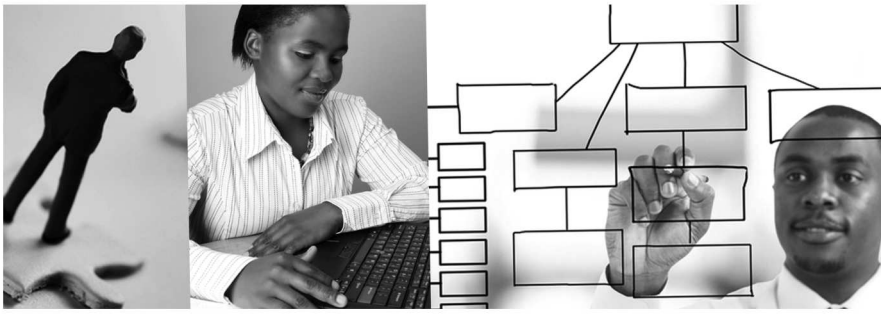
Introduction to

ENTREPRENEURSHIP & SMALL BUSINESS MANAGEMENT

Only study guide for

MNE2601



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Introduction

1 WORD OF WELCOME

Welcome to this module in Entrepreneurship and Small Business Management. We hope that studying this course will be one of your most memorable learning experiences ever. We invite you to join us on a journey through the world of entrepreneurship. We encourage you to make the most of this opportunity to study, not merely to pass the examinations, but to use your newly acquired knowledge and skills to make a difference in your own life and the lives of those involved in business, and to assist communities in need.

In this module we will help you gain the knowledge, understanding and skills required to run a business successfully.

2 PURPOSE OF THE MODULE

The purpose of this module is to empower you with the commensurate knowledge, skills and expertise to

- understand the mechanics of entrepreneurship
- be able to start and grow your own business in a South African context by grasping the entrepreneurial process
- be able to select and implement alternative routes to entrepreneurship

3 APPROACH TO AND OUTCOMES FOR THE MODULE

This module has been developed in accordance with the outcomes-based approach to education and training. You will therefore find a number of learning outcomes at the beginning of each topic. These learning outcomes are there to guide you through the study material. They inform you of what skills you should be able to demonstrate or what you should know at the end of each topic. They also indicate what you may be expected to demonstrate in the assessment process, that is, in the assessment and examination.

When you have completed this module, you should

- be able to apply your newly gained knowledge and skills to keep abreast of occurrences in the business environment in terms of small business
- be able to disseminate correct and relevant information on entrepreneurship in your community in an effort to prevent failure in business
- grasp the entrepreneurial process and how to start and grow a business
- be able to identify the requirements for becoming a successful entrepreneur and alternative routes to entrepreneurship

4 FRAMEWORK OF THE MODULE

The framework of this module is as follows:

Topic number	Study unit number	Description
1		**Entrepreneurship and entrepreneurs**
	1	The nature and development of entrepreneurship
	2	The entrepreneur
2		**The entrepreneurial process, introduction and aim of the Topic**
	3	Creativity and business opportunities
	4	The window of opportunity
	5	The business plan
	6	Resource requirements and legal and related aspects
	7	Getting started
	8	Financing an entrepreneurial venture
	9	Networking and support
3		**Alternative routes to entrepreneurship**
	10	Entering the family business
	11	Buying a franchise
	12	The business buyout

5 WHAT IS IN IT FOR ME?

We believe that this module will have a huge influence on your personal and professional life as well as on the services you have to offer your society. This belief is supported by some of the feedback we have received from students over the years, as highlighted below.

- Some of our students now own successful businesses.
- Many students have come to realise that they are not powerless in the face of the high failure rate of SMMEs in the country and they are even mentoring small business owners.
- The professional lives of many of our students have been enhanced by their newly acquired knowledge and skills.
- The compassion and commitment of many of our students make a great contribution to the welfare of their communities and society in general.
- Students often come up with the most innovative ideas that they implement in their communities. They start small projects involving opening small businesses and selling products known and liked by communities.
- Some of our students have indicated that they help their family businesses to grow and survive.

6 LEARNING APPROACH IN THE MODULE

We adopted an experiential learning approach in this course, which means that we are giving you the opportunity to be actively involved in the learning process. We do not want you merely to open the prescribed book and learn everything off by heart. The content of your learning material should be evaluated against real-life situations within your own world and your own contexts. The focus of your learning should be holistic, life-long learning and not just learning to complete assignments and to pass examinations. Remember that learning can only be successful if you take ownership of your own learning and if you change in response to that learning.

After this rather formal explanation of what we intend with this course, let us start our journey.

• Before you start the journey

One of the most common effects of travel is the sense of wonder it may instil in the mind and heart of the traveller. What makes any journey memorable is its unique blend of personal experiences – something which cannot be attained by merely reading a travel guide or listening to the experiences of other travellers.

Going on a journey can be one of the most rewarding experiences in one's life. It has the potential to enrich one's life and stimulate new senses of understanding, not previously available to one. In this sense, studying is similar to travelling.

This study guide is an invitation to participate in a journey through the world of business and entrepreneurship. Although the journey may sometimes be unsettling and frustrating, we believe that it will be worth your while because it will enrich you and prompt you to explore new avenues of compassion for your fellow human beings. Compassion is ultimately what defines us as humans.

We have therefore organised the study guide in such a way that it includes all the components of a journey. To help you to understand the complex nature of business and entrepreneurship and to elicit a responsible, human response to it, we have divided the journey into five topics. Each topic focuses on a specific destination or aspect of the business such as entrepreneurship and the entrepreneur; the entrepreneurial process; alternative routes to entrepreneurship; post-start-up challenges and corporate venturing.

But before we can explore the road ahead, you first need to reflect by answering the following question:

• What you need for the journey

You will need the following:

- the **study guide** you are reading at the moment
- the **travel guide/prescribed book** (*Entrepreneurship: a South African perspective*) 3rd edition
- a travel **journal** in which to write your experiences. You can use an exercise book for this purpose and design it according to your own needs. You can do your activities in your journal and reflect on your journey in general. This is your book, we do not wish to see it.

The travel guide/prescribed book for this module is:

Nieman, G & Nieuwenhuizen, C. 2014. *Entrepreneurship: a South African perspective*. 3rd edition. Pretoria: Van Schaik

• Preview of the course

As mentioned earlier, your journey will take you through five topics and several study units. Along the way we will constantly give you travel directions to ensure that you stay on track and do not overlook anything important. These directions will include emerging issues (at the beginning of each topic) and in each study unit, you may find some of the following markers:

• Travel pointers (or key questions)

No journey can start without a detailed map to guide the traveller so that he/she knows exactly where to go. Every study unit will therefore start with a few key questions that will give you an overview of what to expect in the study unit.

• Picking up useful words (or key concepts)

Travelling to a foreign country is always so much easier if you learn a few new words to help you communicate with and understand the people you meet along the way. We therefore highlight all the important (and often new) concepts that you will encounter on your journey through the entrepreneurship landscape.

• Reading your travel guide (or prescribed book)

To really enjoy your travelling experience, you first need to do your homework or travel research. For example, it can be highly frustrating (and a useless experience) standing in the middle of OR Tambo International Airport, not knowing what you are looking at or what its significance is. The prescribed book is there to help you grasp where you are and where you are going.

• Studying

The sections that have to be studied are clearly indicated and form the basis for assignments and examinations. To be able to do the activities and assignments for this module, to achieve the learning outcomes, and to be successful in the examination, you will need to understand the learning material thoroughly. This means that you must accept responsibility for your own studies and must understand that learning is not the same as memorising. You will be expected to show that you understand and can apply the information, not just remember it.

• Reading

In some parts of the study guide, we will indicate that you need to read a certain section in the prescribed book. This means that you should take careful note of the content, because it usually contains useful background information, offers another perspective or provides further examples. It will give you some context, improve your ability to take notes and enhance your understanding.

You will need to spend at least 120 hours on this module. This includes approximately 40 hours of reading and studying of the learning material, 40 hours spent on doing the activities and assignments, and 40 hours of preparation for the examinations.

You may wish to read more widely than just the study guide and the prescribed book. When you read information in the prescribed book or in other sources, you should not simply accept it without question, but rather question all ideas and information that you come across.

To test your understanding of the ideas about which you will learn in this module, you should try to apply them to real-life situations.

- **Activities**

You will encounter various types of activities in the study guide. You will be expected to

- reflect on the work covered

- **Do the self-evaluation activities**

We consider your completion of the activities in this study guide and the assignments as crucial to your successful completion of this module. Firstly, the activities in the study guide will help you to develop an understanding of the topic at hand and to master the learning outcomes meaningfully. Secondly, since feedback is provided at the end of each activity, you can assess yourself and learn from the insight you have gained.

- **Self-reflection: go to your travel journal (your exercise book)**

This is where you can reflect on your journey thus far and what it meant to you. Have you experienced that sense of wonder that a journey may instil in the mind and heart of the traveller we mentioned earlier? Are you a changed person after this section of the journey? Since no-one else is going to read your travel journal, you can be really honest with yourself.

- **Share your experiences with your co-travellers**

In this section, we will refer you to myUnisa for certain group activities such as discussion groups and sharing activities. Remember, half of the fun of travelling is in sharing it with someone else.

IMPORTANT INFROMATION

Please activate your myUnisa and myLife e-mail addresses and ensure that you have regular access to the myUnisa module site MNE2601/2018/S1 OR MNE2601/2018/S2; depending on which semester you are registered in, as well as your group site.

