aligned to those that the business you have in mind requires. It also helps you to check that a profitable market exists for your products or services. You can use this section as a vehicle for sifting through your business ideas to see if they are worth the devotion of time and energy that you need to start up a business.

REMEMBER

You may well not have all the expertise you need to do everything yourself. Chapter 7 introduces you to the zillions of agencies and advisers who can fill in the gaps in your expertise.

Assessing your abilities

Business lore claims that for every ten people who want to start their own business, only one finally does. It follows that there are an awful lot of dreamers who, while liking the idea of starting their own business, never get around to taking action. Chapter 3 looks in detail at how you can assess whether you are a dreamer or a doer when it comes to entrepreneurship. For now, see whether you fit into one of the following entrepreneurial categories.

- **Nature.** If one of your parents or siblings runs their own business, successfully or otherwise, you are highly likely to start up your own business. No big surprise here, as the rules and experiences of business are being discussed every day and some of it is bound to rub off. It also helps if you are a risk taker who is comfortable with uncertainty.
- **Nurture.** For every entrepreneur whose parents or siblings have a business there are two who don't. If you can find a business idea that excites you and has the prospect of providing personal satisfaction and wealth, then you can assemble all the skills and resources needed to succeed in your own business. You need to acquire good planning and organisational skills (Chapter 6 covers all aspects of writing a business plan) and either develop a well-rounded knowledge of basic finance, people management, operational systems, business law, marketing, and selling, or get help and advice from people who have that knowledge.
- **Risk taker.** If you crave certainty in everything you do, then running your own business may be something of a culture shock. By the time the demand for a product or service is an absolutely sure-fired thing, there may already be too many other businesses in the market to leave much room for you. Don't confuse risk taking with a pure gamble. You need to be able to weigh matters up and make your risk a calculated one.
- **Jack-of-all-trades.** You need to be prepared to do any business task at any time. The buck definitely stops with you when you run your own business. You can't tell a customer that their delivery is late just because a driver fails to show up. You just have to put in a few more hours and do the job yourself.

Discovering a real need

You may be a great potential entrepreneur, but you still need to spell out exactly what it is you plan to do, who needs it, and how it can make money. A good starting point is to look around and see if anyone is dissatisfied with their present suppliers. Unhappy customers are fertile ground for new businesses to work in.

One dissatisfied customer is not enough to start a business for. Make sure that unhappiness is reasonably widespread, as that gives you a feel for how many customers may be prepared to defect. Once you have an idea of the size of the potential market, you can quickly see if your business idea is a money-making proposition.

Aside from asking around, one way to get a handle on dissatisfaction levels is to check out Web sites that allow consumers to register their feelings, such as www.complaints.com, www.grumbletext.co.uk, and www.blagger.com. Then scour blogs (short for weblogs), where irate people can complain their hearts out. Check out websites such as www.technorati.com, www.clusty.com, www.newsgator.com, or www.measuremap.com, now part of the Google empire, who all operate blog-indexing services that can help you filter through the 70 million plus blogs and reach the few dozen that serve the sector you are interested in.

The easiest way to fill a need that people are going to pay to have satisfied is to tap into one or more of these triggers:

- **Cost reduction and economy.** Anything that saves customers money is always an attractive proposition. Lastminute.com's appeal is that it acts as a 'warehouse' for unsold hotel rooms and airline tickets that you can have at a heavy discount.
- **Fear and security.** Products that protect customers from any danger, however obscure, are enduringly appealing. When Long-Term Capital Management (LTCM), one of America's largest hedge funds, collapsed and had to be rescued by the Federal Reserve at a cost of $2 billion, it nearly brought down the American financial system single-handedly. Two months later Ian and Susan Jenkins launched the first issue of their magazine, *EuroHedge*. At the time 35 hedge funds existed in Europe, but investors knew little about them and were rightly fearful for their investments. *EuroHedge* provided information and protection to a nervous market and five years after its launch the Jenkinses sold the magazine for £16.5 million.
- **Greed.** Anything that offers the prospect of making exceptional returns is always a winner. *Competitors' Companion*, a magazine aimed at helping anyone become a regular competition winner, was an immediate success. The proposition was simple: Subscribe and you get your money back if you don't win a competition prize worth at least your subscription.