Note: This is a blended module; therefore your module is available on myUnisa. However, in order to support you with your studies, you will also receive certain study material in printed format.

- **Assignments**

Information on the assignments for this module will be provided in Tutorial Letter 101.

It is crucial for you to complete the assignments if you wish to achieve the learning outcomes. By completing the assignments, you will get a feel for the type of questions you can expect in the examination and obtain first-hand feedback from the lecturer. The assignment questions also afford you the opportunity to apply the theory to a case study or practical situation. In each assignment, you will be informed of the purpose of the assignment. Details of the assignments with their associated assessment criteria and the format of and requirements for the examination will be provided in tutorial letters.

- **Assessment questions**

At the end of each section, you will find a list of possible assessment questions based on the work done in that section. We advise you to work through these questions diligently since they will provide extremely useful opportunities to prepare for possible examination questions. Self-assessment plays a very important role in the mastery of learning outcomes and therefore, you should complete the self-assessment activities in this study guide.

Because you will find most of the answers to these questions in the learning material covered in this study guide and the prescribed book, you should not have to face any surprises in the examination. Consequently, it is in your own interest to work through all the assessment questions.

- **Assessment of the module**

Your assignments and the examination will be assessed in accordance with transparent assessment criteria that relate directly to the learning outcomes for the module.

The compulsory assignment mark(s) and your examination mark will make up your total mark for the module. Additional information on the assessment procedure and examination requirements for this module will be provided in Tutorial Letter 101.

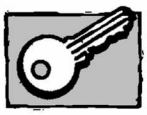
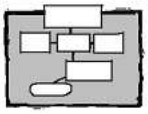
7 HOW YOU WILL BENEFIT FROM THIS MODULE AND IMPORTANT ADVICE

Your likelihood of success will increase if you consider the following suggestions:

- Study the prescribed study guide conscientiously, according to the guidelines and in the same sequence as in the study guide.
- Relate the subject matter to your work situation (discuss the subject matter with your colleagues).
- Plan your studies according to the time available and our recommendations.
- Engage in the activities and do the assignments.
- Prepare properly for the examination.
- Do not hesitate to contact us if you have a problem with any aspect of the study material.

8 USE OF ICONS

The following icons will be used in this study guide:

	**Key concepts.** This icon focuses your **attention** on certain key words or concepts that you will encounter in the topic or study unit.
	Learning outcomes. This icon indicates what aspects of the particular topic or study units you have to master and demonstrate that you have mastered.
	**Mind map.** Mind maps are provided to help you to see the relationship between various parts of the study material.
	Study. This icon indicates which sections of the prescribed book or the study guide you need to study and internalise.
	Read. This icon will instruct you to read certain sections of the prescribed book for background information.
	Activity. This icon refers to activities that you must do in order to develop a deeper understanding of the learning material.
	Reflection. This icon requires you to reflect on the key issues or problems dealt with in the study guide.
	Assessment. This icon requires you to test your knowledge, understanding and application of the study material you have just studied.
	Feedback. This icon indicates that you will receive feedback on your answers to the self-assessment activities.

9 WHAT YOU CAN EXPECT FROM UNISA

You can expect us to do the following:

- We will provide you with up-to-date and relevant learning material that is regularly compared with and benchmarked against similar local and international programmes.
- We will ensure that the study material is in line with the needs of industry and commerce by consulting regularly with the profession, industry leaders and government officials.
- We will afford you the opportunity to develop competencies and skills at a certain level. The learning outcomes correspond to the National Qualifications Framework (NQF) level 5. You will be assessed on the basis of the level descriptors of the NQF.
- We will support you whenever you require assistance. You may make personal appointments with your lecturers or contact them telephonically or via email or the internet. We understand that studying through distance education is more challenging than attending a residential university.
- We will provide you with clear indications of what we expect from you in terms of your assessment.
- We will give you timeous feedback on assignments. We will return your assignment and our feedback within three weeks of the due date, provided that you submit your assignment on or before the due date.

10 CONCLUSION

We trust that you will enjoy your studies. We are certainly looking forward to being your partner in this exciting adventure.

Best wishes

Your lecturers in Entrepreneurship and Small Business Management

Topic 1

Entrepreneurship and entrepreneurs

INTRODUCTION AND AIM OF THE TOPIC

The aim of this topic is for you to explore the nature and development of entrepreneurship and the entrepreneur.

Entrepreneurs and the new businesses they create play a crucial role in the development and well-being of society. As such, there is increased appreciation for and acknowledgement of the role played by new and small businesses in an economy. The primary measure that the Global Entrepreneurship Monitor uses is the total early-stage entrepreneurial activity (TEA). This is the percentage of the adult population aged between 18 and 64 years who are in the process of starting a business or owner manager of a new business which is less than 42 months old. According to the GEM report (2016:33) South Africa has a low prevalence of entrepreneurial activity (6.3%) in the 18–24 age cohort as is in line with general GEM trends. However the percentage of 18–24 year old in South Africa involved in early-stage entrepreneurial activity is considerably lower than the average for Africa (15%) as well as lower than the average for efficiency-driven economies, which at 13% is double the South African figure. Entrepreneurial activity in the 25–34 year age cohort is 10.9% (the age where TEA usually peaks) which is also less than half the Africa average (24%) as well as considerably lower than the average for efficiency driven economies (18%).

The low prevalence of entrepreneurial activity among the youth is of concern in the South African context. The youth represent a high percentage of the total population within South Africa – therefore it is critical to identify and explore factors that will contribute to strategies that enable economies to benefit from the talents, energy and ideas that young people bring to the labour market (GEM Report, 2016:34). Important elements of such strategies include education and skills development, as well as entrepreneurship development.

Learning outcomes

After working through this topic, you should be able to

- discuss and explain the principles of entrepreneurship theory
- differentiate between entrepreneurship, entrepreneur, small business and entrepreneurial ventures
- analyse the entrepreneurial development model in order to evaluate variables that affect the development of entrepreneurship
- evaluate the entrepreneurial and managerial skills required for business success
- explain the entrepreneurial process in terms of the characteristics and challenges faced by entrepreneurs
- analyse entrepreneurial networking systems (such as role models, support systems) and how they influence women and emerging entrepreneurs

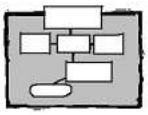
Emerging issues

- What is entrepreneurship?
- What is the difference between entrepreneurship, entrepreneur and small business?
- What is the importance of entrepreneurship?
- What is the difference between a small business and an entrepreneurial venture?
- What challenges face entrepreneurs?

Each one of these questions will be discussed in a separate study unit, and in this way, we will endeavour to suggest possible answers to the entrepreneurship issue.

CONTENT OF THE TOPIC

Topic 1 comprises the following study units:



TOPIC 1	
Study unit 1	**Study unit 2**
The nature and devopment of entrepreneurship	The entrepreneur

Before starting your journey, now would be an appropriate time to pause and engage in self-reflection:

Activity

Activity: self-reflection (journal)

Do you think entrepreneurship should be taught?

Start your journal by answering the question below. Be honest. Nobody else is going to read your journal. The way you answer this question will primarily determine your attitude towards this module.

(1) **Choose** one or more of the alternatives below which best describe your view on this module.

- I do not think entrepreneurship should be taught/learnt.
- I think the module should be taught. I hope that my study of the module will help me become an entrepreneur.
- I think only those who have businesses should register for this module.
- I am only doing this module for degree purposes.
- I think it is important for everybody to study this module.
- None of the above

(2) **Also, write down** any additional notes about your feelings, assumptions and attitudes with regard to this entrepreneurship module.

(3) **Now that you have made your choice,** do you think your views are realistic? Are they based on correct assumptions? How can you test your assumptions?

Unfortunately, people often make the wrong assumptions on the basis of incorrect or incomplete knowledge. One of the basic tenets of the scientific approach is to challenge all assumptions, and that is what we will be doing in this module.

The following study unit will serve as a test for your basic assumptions about entrepreneurship. After completing it, we will return to your list.

Study unit 1

The nature and development of entrepreneurship

Contents

Introduction
Travel pointers
1.1 The economic impetus of entrepreneurship
1.2 The development of entrepreneurship theory
1.3 Defining the concepts of entrepreneurship, the entrepreneur, small businesses and entrepreneurial ventures
1.4 A model of entrepreneurship
1.5 The domains of entrepreneurship, management and leadership
1.6 Success factors of entrepreneurs
1.7 The entrepreneurial process
Assessment
Summary

INTRODUCTION

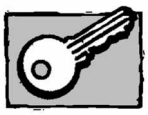
As an introduction to the field of entrepreneurship, this study unit describes the entrepreneur, his or her orientation and in what way he or she differs from a small business owner. This study unit will introduce you to the entrepreneurial process and give you insight into what successful entrepreneurs do when they establish and manage their businesses. Read the introduction in Nieman and Niewenhuizen (2014:3).

Study pages 3 to 21 in Nieman and Nieuwenhuizen (2014).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit.

- What is the importance of entrepreneurship?
- Where did entrepreneurship originate?
- What is the difference between entrepreneurship, the entrepreneur, small businesses and entrepreneurial ventures?
- Who are the main roleplayers in entrepreneurship development?
- What is the difference between an entrepreneur, a leader and a manager?
- Who is a successful entrepreneur?
- How does an entrepreneur start a business in the entrepreneurial process?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working your way through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- entrepreneur and entrepreneurship
- SMME
- gross domestic product
- unemployment
- economic and behaviourist perspective

Make a list in your journal of the above terms and write a brief explanation of each as it appears in the prescribed book.

1.1 THE ECONOMIC IMPETUS OF ENTREPRENEURSHIP

According to Nieman and Nieuwenhuizen (2014), it is essential to know that a combination of all types of businesses small, micro, medium-sized and large national and international businesses determines the state of the economy.

The economic growth rate of a country is determined by the year-on-year change in the value of real gross domestic product (GDP). GDP is the value of all production within a country's geographical boundaries, and we use it to measure the state of our economy – that is, whether the economy is growing or declining.

During the 1980s, South Africa's GDP decreased to 2,2%, with no growth between 2000 and 2004 and an increase to 4,9% in 2006. The aim in South Africa is to achieve 6% growth in the next few years in order to sustain and improve the country's economic development. The contribution of entrepreneurs will be relied on for a large part of the prospective 6% growth. Recently South Africa's GDP growth rate has been declining and was 0,2% in 2016.

Employment is also closely linked to the state of the economy. When there is little growth in the economy, fewer employment opportunities are available. The employment rate in South Africa is low, with an approximate unemployment rate of 27,1% (Labour Force Survey 2016).

The importance of entrepreneurs is crucial for the improvement of the South African economy and is also regarded as the best employment opportunity that exists. You need to be aware of the significance of entrepreneurship for the economy, with the focus on job creation and economic growth.

Activity 1.1 Self-reflection (journal)

For this activity, you will need to use any one of the following resources:

– the internet (an Internet Café if you do not have the internet)
– the Unisa library or your local community library
– newspapers

(1) Visit the SEDA website at http://www.seda.org.za/content.asp and answer the following questions:

(a) What contribution do SMMEs make to the GDP of the South African economy?
(b) How does this contribution compare with that of Australia and Peru?
(c) What is the current unemployment rate in South Africa? Give possible reasons why the unemployment rate is as it is.
(d) How can SMMEs contribute to a decrease in South African unemployment rates?

(2) Use any of the above resources to find the origin of the word "entrepreneurship".

If you have a link to the internet, use the Google search engine and search for the word "entrepreneurship". This search will return hundreds of definitions and concept theories. Try to find as many versions as possible.

Now ask yourself the following questions:

(a) Who are the founders or pioneers of entrepreneurship?
(b) When did entrepreneurship originate?

The following section in your prescribed book asks you to seriously consider some critical theories about the history and origin of entrepreneurship. While reading the material, try to identify the reasons given for each view and think about how convincing you find them.

Study the development of entrepreneurship theory in Nieman and Nieuwenhuizen (2014:5).

1.2 THE DEVELOPMENT OF ENTREPRENEURSHIP THEORY

As a student of entrepreneurship, you have to understand the progress in entrepreneurship research and the different views on defining the concept.

Read pages 5 to 8 in Nieman and Nieuwenhuizen (2014). The authors define the economic and behaviourist perspectives of entrepreneurship.

Economic perspective	**Behaviourist perspective**
• Detectors of opportunities • Venture creation • Risk taking • Profit • Innovation • Tolerance for ambiguity	• Weber • McClelland

They go on to explain

- the explosion of the field of entrepreneurship
- the development of entreprenology

Activity 1.2

(1) Differentiate between the following concepts, according to your own understanding of the concepts of entrepreneur, entrepreneurship and small business.

Feedback

Compare your definitions with the information on section 1.3 below.

1.3 DEFINING THE CONCEPTS OF ENTREPRENEURSHIP, THE ENTREPRENEUR, SMALL BUSINESSES AND ENTREPRENEURIAL VENTURES

1.3.1 The entrepreneur and entrepreneurship

An entrepreneur is someone who sees an opportunity in the market, gathers resources, and creates and grows a business venture to meet these needs. He or she bears the risk of the venture and is rewarded with profit if it succeeds (Nieman & Nieuwenhuizen 2014:9–10).

In this section, the authors provide other definitions of entrepreneurs and define the main characteristics of entrepreneurs.

Entrepreneurs can also be found in large corporations where they have the freedom to build their own organisation in their own way with a profit motive. In such instances, they are referred to as intrapreneurs or corporate entrepreneurs (Nieman & Nieuwenhuizen 2014:10).

1.3.2 Small businesses

It is important to distinguish between entrepreneurial ventures and small businesses as highlighted in Nieman and Nieuwenhuizen (2014:10).

The authors go on to define small owners as individuals who establish and manage their businesses for the principal purpose of furthering personal goals and ensuring security.

Finally, a small business is defined in qualitative and quantitative terms.

In terms of quantitative criteria, when relating it to the ownership structure, a small business is defined as follows:

- a separate and distinct business entity
- not part of a group of companies

- including any subsidiaries and branches when measuring the size managed by its owners
- a natural person (eg sole proprietor or partnership) or legal person (eg close corporation or company)

The quantitative criteria used to define micro, small and medium businesses include the following (Nieman & Nieuwenhuizen 2014:11):

- the number of full-time paid employees
- the total annual turnover
- the total gross asset value

In South Africa, the National Small Business Act defined small business medium, small, very small and micro enterprises based on certain characteristics. The National Small Business Amendment Act (26 of 2003) aims to update and further define business according to five categories established by the original act, namely, standard industrial sector and subsector classification, size of class, equivalent of paid employees, turnover and asset value – excluding fixed property.

1.3.3 Entrepreneurial ventures

Entrepreneurial ventures are businesses in which the principal objectives are profitability and growth (Nieman & Nieuwenhuizen 2014:11). The following characteristics distinguish an entrepreneurial venture from a small business:

- innovation
- potential for growth
- strategic objectives

The above authors highlight the difference between small businesses and entrepreneurial ventures.

1.4 A MODEL OF ENTREPRENEURSHIP

Study figure 1.1 in Nieman and Nieuwenhuizen (2004:12).

This model demonstrates how variables affect entrepreneurship and should therefore evaluate the influence of the business environment on entrepreneurship.

The above authors discuss the following factors that influence the entry of entrepreneurs:

– entrepreneurial orientation
  - family and role models
  - education
  - culture
  - work experience
  - personal orientation

– a supportive environment
  - financing
  - training and development

– infrastructure
    - a cooperative environment

1.5 THE DOMAINS OF ENTREPRENEURSHIP, MANAGEMENT AND LEADERSHIP

The question is whether there is a difference between entrepreneurship, management and leadership. The answer lies in the management and leadership skills that are critical for entrepreneurial success. Not all entrepreneurs are good managers or leaders. See figure 1.2 in Nieman and Nieuwenhuizen (2014:14).

Entrepreneurs are innovative. They have the ability to identify business opportunities and grow them into businesses by applying the necessary resources. Once the business has been established, it needs to be managed. The role now changes to that of a manager, which includes functions such as planning, organising, leadership and control. The various business functions also have to be managed. These functions are, for example, marketing, purchasing, production, human resources, administration, public relations (corporate communication) and finance.

The authors also briefly discuss the entrepreneurial and management skills required by business owners. The next section will address the managerial and entrepreneurial success factors of entrepreneurs.

1.6 SUCCESS FACTORS OF ENTREPRENEURS

What makes entrepreneurs successful? Successful entrepreneurs have certain entrepreneurial skills or personal characteristics and managerial skills. According to Nieman and Nieuwenhuizen (2014:31, 33), these skills/success factors are as follows:

Entrepreneurial factors	**Managerial factors**
Creativity and innovation	Planning
Risk orientation	Knowledge of competitors
Leadership, dynamism	Mainly market oriented
Good human relations	Client service
Positive attitude	High-quality work
Perseverance and determination	Financial insight and management
Commitment	Business knowledge and skills
High energy levels	The use of experts
Confidence	
Resourcefulness	
Need for independence	
Internal locus of control	
Positive response to challenges	
Orientation to clear goals	

Activity 1.3

Read the case study in Nieman and Nieuwenhuizen (2014:31) titled "SA's greatest giant entrepreneur" and then do the following:

Identify the success factors evident from Rupert's story that ensured the success of the business.

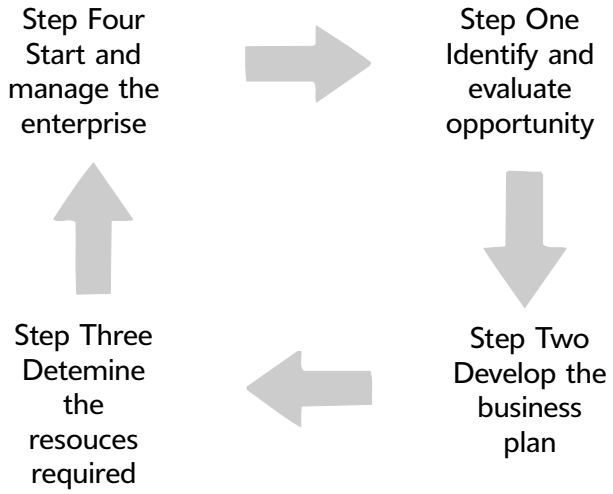
Feedback

You should have identified the following success factors:

- *Rupert displayed leadership and dynamism. "Rupert fought regulations and dirty tactics authorities and monopolies thrown at entrepreneurs.*
- *He displayed resourcefulness. "Everyone knows the story of how Rupert manufactured cigarettes in his garage and sold them on the streets".*
- *He had knowledge of his competitors. "However, the competition and other obstacles in the tobacco industry made him decide to diversify and add liquor to his portfolio.*
- *Rupert had a positive attitude and positive response to challenges. "Rupert showed that entrepreneurs should learn form mistakes and never throw in the proverbial towel".*
- *Rupert had the ability to learn from mistakes.*
- *He had good client service. "Rupert also strongly believed that the consumer is king. This should be the cornerstone of any business, big or small".*

1.7 THE ENTREPRENEURIAL PROCESS

Nieman and Nieuwenhuizen (2014:15) identify the following four steps in the entrepreneurial process:



The entrepreneurial process is one in which the entrepreneur creates a new venture. This process involves bringing resources together to form the organisation in order to pursue the opportunity. The four steps in the entrepreneurial process as highlighted in the above figure are as follows:

(1) Identify and evaluate the opportunity (the window of opportunity will be discussed in study unit 4).