The magazine provided details of every competition being run that week, details of how to enter, the factual answers to all the questions, and pointers on how to answer any tie breakers. It also provided the inspiration to ensure success with this sentence: You have to enter competitions in order to have a chance of winning them.

- **Niche markets.** Big markets are usually the habitat of big business – encroach on their territory at your peril. New businesses thrive in markets that are too small even to be an appetite whetter to established firms. These market niches are often easy prey to new entrants as businesses have usually neglected, ignored, or served them badly in the past.
- **Differentiation.** Consumers can be a pretty fickle bunch. Just dangle something faster, brighter, or just plain newer and you can usually grab their attention. Your difference doesn't have to be profound or even high-tech to capture a slice of the market. Book buyers rushed in droves to Waterstone's for no more profound a reason than that its doors remained open in the evenings and on Sundays, when most other established bookshops were firmly closed.

Checking the fit of the business

Having a great business idea and possessing the attributes and skills you require to start your own business successfully are two of the three legs you need to make your business stool balance. Without the third leg, though, your stool isn't stable at all. You have to be sure that the business you plan to start is right for you.

Before you go too far, make an inventory of the key things that you are looking for in a business. These may include working hours that suit your lifestyle; the opportunity to meet new people; minimal paperwork; a chance to travel. Then match those up with the proposition you are considering. (Chapter 3 talks more about finding a good business fit.)

Confirming Viability

An idea, however exciting, unique, revolutionary, and necessary, is not a business. It's a great starting point, and an essential one, but you have to do a good deal more work before you can sidle up to your boss and tell them exactly what you think of them.

The following sections explore the steps you need to take so that you don't have to go back to your boss in six months and plead for your old job back (and possibly eat a large piece of humble pie at the same time).

Researching the market

However passionate you are about your business idea, you're unlikely already to have the answers to all the important questions concerning your marketplace. Before you can develop a successful business strategy, you have to understand as much as possible about your market and the competitors you are likely to face.

The main way to get to understand new business areas, or areas that are new to you at any rate, is to conduct market research. The purpose of that research is to ensure that you have sufficient information on customers, competitors, and markets so that your market entry strategy or expansion plan is at least on target, if not on the bull's-eye itself. In other words, you need to explore whether enough people are attracted to buy what you want to sell at a price that gives you a viable business. If you miss the target altogether, which you may well do without research, you may not have the necessary resources for a second shot.

The areas to research include:

- **Your customers:** Who may buy more of your existing goods and services and who may buy your new goods and services? How many such customers are there? What particular customer needs do you meet?
- **Your competitors:** Who are you competing with in your product/market areas? What are those firms' strengths and weaknesses?
- **Your product or service:** How can you tailor your product or service to meet customer needs and give you an edge in the market?
- **The price:** What do customers see as giving value for money, so encouraging both loyalty and referral?
- **The advertising and promotional material:** What newspapers, journals, and so forth do your potential customers read and what Web sites do they visit? Unglamorous as it is, analysing data on what messages actually influence people to buy, rather than just to click, holds the key to identifying where and how to promote your products and service.
- **Channels of distribution:** How can you get to your customers and who do you need to distribute your products or services? You may need to use retailers, wholesalers, mail order, or the Internet. These methods all have different costs and if you use one or more, each wants a slice of your margin.
- **Your location:** Where do you need to be to reach your customers most easily at minimum cost? Sometimes you don't actually need to be anywhere near your market, particularly if you anticipate most of your sales coming from the Internet. If this is the case you need to have a strategy to make sure that potential customers can find your Web site.

Try to spend your advertising money wisely. Nationwide advertisements or blanketing the market with free CD-ROMs may create huge short-term growth, but little evidence exists that indiscriminate blunderbuss advertising works well in retaining customers. Certainly, few people using such techniques make any money.

Doing the numbers

Your big idea looks as though it has a market. You have evaluated your skills and inclinations and you believe that you can run this business. The next crucial question is – can it make you money?