(2) Develop the business plan (details about the business plan and its layout will be discussed in study unit 5).

(3) Determine the resources required (resources required to start a business will be discussed in study unit 6).

(4) Start and manage the enterprise
Study Nieman and Nieuwenhuizen (2014:15–16)

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

(1) Explain the contributions of entrepreneurship and the entrepreneur to the economy.
(2) Define the economic and the behaviourist views of entrepreneurship.
(3) Define the following terms:

(a) entrepreneur
(b) entrepreneurship
(c) small businesses
(d) entrepreneurial ventures

(4) Explain the difference between an entrepreneur and a small business owner.
(5) Explain the differences between small business and entrepreneurial ventures.
(6) Discuss the elements that play a role in the development of a model of entrepreneurship.
(7) Explain the entrepreneurial and management success factors.
(8) Describe the entrepreneurial process.

Answers to the assessment questions

Refer to the following pages in Nieman and Nieuwenhuizen (2014):

(1) page 16
(2) pages 5 to 7
(3) pages 9 and 10
(4) pages 9
(5) pages 10–11
(6) pages 11 to 12 and figure 1.1
(7) pages 31, 33
(8) pages 15 and 16

SUMMARY

This study unit covered the basic concepts of entrepreneurship. We distinguished between the entrepreneur and the small business owner, and the small business and entrepreneurial venture. We also introduced a model of entrepreneurship development and described the critical entrepreneurial and management success factors. In conclusion, we discussed the entrepreneurial process in which new ventures are created.

The entrepreneur fulfils a critical role in the economy – hence the importance of helping more people to develop their own entrepreneurial ventures. Study unit 2 will focus more on the entrepreneur and the challenges he or she faces.

Study unit 2

The entrepreneur

Contents

Introduction
- 2.1 The entrepreneur as a catalyst for economic activity
- 2.2 Entrepreneurs at various levels
- 2.3 The background and characteristics of entrepreneurs
- 2.4 Role models and support systems
- 2.5 Push and pull factors
- 2.6 Challenges facing entrepreneurs and SMMEs in South Africa
- 2.7 Women and emerging entrepreneurs
- 2.8 Emerging entrepreneurs
- 2.9 Entrepreneurs versus inventors

Assessment

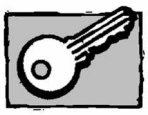
Summary

INTRODUCTION

South Africa needs more entrepreneurs because they play a fundamental role, not only in providing goods and services to customers, but also in their potential to solve the unemployment crisis in the country. Increasingly more people are choosing entrepreneurship as their career path or are being forced to create their own employment because of the unemployment crisis facing South Africa. This study unit will introduce you to the various levels of entrepreneurs, the challenges facing entrepreneurs, and acknowledge women and emerging entrepreneurs and the role they play in the economy.

Read "The importance of entrepreneurs in South Africa" in Nieman and Nieuwenhuizen (2014:24).

Study Nieman and Nieuwenhuizen (2014:23–52).



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- entrepreneur
- support systems
- push and pull factors
- emerging entrepreneurs
- survivalists
- inventors

Make a list of the above terms in your journal and write down a brief explanation of each one as they occur in the prescribed book.

2.1 THE ENTREPRENEUR AS A CATALYST FOR ECONOMIC ACTIVITY

This section explains the importance of entrepreneurship in the South African economy. As a student of entrepreneurship, you have to understand that entrepreneurship is a key driver of our economy**.** Entrepreneurs are highly valued as contributors to the economic and social growth of a country. Entrepreneurs in South Africa are seen as primary creators and drivers of new businesses. They play a vital role in the survival and growth of any emerging economy. Entrepreneurship becomes the critical solution to low economic growth, the high unemployment rate and the unsatisfactory levels of poverty. While the relationship between entrepreneurship and economic growth is multifaceted and complex, entrepreneurial capability is a necessary ingredient in a country's capacity to sustain economic growth. It is accepted that a well-functioning small business sector contributes to the economic and social growth of a country.

2.2 ENTREPRENEURS AT VARIOUS LEVELS

Nieman and Nieuwenhuizen (2014:26) explain that there are various levels of entrepreneurship based on the nature of the entrepreneurial activity. Read Nieman and Nieuwenhuizen (2014:26–27) and complete the following table:

Levels of entrepreneurship	**Description**
Basic survivalist	
Pre-entrepreneurs	
Subsistence entrepreneurs	
Micro-entrepreneurs	
Small-scale entrepreneurs	Well educated, has collateral to apply for a loan

You should now have an understanding of the different levels of entrepreneurial activity.

2.3 THE BACKGROUND AND CHARACTERISTICS OF ENTREPRENEURS

As a student of entrepreneurship, you have to understand that the environment in which an individual is raised (eg an entrepreneurial family background) and certain characteristics will clearly distinguish an entrepreneur from other people.

Activity 2.1

(1) How does one's background motivate and influence one to become an entrepreneur?

(2) Identify at least five characteristics that you think an entrepreneur should have in order to be successful. You may use some of the ideas proposed by Nieman and Nieuwenhuizen (2014).

Feedback

(1) You should have identified the following background factors that contribute to entrepreneurship:

- *childhood and environment (eg entrepreneurial parents)*
- *education*
- *personal values*
- *age*
- *work experience*

See Nieman and Nieuwenhuizen (2014:27).

(2) The following characteristics stand out:

- *a passion for business activities*
- *an internal locus of control (the need to be in charge of one's own life)*
- *the need for independence (the need to be one's own boss)*
- *the need for achievement*
- *risk taking and uncertainty*
- *creativity and innovation*
- *determination and persistence*

See Nieman and Nieuwenhuizen (2014:28–31).

2.4 ROLE MODELS AND SUPPORT SYSTEMS

Entrepreneurs need role models and support systems to develop and implement their ideas. They also require support for the development and growth of their businesses, that is, a network system. Nieman and Nieuwenhuizen (2014:213) identify the following types of support networks for entrepreneurs:

- social networks – mainly for the exchange of information
- personal networks – people with whom the entrepreneur has daily contact
- extended networks – a network of organisations as opposed to individuals
- other networks – including the internet, suppliers and investors

2.5 PUSH AND PULL FACTORS

This section focuses on the main reasons why individuals become entrepreneurs. These reasons can be classified as either opportunity (pull factors) or necessity (push factors) in entrepreneurship.

Activity 2.2

Complete the following questionnaire on why you think people become entrepreneurs. First, read through the list in the left-hand column, and then indicate in the right-hand column your choice of "yes", "no" or "maybe".

Reasons why people become entrepreneurs	**Yes/no/maybe**
(1) They are born to be entrepreneurs	
(2) They study entrepreneurship at university.	
(3) They want a business of their own.	
(4) They are unemployed.	
(5) They are bored.	
(6) They desire more money.	
(7) They want to be independent.	
(8) They want to satisfy their unsatisfied needs.	
(9) They wish to become wealthy.	
(10) They have inherited a business from their parents.	

Feedback

To assess your choices, consult Nieman and Nieuwenhuizen (2014:37).

Study figure 2.2 in Nieman and Nieuwenhuizen (2014:38).

Push factors (A necessity: an entrepreneur starts a business because there is no other alternative.)	**Pull factors** (An opportunity: an entrepreneur starts a business to take advantage of an opportunity to work for himself or herself and to make more money.)
Unemployment	Independence
Job insecurity	Achievement

Push factors	Pull factors
Career limitations	Recognition
Not fitting in with the organisation	Personal development
Limitation of financial rewards in a conventional job	Personal wealth
No other alternatives	

Why is it important to distinguish between necessity and opportunity entrepreneurs?

Research has shown that the opportunity-motivated entrepreneur's economic contribution is much higher than that of the necessity-based firms. South Africa, compared to other developing countries, has the lowest opportunity entrepreneurship rate.

2.6 CHALLENGES FACING ENTREPRENEURS AND SMMEs IN SOUTH AFRICA

According to Nieman and Nieuwenhuizen (2014:39), in South Africa, a high number of SMMEs fail during their first few years of existence.

Activity 2.3

Go to "www.bbc.com/news/business-36902221"

What, in your opinion, are the challenges facing South African entrepreneurs?