You absolutely must establish the financial viability of your idea before you invest money in it or approach outsiders for backing. You need to carry out a thorough appraisal of the business's financial requirements. If the numbers come out as unworkable, you can then rethink your business proposition without losing anything. If the figures look good, then you can go ahead and prepare cash flow projections, a profit and loss account, and a balance sheet, and put together the all-important business plan. (Chapters 6 and 13 cover these procedures.)

Inflated numbers on the Internet

If you plan to advertise on an Internet site it makes sense to check out the different sites you're considering. Be aware that some sites publish a fair amount of gobbledygook about the high number of 'hits' (often millions) they receive. Millions of hits don't mean that the site has millions of visitors. Some Internet sites increase their hit rate by the simple expedient of leading each viewer through a number of pages, each of which adds to the number of hits. Another mildly meaningless measure of the advertising value of a site is the notion of a 'subscriber'. In Internet parlance anyone visiting a Web site and giving over their e-mail address becomes part of that company's share price! Compare that to the suggestion that anyone passing a shop and glancing in the window turns into hard cash the following day.

Any real analysis of Web site use starts with 'page impression', which is a measure of how many times an individual page has been viewed. The Audit Bureau of Circulations, which started its life measuring newspaper response, has now turned its attention to auditing Web sites (`www.abc.org.uk`). Also check out the World Internet Usage Web site (`www.internetworldstats.com/stats.htm`) for the latest statistics on Internet penetration by continent and country. That gives you a realistic measure of the maximum traffic and relative importance of each market you are interested in.

You need to establish for your business:

- Day-to-day operating costs
- How long it will take to reach break-even
- How much start-up capital you need
- The likely sales volume
- The profit level you require for the business not just to survive, but also to thrive
- The selling price of your product or service

Many businesses have difficulty raising start-up capital. To compound this, one of the main reasons small businesses fail in the early stages is that they use too much start-up capital to buy fixed assets. While some equipment is clearly essential at the start, you can postpone other purchases. You may be better off borrowing or hiring 'desirable' and labour-saving devices for a specific period. This is obviously not as nice as having them to hand all the time, but remember that you have to maintain and perhaps update every photocopier, printer, computer, and delivery van you buy and they become part of your fixed costs. The higher your fixed costs, the longer it usually takes to reach break-even point and profitability. And time is not usually on the side of the small, new business: it has to become profitable relatively quickly or it simply runs out of money and dies.

Raising the money

Two fundamentally different types of money that a business can tap into are debt and equity.

- **Debt** is money borrowed, usually from a bank, and that you have to repay. While you are making use of borrowed money you also have to pay interest on the loan.
- **Equity** is the money that shareholders, including the proprietor, put in and money left in the business by way of retained profit. You do not have to give the shareholders their money back, but shareholders do expect the directors to increase the value of their shares, and if you go public they will probably expect a stream of dividends too.

  If you do not meet the shareholders' expectations, they will not be there when you need more money – or, if they are powerful enough, they will take steps to change the membership of the board.

Alternative financing methods include raising money from family and friends, applying for grants and awards, and entering business competitions. Check out Chapter 8 for a review of all these sources of financing.

Writing up the business plan

A *business plan* is a selling document that conveys the excitement and promise of your business to potential backers and stakeholders. These potential backers can include bankers, venture capital firms, family, friends, and others who may help you launch your business if they only know what you want to do. (Chapter 8 considers how to find and approach sources of finance.)

Getting money is expensive, time consuming, and hard work. Having said that, you can get a quick decision. One recent start-up succeeded in raising £3 million in eight days, after the founder turned down an earlier offer of £1 million made just 40 minutes after he presented his business plan. Your business plan should cover what you expect to achieve over the next three years. (Chapter 6 gives full details on how to write a winning business plan.)