Feedback

Nieman and Nieuwenhuizen (2014:40) identify the following challenges:

- Access to start-up and expansion finance. *Access to appropriate finance is a major constraint in the successful development of SMMEs. This lack of finance can be attributed to*
  - *risk aversion by banks towards SMMEs*
  - *a decline in alternative financial institutions*
  - *inadequate funding proposals and business plans*
- Access to markets. *Most entrepreneurs do not start their businesses with an original idea. They merely follow what everyone else does or what has worked in the past. Most entrepreneurs do not probe or segment their market, analyse customer demand, know their competition and interpret trends.*
- Access to appropriate technology. *Use of appropriate technology can create competitive advantages for the business by improving efficiency, offering better products and services, reducing costs and improving quality.*
- Access to human resources. *Entrepreneurs have to gather and mobilise resources in order to create a new business. These resources include land, labour and capital. Entrepreneurs may have an excellent idea for a business, but may not know how to manage the idea or the people employed in the business.*

The GEM Report (2016:53) has shown that there is a direct correlation between the levels of perceived capabilities and the level of TEA in a country. Education is inextricably linked to entrepreneurial intentions and growth as it influences entrepreneurs' confidence in whether they have the skills and knowledge to start a business. Previous GEM South African reports have suggested that there is an association between educational levels and success in entrepreneurial ventures, and South Africa's poor skills level is certainly an important contributing factor to the country's below-average entrepreneurial capacity.

Activity 2.4

Although more women are taking the leap into going into business, they still face challenges. According to GEM, women entrepreneurs need more resources and better programs in order to build new collaborations and leverage ideas; develop entrepreneurial abilities and attitudes; and access to the means necessary to expand their businesses and generate jobs. See the link below

http://www.smesouthafrica.co.za/15864/Inspirational-quotes-from-some-of-women-leaders-in-business/

(1) Identify and then analyse some of the barriers facing women entrepreneurs in South Africa?

Feedback

Nieman and Nieuwenhuizen (2014:43) identify the following barriers that affect female entrepreneurship.

- *limited access to financial resources*
- *a lack of support structures*
- *balancing business and family responsibilities*
- *the prevailing negative sociocultural attitudes*
- *gender discrimination and bias*
- *a lack of training and education*
- *personal difficulties*

2.7 WOMEN AND EMERGING ENTREPRENEURS

Although entrepreneurship and business in general have been male dominated, the trend is changing rapidly. The economic role of women has been recognised in South Africa. Nieman and Nieuwenhuizen (2014:43) distinguish between the following different types of women business owners:

- traditional
- innovative
- domestic
- radical

The authors then go on to explain the obstacles facing women entrepreneurs.

2.8 EMERGING ENTREPRENEURS

Nieman and Nieuwenhuizen (2014:45) describe the different types of entrepreneurs, namely:

– survivalist and microentrepreneurs
– youth entrepreneurs
– technology entrepreneurs
– social entrepreneurs
– tourism entrepreneurs

To ensure that you understand each of the above concepts read Nieman and Nieuwenhuizen (2014:45–47).

2.9 ENTREPRENEURS VERSUS INVENTORS

The difference between an entrepreneur and an inventor is that the latter creates something new for the first time but lacks the skills to sell it. The entrepreneur will take over from the inventor and start a business venture in order to market the new invention (Nieman & Nieuwenhuizen 2014:50).

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

(1) List and explain the various levels of entrepreneurial sophistication.
(2) Do you believe that entrepreneurs are born with special characteristics? If not, would it be possible to teach someone to become an entrepreneur?
(3) What factors play a role in the decision to become an entrepreneur?
(4) List the barriers facing women entrepreneurs.
(5) Answer the following multiple-choice questions:

5.1 For which of the following issues is the field of entrepreneurship a critical solution?

(a) low economic growth
(b) high unemployment
(c) an unsatisfactory level of poverty
(d) All of the above

5.2 An example of a pre-entrepreneur is _____ .

(a) a person with a sign around his or her neck
(b) a street vendor
(c) a person selling exactly the same products as ten other people at exactly the same prices
(d) the owner of a home-based business

5.3 Role models can be seen as support systems because they can _____ .

(a) *develop relationships and trust between people with whom they come into direct contact*
(b) *provide emerging entrepreneurs with real entrepreneurial examples*
(c) *provide networking opportunities*
(d) *Both (a) and (b)*

5.4 One/some of the benefits of networks for entrepreneurs is/are _____ .

(a) *group or joint marketing of products*
(b) *taking a competitor's idea*
(c) *sharing a factory*
(d) *Both (a) and (b)*

5.5 One of the main reasons for the failure of entrepreneurial ventures is the lack of _____ .

(a) *access to labour*
(b) *access to finance*
(c) *access to the internet*
(d) *access to land*

5.6 It is important for entrepreneurs to address the skills, attitudes and expectations of employees by _____ .

(a) *giving them gifts*
(b) *inviting their families for a Sunday braai*
(c) *having work parties and functions on a weekly basis*
(d) *building team spirit and loyalty amongst employees*

5.7 Traditional women business owners are _____ .

(a) *highly committed to entrepreneurial ideas, but not to traditional gender roles*
(b) *highly committed to entrepreneurial ideas and the acceptance of entrepreneurial gender roles*
(c) *not committed to entrepreneurial ideas, but highly attached to traditional gender roles*
(d) *neither committed to entrepreneurial ideas nor to traditional gender roles*

5.8 _____ contribute positively to the economy by providing products and services at low prices.

(a) *Informal entrepreneurs*
(b) *SMMEs*
(c) *Street vendors*
(d) *Emerging entrepreneurs*

5.9 Informal and survivalist enterprises have _____ .

(a) *no potable water and electricity*
(b) *a low level of formal training*
(c) *low working and investment capital*
(d) *All of the above*

5.10 Entrepreneurship at schools (student entrepreneurship) was formally known as _____ .

(a) minority entrepreneurship
(b) youth entrepreneurship
(c) young entrepreneurship
(d) Both (a) and (b)

Answers to the assessment questions

Refer to the following pages in Nieman and Nieuwenhuizen (2014):

(1) pages 26
(2) Because entrepreneurs are not necessarily born with these characteristics, they can be acquired through life experience. The characteristics are listed on page 27.
(3) page 28
(4) page 43
(5) The answers to the multiple-choice questions are as follows:

5.1 (d)
5.2 (c)
5.3 (d)
5.4 (a)
5.5 (b)
5.6 (d)
5.7 (b)
5.8 (c)
5.9 (d)
5.10 (d)

SUMMARY

After working through this study unit, you should be familiar with the various levels of entrepreneurial sophistication and understand that entrepreneurs have unique characteristics that distinguish them from other individuals. You should also realise that SMMEs face certain challenges and know about the economic role of the female entrepreneur that has emerged. Work through the discussion questions and case studies at the end of the chapter in your prescribed book. These will afford you additional learning opportunities.

The next study unit will focus on creativity and business opportunity.

Mementoes and skills to take home

Since you have now completed topic 1 (Entrepreneurship and entrepreneurs), this would be an opportune moment to pause and look back on what you have experienced and acquired during your journey so far. Read through the following list of skills and make a tick [✓] in the box if you feel that you are able to

– explain to a friend the concept entrepreneurship and what it takes to be an effective entrepreneur ☐
– advise emerging entrepreneurs about the challenges facing them ☐
– write an article to your local newspaper about the factors that ensure the success of entrepreneurs ☐

– explain to one of your fellow students how the environment in which one grows up and certain characteristics clearly distinguish an entrepreneur from other individuals □

TOPIC SUMMARY

This topic should have given you a better understanding of the concept of entrepreneurship and the characteristics of a good entrepreneur. You are expected to identify the different types of entrepreneurs as well as the challenges facing them. You should understand the important role entrepreneurs play in the South African economy.

Topic 2

The entrepreneurial process, introduction and aim of the Topic

The aim of this topic is to help you understand how entrepreneurs manage themselves and their businesses in order to succeed, and what the process of entrepreneurship entails. Have you ever wondered how businesses come into existence? There is no easy answer to this question because a variety of issues needs to be considered. This topic will introduce you to some of these issues, such as the business opportunity and the window of opportunity. Furthermore, every business owner needs to understand the function and importance of a business plan and must be able to use a standard layout to draft one. You need to know the resource and legal requirements for starting a business and how to finance your venture. Lastly, we will focus on networking and support for small businesses.

Learning outcomes

After working through this topic, you should be able to

- demonstrate an understanding of the theory of creativity and innovation
- identify the window of opportunity and differentiate between an idea and an opportunity
- design and draft a simple business plan
- examine the different legal forms of business and how to legally protect a product
- identify and explain different ways of starting and financing a business
- explain the significance of networking and support for small businesses

Emerging issues

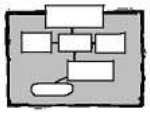
- What is creativity?
- What is the difference between creativity and an opportunity?
- What is the window of opportunity?
- What is a business plan?

– Why is it necessary for a prospective small business owner to draw up a business plan?
– What resources are required for starting a business?
– Why is business networking so important?

Each one of these questions will be discussed in a separate study unit and in this way, we will endeavour to suggest possible answers to the entrepreneurship issue. A mind map of topic 2 and the study units contained in it is provided below.

CONTENT OF THE TOPIC

Topic 2 comprises the following study units:



TOPIC 2						
Study unit 3	**Study unit 4**	**Study unit 5**	**Study unit 6**	**Study unit 7**	**Study unit 8**	**Study unit 9**
Creativity and business opportuni-ties	The window of opportunity	The business plan	Resource require-ments and legal and related aspects	Getting started	Financing an entrepre-neurial venture	Networking and support

Study unit 3

Creativity and business opportunities

Contents

Introduction
Travel pointers
3.1 The theory of creativity
3.2 The creativity model
3.3 Legal protection of products
Assessment

INTRODUCTION

The two characteristics people generally associate with entrepreneurship are creativity and innovation. We live in an economy in which all businesses (regardless of size) need to innovate in order to satisfy new and changing market needs.