Most business plans are dull, badly written, and frequently read only by the most junior of people in the financing organisations they're presented to. One venture capital firm in the United States went on record to say that in one year it received 25,000 business plans asking for finance and invested in only 40. Follow these tips to make your business plan stand out from the crowd:

- **Hit them with the benefits.** You need to spell out exactly what you do, for whom, and why that matters. One such statement that has the ring of practical authority is: 'Our Web site makes ordering gardening products simple. It saves the average customer two hours a week browsing catalogues and £250 a year through discounts, not otherwise available from garden centres. We have surveyed 200 home gardeners, who rate efficient purchasing as a key priority.'
- **Make your projections believable.** Sales projections always look like a hockey stick – a straight line curving rapidly upwards towards the end. You have to explain exactly what drives growth, how you capture sales, and what the link between activity and results is. The profit margins are key numbers in your projections, alongside sales forecasts. Financiers tend to probe these figures in depth, so show the build-up in detail.
- **Say how big the market is.** Financiers feel safer backing people in big markets. Capturing a fraction of a percentage of a massive market may be hard to achieve – but if you get it at least the effort is worth it. Going for 10 per cent of a market measured in millions rather than billions may come to the same number, but the result isn't as interesting.
- **Introduce you and your team.** You need to sound like winners with a track record of great accomplishments.

- **Include non-executive directors.** Sometimes a heavyweight outsider can lend extra credibility to a business proposition. If you know or have access to someone with a successful track record in your area of business who has time on their hands, you can invite them to help. If you plan to trade as a limited company (Chapter 4 has details on legal structures) you can ask them to be a director, without specific executive responsibilities beyond being on hand to offer advice. But non-executive directors do need to have relevant experience or be able to open doors and do deals. Check out organisations such as Venture Investment Partners (`www.ventureip.co.uk`) and the Independent Director Initiative (`www.independentdirector.co.uk`), a joint venture between Ernst & Young and the Institute of Directors, for information on tracking down the right non-executive director for your business.
- **Provide financial forecasts.** You need projected cash flows, profit and loss accounts, and balance sheets for at least three years ahead. No one believes them after Year 1, but the thinking behind them is what's important.
- **Demonstrate the product or service.** Financiers need to see what the customer is going to get. A mock-up is okay or, failing that, a picture or diagram. For a service, show how customers can gain from using it – that it can help with improved production scheduling and so reduce stock holding, for example.
- **Spell out the benefits to your potential investors.** Tell them that you can pay their money within *x* years, even on your most cautious projections. Or if you are speaking to an equity investor, tell them what return they may get on their investment when you sell the business in three or five years' time.

Going for Growth

Growth is as natural a feature of business life as it is of biological life. People, animals, and plants all grow to a set size range and then stop. A few very small and very large specimens come to fruition, but the vast majority fit within a fairly narrow size band.

Businesses follow a similar formula: Most successful new businesses, those that survive that is, reach a plateau within five to seven years. At that stage the business employs 5 to 20 people and has annual sales of between £250,000 and £1 million. Of the 4.4 million private businesses operating in the United Kingdom, fewer than 120,000 have a turnover in excess of £1 million a year. That doesn't represent a bad result. Viewed from the position of a one-man-band start-up, having a couple of hundred thousand pounds in sales each year is an admirable (and unusual) success.

The following sections demonstrate the great benefits of growth (Chapters 15, 16, and 17 contain more advice on how to make your business grow).

Proving that small firms matter

One unusual factor to strike anyone thinking seriously about starting up their first business is just how many organisations have timely and valuable advice to offer and appear willing and able to offer a helping hand. Enterprise Agencies, Business Link, and the Small Business Service, which I tell you more about in Chapter 7, just seem to be busting a gut to help you get rich.

While you may want to believe that making sure that your venture succeeds is these organisations' only goal, it ain't necessarily so. Many of those organisations are either directly or indirectly linked to some government initiative. Apart from the obvious fact that the government types running those organisations want voters to see them in a favourable light – and over 40 million owner managers with votes exist in the United States and Europe alone – practical reasons suggest they should give small businesses a helping hand.

David Birch, an American academic, first brought to light the most compelling reason small firms matter so much. While conducting research at the Massachusetts Institute of Technology Birch demonstrated that enterprises employing fewer than 20 workers were responsible for over two-thirds of the increase in employment in the United States. This revealing statistic, which Birch showed to be valid for much of the developed world, was seized on as the signal for governments and others to step up their efforts to stimulate and encourage enterprise. The details of his research can be seen in an article published in *Monthly Labor Review*, Bureau of Labor Statistics, U.S. Department of Labor (`www.bls.gov/opub/mlr/1982/09/art1full.pdf`).