Creativity can be defined as the process of generating ideas that result in the improved efficiency or effectiveness of a system (Kuratko & Hodgetts 2004:138).

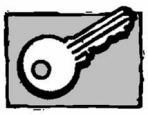
It is imperative that you understand the process of how to think creatively so that as potential entrepreneurs you can generate new and novel ideas for a business.

Study Nieman and Nieuwenhuizen (2014:61–98).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you retain your focus on the important issues in this study unit.

- What is creativity?
- How is creativity related to entrepreneurship?
- What are some of the misconceptions about creative thinking?
- What are the barriers to creativity?
- What creative techniques can help one to think creatively and develop ideas?
- What legal forms of protection are needed to protect a product from being copied?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and in what context they are used:

- creativity and creative thinking
- ideas and opportunities
- creative techniques
- legal forms of protection: patent, trademark, design, know-how, licence, copyright and plants

Make a list in your journal of the above words and write down a brief explanation of each as it appears in the prescribed book.

3.1 THE THEORY OF CREATIVITY

A general definition of creativity includes the following (Nieman & Nieuwenhuizen 2014:62):

- information about the product (which is a result of creative thinking and should thus create value)
- information about the thinking process (which is often unconventional)
- performance motivation (which supports the thinking process)
- a vague and unstructured initial problem
- thinking that results in ideas that are unique, practical and understandable

3.2 THE CREATIVITY MODEL

According to Nieman and Nieuwenhuizen (2014:64), the creativity model (the four-P model of creativity) serves as a basis for entrepreneurial activity and consists of the

- person
- process
- product
- press (business environment)

3.2.1 The person

The first "P" in the model of creativity is the person who is the entrepreneur, and he or she needs expertise, motivation and creative thinking skills in order to be creative.

There are many misconceptions about creativity and a person's ability to be creative. These misconceptions involve the following:

- Creativity skills cannot be acquired through training.
- Only "rebels" are seen as creative.

– Only artists are creative.
– Creativity only kicks in if one is crazy.
– One does not have to be highly intelligent to be creative.
– There is group versus individual creativity.
– All new products are discovered accidentally.

Activity 3.1

Do a Google search, or consult newspapers and books from the library, to explain some of the obstacles/barriers that prevent people from being creative and innovative in a business environment. It might be useful to explain your answer under the following headings:

– the social environment
– the economic environment
– the physical environment

Feedback

Study section 3.3.1 in Nieman and Nieuwenhuizen (2014:66) for information on the barriers to and challenges of creativity. You can also do an internet search (Google or Yahoo) to access more information on the barriers to creative thinking and innovation.

The following barriers are generally seen as obstacles to thinking and acting creatively. These will affect many tasks in the workplace.

Blockages to creativity include

– *environmental barriers (social, economic and physical environments)*
– *cultural barriers (eg stereotyping)*
– *perceptual barriers (eg assuming that an idea will work without doing the necessary research)*

In addition to the above, other blockages include lack of cooperation between colleagues, lack of support in implementing ideas, punishment for risk taking and autocratic managers.

The second "P" in the creativity model will now be discussed.

3.2.2 The process

Creativity forms part of a continuous process. This process involves the following three steps:

Step 1: generating new ideas
Step 2: developing the most suitable idea (process of invention)
Step 3: transforming the most suitable idea into an innovation (new product, service or process)

Study figures 3.4 and 3.5 and table 3.1 in Nieman and Nieuwenhuizen (2014:64, 70–71).

There are also a number of creative techniques that will help one to think creatively and develop new ideas. These techniques are an integral part of the creative process.

Nieman and Nieuwenhuizen (2014:72) explain the following techniques:

– random input
– problem reversal
– the five W's and H technique
– the association technique
– the discontinuity principle

Other techniques include brainstorming, surveys, focus groups and customer advisory boards (Barringer & Ireland 2006:39).

3.2.3 Ideas versus opportunities

At this stage, it is necessary to differentiate between an *idea* and an *opportunity*. Resources may be wasted on an idea that is incorrectly perceived as an opportunity.

How does one differentiate between an *idea* and an *opportunity*? Essentially, entrepreneurs recognise opportunities and turn them into successful businesses.

– An idea is a thought, impression or notion for a new product or service. Bear in mind that not all ideas are opportunities.
– An opportunity is a favourable set of circumstances that creates a need for a new product, service or business.
– The following factors may result in an opportunity:
    - general or specific problems faced by consumers
    - technological changes
    - market shifts
    - government regulations
    - competition

An opportunity is attractive, durable, timely and anchored in a product, service or business that creates or adds value for the buyer or end user. To capitalise on an opportunity, its *window of opportunity* must be open. This concept will be discussed in the next study unit.

3.2.4 The product

The product is the result of the creativity process. It is the new innovation.

Nieman and Nieuwenhuizen (2014:83) distinguish between *fundamental changes* (radical changes) and *incremental changes*. They also discuss critical areas in which innovations could be made. These include *new*

– products
– services
– production techniques
– operating practices
– ways of delivering the product or service to the customer

– ways of informing the customer about the product
– ways of managing relationships in the organisation

The product part of the model is the final outcome of the creative process and forms an integral part of the creative person.

After reading the above discussion, you should have a good idea of the importance of creativity and innovation, both for the entrepreneur and for businesses in South Africa.

Press. The press represents the environment in which the entrepreneur operates. The environment may be his or her immediate environment (workplace), the market environment (customers, suppliers, intermediaries and competitors) or even the macroenvironment (the economic, technological or international environment).

3.3 LEGAL PROTECTION OF PRODUCTS

Since someone else can easily copy an entrepreneur's new product, some form of legal protection is necessary.

The following options are available to entrepreneurs:

– *Patents.* A patent can be used for any invention that takes the form of an apparatus, article, device, method or process.
– *Know-how.* Secret technology, which usually relates to processes, can be licensed to others in return for payment.
– *Trademarks.* Trademarks can be registered for name, logo, design and service protection.
– *Registered designs.* These designs can be used to protect aesthetic designs.
– *Unlawful competition.* This option can be used to protect the entrepreneur and his or her business from other companies marketing products and providing services in a manner that confuses them with the entrepreneur's business.
– *Copyright.* This option can be used for the protection of intellectual content such as literary works.
– *Plants.* This option can be used for the protection of new varieties of plants.
– *Licences.* Licences protect all forms of intellectual property.

Activity 3.2

Mr Ndlovu has invented a new kitchen product and has also published a booklet with recipes and uses for the product. Explain to Mr Ndlovu what legal forms of protection are available to prevent others from copying his product and booklet.

Feedback

Mr Ndlovu could have his new kitchen product patented, which would protect him from others copying the product.

Mr Ndlovu could also copyright the booklet containing his recipes and information about the different uses of his product.

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

(1) Melanie is a perceptive person and believes that she has identified an opportunity for a new business in the fashion industry. What criteria could Melanie use to determine whether she has identified an attractive opportunity and is not simply following a hunch?
(2) What is meant by creativity? Formulate your own definition in the context of entrepreneurship.
(3) To what extent can creativity, as an entrepreneurial skill, assist the entrepreneur in establishing and growing a business?
(4) Apply Couger's creativity model to assess the creative entrepreneur. What environmental factors in South Africa would affect a business opportunity negatively?
(5) Assess the basic barriers to creativity for the entrepreneur in your immediate environment. To what extent would these factors hinder growth?
(6) Using suitable examples, explain the difference between an idea and an opportunity.
(7) Distinguish between fundamental and incremental changes.
(8) Graphically illustrate the creativity model and explain its contents.

Answers to the assessment questions

Refer to the following pages in Nieman and Nieuwenhuizen (2014):

(1) pages 72–74
(2) You need to formulate your own definition of creativity. The definition should include the following variables at least: uniqueness, novel, unconventional *and* process *(see sec 3.2 on page 62).*
(3) Creativity serves as a catalysing agent in various aspects of the entrepreneurial process, including the development of new products or services and/or processes, and the identification of opportunities. Creative thinking is also the foundation for problem solving which generally happens in the small business environment.
(4) See page 63 in section 3.3 in Nieman et al (2014:63). The four P model consists of the following variables:

- People. *This refers to the creative person or entrepreneur. The entrepreneur utilises his or her creative abilities to develop and manage different situational aspects in his or her environment. The core differentiating skill of the true entrepreneur is innovation, that is, the ability to develop a new product, service or process in the marketplace.*
- Process. *The creative process refers to the procedure followed to develop the "new" product or solve a problem effectively.*
- Product. *The product is the final outcome of the creative process and is also referred to as the innovation.*

In what way could the South African environment affect the entrepreneur negatively?

The answer to this question depends on which environment we focus on. The microenvironment, also known as the immediate environment, may be affected by personnel strikes (problem-solving actions needed). A competitor in the market environment may, for instance, copy the entrepreneur's product and market it

more effectively and successfully. The economic environment (macroenvironment) could generate fundamental negativity for the entrepreneur. A decrease in the value of the rand, for example, could influence the bottom line negatively if the raw materials or equipment required for the product has to be imported from the USA. The entrepreneur's creative ability should help him or her to overcome these problem situations.

(5) Your answer should mention environmental, cultural, perceptual and environmental barriers. See page 66, "Blocks to creativity".
(6) See Nieman et al (2014:72) "Idea versus opportunity" on page 72. An idea, for example, could be the potential development of a motor vehicle that adapts the interior temperature to match that of the human body. This might be a wonderful idea, but not necessarily a feasible opportunity. To develop a vehicle with the ability to manage the climate inside the cabin would be a more feasible opportunity in the luxury motor segment.
(7) Refer to Nieman and Nieuwenhuizen (2014:83).
(8) Refer to figure 3.1 and 3.2 pages 63–64.

Mementos and skills acquired on the journey

After completing the journey through study unit 3, you should have acquired the following "mementoes" and skills on your journey:

- *You learned how an entrepreneur could use creativity as a fundamental tool in developing new ideas for products, services and businesses.*
- *It became clear that the entrepreneur needs expertise, motivation and creative thinking skills to run a business successfully.*
- *You also learned how you could protect an innovation legally.*

The next study unit will focus on the window of opportunity and will look at how to evaluate an opportunity.

In conclusion, read the case study entitled "Low-cost mobile and medical device for development: of inventions, business prospects and market failures". Assess the likely commercial success of this new venture with the Innovator C, which follows the case study.

Refer to pages 86–91 in Nieman and Nieuwenhuizen.

Study unit 4

The window of opportunity

Contents

Introduction
Travel pointers
4.1 An opportunity
4.2 An idea versus an opportunity
4.3 The sources and drivers of ideas and opportunities
4.4 Opportunity evaluation
4.5 The pursuit of opportunities
4.6 Why larger businesses leave gaps in the market
4.7 The window of opportunity
4.8 Seeing, locating, measuring and opening the window of opportunity
4.9 Continuous opportunity evaluation and utilisation
Assessment
Summary

INTRODUCTION

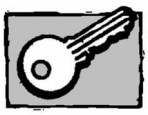
This study unit will guide you through the process of opportunity evaluation and, more specifically, through the different phases of the window of opportunity. The window of opportunity describes the time period in which a business can realistically enter a market. Once the market for a new product has been established, the window of opportunity is open. When the market matures, the window of opportunity closes.

Study Nieman and Nieuwenhuizen (2014:101–114).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you retain your focus on the important issues in this study unit:

- What is an opportunity?
- What is a window of opportunity?
- What is the difference between an idea and an opportunity?
- When is an idea an opportunity?
- What does the expression "seeing, locating and measuring, opening and closing the window of opportunity" mean?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- an opportunity
- a window of opportunity
- seeing, locating, measuring, opening and closing the window of opportunity technological inertia
- cultural inertia

Make a list in your journal of the above words and write a brief explanation of each as it occurs in the prescribed book.

4.1 AN OPPORTUNITY

See Nieman and Nieuwenhuizen (2014:101) for various definitions of the term "opportunity". In a nutshell, an opportunity is an idea that is attractive, durable, timely and anchored in a product or service that creates or adds value for the end user.

Read "The role of ideas" in Nieman and Nieuwenhuizen (2014:102).

4.2 AN IDEA VERSUS AN OPPORTUNITY

Not all good ideas are opportunities. An idea must attract the attention of consumers, that is, encourage them to purchase the goods or services. Moreover, the idea must be presented to the market at the right time.

You should be able to distinguish between an idea and an opportunity by referring to the definitions of each, as discussed in previous sections.

4.3 THE SOURCES AND DRIVERS OF IDEAS AND OPPORTUNITIES

Finding good ideas and converting them into opportunities is a conscious, deliberate and creative process. According to Nieman and Nieuwenhuizen (2014:103), ideas can be generated from skills, common needs, existing problems, everyday problems and other sources, such as expired patents, trade shows and overseas products.

After coming up with an idea, you have to evaluate it in order to determine whether or not it will be lucrative. This is explained below.

4.4 OPPORTUNITY EVALUATION

The following criteria can be used to screen opportunities (Nieman & Nieuwenhuizen 2014:103–104):

- industry and market issues (eg a niche market and the attractiveness of the market)
- economics (eg the attractiveness of ventures requiring low start-up costs and little capital equipment)
- harvest issues (exit strategy)
- management team (eg the need for an experienced team with integrity, opportunity obsession and tolerance of ambiguity)
- fatal flaw issues (eg a too small market, entry barriers or an inability to gain a competitive advantage in the market)
- personal criteria (a committed and dedicated entrepreneur)
- strategic differentiation (eg positioning in the market)

4.5 THE PURSUIT OF OPPORTUNITIES

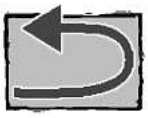
Read this section in Nieman and Nieuwenhuizen (2014). It looks at why larger businesses leave gaps in the market, and is closely related to the next section.

4.6 WHY LARGER BUSINESSES LEAVE GAPS IN THE MARKET

Larger businesses tend to leave gaps in the market for numerous reasons. Once these gaps are left open, it is easy for smaller organisations to spot the opportunity and make the most of it. Nieman and Nieuwenhuizen (2014) discuss a number of reasons why larger businesses leave gaps in the market.

Activity 4.1

Do some larger businesses not always pursue lucrative business opportunities? Explain why you agree or disagree with this statement.



Feedback

Here you should have identified the following reasons:

- *Large businesses often fail to see new opportunities.*
- *Large businesses tend to underestimate opportunities as lucrative.*
- *Large businesses do not always keep abreast of the technological changes in the marketplace.*
- *Large businesses tend to be too rigid in meeting challenges in the market environment.*
- *Most large businesses have political issues and experience internal fighting.*
- *Governments tend to support to small businesses instead of larger businesses.*

Study the above factors in Nieman and Nieuwenhuizen (2014:106–110).

4.7 THE WINDOW OF OPPORTUNITY

The window of opportunity refers to the favourable period of time available for creating new ventures. See Nieman and Nieuwenhuizen's (2014) detailed definition of the window of opportunity.

An entrepreneur should know what the size of the market is as well as the length of the window of opportunity, in order to determine the risk and reward involved in exploiting the opportunity.

4.8 SEEING, LOCATING, MEASURING AND OPENING THE WINDOW OF OPPORTUNITY

Nieman and Nieuwenhuizen (2014:111) identify the five stages in the window of opportunity:

(1) seeing the window (identifying gaps in the market and possible opportunities)

(2) locating the window (fully understanding how product/service offerings in the market compare with those of competitors – this allows the entrepreneur to gain a sustainable competitive advantage over his or her competitors)

(3) measuring the window (ensuring that the opportunity is feasible and viable)

(4) opening the window (entry into the market and starting the business activity)

(5) closing the window (the entrepreneur should try to create and maintain a sustainable competitive advantage)

Note the following important concepts:

– *Feasibility study.* The feasibility study looks at the entrepreneur's ability to match his or her skills to the requirements of the venture. It is a process of determining whether or not a business idea is viable. It is a preliminary evaluation of a business idea, conducted for the purpose of determining whether the idea is actually worth pursuing.

  Criteria that will be considered during such a study, include marketing costs, production costs, potential profit margins, the size of the potential market and the industry (Kuratko & Hodgetts 2008:414).

– *Viability study.* A viability study is conducted to determine how the market will respond to the innovation.

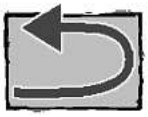
  Read the section entitled "The real time window of opportunity – a holistic approach" in Nieman and Nieuwenhuizen (2014:113).

4.9 CONTINUOUS OPPORTUNITY EVAUATION AND UTILISATION

Once the entrepreneur has worked through the stages of opportunity evaluation and has found that he or she has a lucrative window of opportunity, he or she must start implementing his or her new product or service. An entrepreneur must understand that a window of opportunity will not last forever – hence the need to create and maintain a continuous and sustainable competitive advantage.

Activity 4.2

A novice (new) entrepreneur approaches you for advice on how to increase her competitive advantage. You are required to explain to her the meaning of term "competitive advantage" using relevant and pertinent examples such as technology, customer experience and price value. Consult the section dealing with bases of competitive advantage in Nieman and Nieuwenhuizen (2014) in order to answer this question.



Feedback

A competitive advantage entails a business offering – a product/service that the customers perceive as superior to those of competitors (Nieman & Nieuwenhuizen 2014:112).

The bases of a competitive advantage are as follows:

- *unique service features (eg Scooters' pizzas are delivered within a specific time, otherwise the client receives them for free)*
- *notable product attributes (eg a cellphone with a built-in camera)*
- *customer experience (moments of truth)*
- *price/value*
- *customer convenience (eg Pick n Pay affords its clients the opportunity to do online shopping in the convenience of their homes, and delivers the groceries they order within 24 hours)*

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

Select ONE correct answer for each question.

(1) A good idea is not necessarily a feasible and viable _____ .

(a) business
(b) service
(c) opportunity
(d) chance
(e) product

(2) In order for an idea to be timely, it must be presented to the _____ at an opportune time.

(a) bank
(b) inventor
(c) manufacturer
(d) investor
(e) market

(3) By ___ potential opportunities, vital issues and considerations that might be overlooked or underemphasised, to the detriment of the venture, are brought to light.

(a) quantifying
(b) screening
(c) solving
(d) seeking
(e) sorting

(4) The customers that make up the _____ market tend to be accessible as well as willing to purchase the product or service.