Small firms were neglected for most of the post-Second World War years. In the United Kingdom various studies, including the influential Bolton Committee Report that the government commissioned to investigate the state of the small business sector, identified this sector as starved of equity capital and experienced management. But until Birch's paper no one accepted quite how important new and small firms were to a country's economic well-being.

Alongside this recognition of the significance of small businesses, Birch's research also revealed their fragility. He estimated that roughly 8 million enterprises operating in America closed every year, which means that 'every five to six years, we have to replace half of the entire US economy'. These findings on small firm failure rates have been repeated in study after study, throughout the world. Ultimately, only about half of all small firms survive for more than five years.

In the years since Birch's research was first published, the rate of new business creation has rapidly increased. In the United Kingdom alone the small business population has more than doubled, from 1.9 million in 1980 to nearly 4.4 million in 2008. However, the failure rates, though getting better, remain worryingly high. General agreement exists that the two main reasons for small business failure are lack of management expertise and undercapitalisation, aside that is from the effects of macroeconomic mismanagement.

Arising from these twin findings that new firms are both vital and fragile have come a plethora of government initiatives to both foster and protect small firms during their formative years. I talk more about where to go for help and advice in Chapter 7.

Gaining economies of scale

Once a business starts to grow, you can spread overhead costs over a wider base. You can buy materials and services in larger quantities, which usually means better terms and lower costs. The combination of these factors generally leads to a higher profit margin, which in turn provides funds to improve the business, which in turn can lead to even lower costs. This *virtuous circle* can make a growing firm more cost competitive than one that is cautiously marking time.

Securing a competitive advantage

A new business can steal a march on its competitors by doing something vital that established businesses cannot easily imitate. For example, a new hairdressing shop can locate where customers are, while an existing shop has to content itself with its current location, at least until its lease expires.

A growing firm can gain advantages over its slower competitors. For example, launching new products or services gives a firm more goods to sell to its existing customer base. This puts smaller competitors at a disadvantage, because they are perceived as having less to offer than the existing supplier. This type of growth strategy can, if coupled with high quality standards, lead to improved customer retention and this too can lead to higher profits – a further push on the momentum of the virtuous circle.

Retaining key staff

The surest way to ensure that a business fails is to have a continual churn of employees coming and going. You have to invest valuable time and money in every new employee before they become productive, so the more staff you lose the more growth you sacrifice. Most employers believe that their staff work for money and their key staff work for more money. The facts don't really support this hypothesis. All the evidence is that employees want to have an interesting job and recognition and praise for their achievements. In Chapter 17 you can find out how to get the best out of your staff.

By growing the business you can let key managers realise their potential. In a bigger business you can train and promote your staff, moving them up the ladder into more challenging jobs, earning higher salaries on merit, while they stay with you rather than leaving for pastures new. And if employees are good at their jobs, the longer they stay with you the more valuable they become. You save time and money on recruitment and you don't have to finance new managers' mistakes while they learn how to work in your business.

Gaining critical business mass

Bigger isn't always better, but a growing business has a greater presence in its market, and that's rarely a bad strategy. Large businesses are also more stable, tending to survive better in turbulent times. Bigger businesses can and do sometimes go bust, but smaller, 'doing nicely' small businesses are far more likely to go bump.

A small company often relies on a handful of customers and just one or two products or services for most or all of its profits. If its main product or service comes under competitive pressure, or if a principal customer goes bust, changes supplier, or spreads orders around more thinly, then the small company is in trouble. Expanding the number of customers so that you break out of the 80/20 cycle – in which 80 per cent of the business comes from just 20 per cent of customers – is a sensible way to make your business safer and more predictable.

One-product businesses are the natural medium of the inventor, but they are extremely vulnerable to competition, changes in fashion, and technological obsolescence. Having only one product can limit the growth potential of the enterprise. A question mark must inevitably hang over such ventures until they can broaden their product base. Adding successful new products or services helps a business to grow and become a safer and more secure venture. This process is much like buying a unit trust rather than investing in a couple of shares. The individual shares are inevitably more volatile, while the spread over dozens of shares smoothes the growth path and reduces the chances of disaster significantly.