(a) consumer
(b) niche
(c) particular
(d) rich
(e) variable

(5) Larger or established businesses tend to leave gaps in the market because of _____ .

(a) their failure to see the wood for the trees
(b) an overestimation of their importance
(c) technological inertia
(d) cultural differences
(e) politicians becoming involved

(6) The _____ of opportunity refers to the time period available for creating new ventures.

(a) time
(b) door
(c) gap
(d) window
(e) threshold

(7) The government is currently seriously involved in efforts to bolster and support _____ in numerous ways.

(a) medium enterprises
(b) factories
(c) businesses
(d) SMMEs
(e) micro enterprises

(8) Once the window has been spotted, it is necessary to understand its _____ .

(a) size
(b) place
(c) location
(d) diameter
(e) movement

(9) The window can be _____ by the entrepreneur creating and maintaining a sustainable competitive advantage.

(a) seen
(b) measured
(c) located

(d) opened
(e) closed

(10) Failure by the entrepreneur to _____ the window of opportunity could effectively reduce his or her potential market share and business activity and, at worst, render the venture obsolete.

(a) close
(b) locate
(c) see
(d) open
(e) measure

Answers to the assessment questions

(1) (c)
(2) (e)
(3) (b)
(4) (b)
(5) (c)
(6) (d)
(7) (d)
(8) (c)
(9) (e)
(10) (a)

SUMMARY

This study unit introduced you to the concept of the window of opportunity. You should now be able to distinguish between an idea and a viable business opportunity. This study unit looked at how to evaluate opportunities.

Do the revision questions on page 114 Nieman and Nieuwenhuizen (2014).

Once an entrepreneur has identified a viable business opportunity, he or she needs to pursue it. The business plan explains in detail how the opportunity will be pursued. The next study unit will focus on the business plan and how to draft one.

Study unit 5

The business plan

Contents

Introduction
Travel pointers
5.1 Defining a business plan
5.2 Reasons for drawing up business plans
5.3 Standard format of a business plan
5.4 How to select the most appropriate business plan
5.5 Types of business plans and their functions
5.6 Problems when drawing up a business plan
5.7 Using the internet as a tool for drawing up a business plan
Assessment
Summary

INTRODUCTION

This study unit will guide you through the process of planning the potential business once a viable opportunity has been identified. Planning is essential to the success of any business because it entails the formulation of goals and strategies for the business.

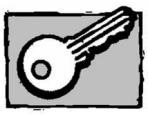
A business plan is a detailed document that helps an entrepreneur to analyse the market and develop business strategies. Drafting a business plan, affords entrepreneurs an opportunity to think ahead and plan for the future. One needs to be aware of common pitfalls when drafting a business plan as well as the different types of business plans. This study unit will introduce you to these concepts.

Study Nieman and Nieuwenhuizen (2014:119–134).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit:

– What is a business plan?
– Why do we need a business plan?
– What should be included in a business plan?
– What problems are sometimes experienced when drawing a business plan?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- business plan
- executive summary
- market description and analysis
- marketing strategy
- management plan
- operations plan
- financial plan
- breakeven analysis

Make a list in your journal of the above words and write a brief explanation of each as it occurs in the prescribed book.

5.1 DEFINING A BUSINESS PLAN

Nieman and Nieuwenhuizen (2014:119) explain that a business plan is a written document that spells out where the business is heading and how it will reach its destination. A business plan therefore explains the business, its management team, the product/service and its goals and strategies. It involves a process of planning, that is, *what* the businessperson would like to achieve (goals). It also outlines strategies and action plans to achieve the goals – in other words, *how* the businessperson will achieve them.

Activity 5.1

A business plan is one of the cornerstones of starting a business. It dictates whether one will be successful in applying for credit, a loan, implementing a strategy for the business, and so forth. Consult any textbook, newspaper article or journal, or do a Google search, and write two paragraphs on what you understand by the term "business plan".

Feedback

After consulting a number of sources, you could have defined a business plan as follows (Kuratko & Hodgetts 2008:296):

> *A business plan is the written document that details the proposed venture. It describes the current status, expected needs and projected results of the new business. The business plan is the entrepreneur's road map for a successful enterprise.*

According to Longenecker, Moore and Petty (2008:151), a business plan is a document that sets out the basic ideas underlying a business and related start-up considerations.

A business plan is a written document, describing all aspects of a business venture, which will be necessary to raise money and attract high-quality business partners (Barringer & Ireland 2006:459).

Who reads the business plan? Numerous professional people will read this document, and this should be kept in mind when drafting the document. These professionals include bank managers, lawyers, consultants, investors and suppliers.

5.2 REASONS FOR DRAWING UP BUSINESS PLANS

According to Nieman and Nieuwenhuizen (2014:120), the three main reasons for drawing up a business plan are as follows:

(1) to obtain funding (A business plan can be used to approach and capture financial resources, that is, present the business plan when applying for a loan at the bank.)

(2) to serve an inside purpose (A business plan can be used in the business. It will give the managers and other staff a sense of direction and focus, and can be used to measure the business's performance against the set objectives.)

(3) to reduce business risk (A business plan forces the entrepreneur to consider each aspect of the business and manage it accordingly.)

5.3 STANDARD FORMAT OF A BUSINESS PLAN

The standard format of a business plan includes the following sections:

- the cover sheet
- a table of contents
- a summary
- a product/service plan
- a marketing plan
- an operations plan
- a management plan
- a financial plan, which should also include
    - a schedule of start-up or establishment costs
    - a breakeven analysis
    - a pro forma cash flow statement
    - a projected income statement
    - a projected balance sheet
    - details of possible risks and problems
- an appendix

Study table 5.1 in Nieman and Nieuwenhuizen (2014:121).

In order to prepare the information in the sections above, the following ten questions must be answered in a business plan:

(1) Is the business an idea or an opportunity with potential?
(2) Does the firm have an exciting business model?
(3) Is the product/service viable?
(4) Is the industry in which the product/service will compete growing, stable or declining?
(5) Does the firm have a well-defined target market?
(6) How will the firm's competitors react to its entry into the market?
(7) Is the firm's management team skilled and sufficiently experienced?
(8) Is the business well organised and are the strategies and business practices ethical and legal?
(9) Are the financial projections realistic?
(10) What are the critical risks surrounding the business and do management have contingency plans in place?

Study Nieman and Nieuwenhuizen's (2014:120–125) discussion of the information included in the different sections of the business plan.

Activity 5.2

An entrepreneur has approached you for advice. He informs you that his gross profit is R150 000 and his sales volume R700 000 per annum. The operating expenses for this business amount to R164 916.

Calculate the breakeven turnover for the business.

Feedback

Breakeven turnover is calculated as gross profit = operating costs

$$\text{Gross profit (\%)} = \frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$$

$$= \frac{R150\,000}{R700\,000} \times \frac{100}{1}$$

$$= 21{,}43\%$$

Therefore

$$21{,}43\% = R164\,916$$

$$= \frac{R164\,916}{21{,}43} \times \frac{100}{1}$$

$$\text{Breakeven turnover} = R769\,556{,}70$$

You can advise the entrepreneur to aim for an annual turnover of R769 556,70 if he is to cover all his costs. Any turnover above this amount will indicate profit.

Do the exercises in Nieman and Nieuwenhuizen (2014:123–124).

5.4 HOW TO SELECT THE MOST APPROPRIATE BUSINESS PLAN

It is vital for an entrepreneur to select the most appropriate business plan for his or her business.

The following guidelines can assist the entrepreneur to select the most appropriate business plan in order to satisfy the business's specific requirements:

- Understand how the new or existing business is going to operate.
- Understand the exact purpose of the specific business plan.
- Study and understand different types of business plans.

5.5 TYPES OF BUSINESS PLANS AND THEIR FUNCTIONS

Different situations may require different types of business plans as highlighted below.

- planning a new business
- transforming or expanding an existing business
- creating a strategic document for an existing or new business
- obtaining a loan
- attracting shareholders or partners
- selling the business
- providing direction for management and staff
- preparing the business for a merger
- preparing the business for a takeover
- helping to position the business in the market

Activity 5.3

Provide an outline of a business plan if you are contemplating

(1) selling your business

(2) applying for a business loan

(3) preparing your business for a merger

Note that you are required to write a separate business plan outline for each of the above situations.

Feedback

Nieman and Nieuwenhuizen (2014:127–131) explain each situation and the requirements of the business plan for each situation.

5.6 PROBLEMS WHEN DRAWING UP A BUSINESS PLAN

There are potential problems in drawing up a business plan, such as failure to anticipate obstacles, underestimation of financial requirements and understatement of financial

expenses. Table 5.2 in Nieman and Nieuwenhuizen (2014) outlines the problems that the entrepreneur could encounter when drawing up a business plan and explains how to avoid such problems.

5.7 USING THE INTERNET AS A TOOL FOR DRAWING UP A BUSINESS PLAN

The internet can be a useful tool for the entrepreneur. It may be a valuable source of information on components of the business plan such as market potential and industry analysis. It can also be used to market a new business. The software and templates for drawing up business plans are available on the internet.

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

(1) Suppose a successful entrepreneur tells you she has never written a business plan even though she has an extremely successful business. She asks you why it is actually necessary to write a business plan. How would you respond?
(2) List the key sections of a business plan.
(3) What is the purpose of the executive abstract/summary in a business plan?
(4) Identify the different situations that may require different types of business plans.
(5) Explain why a business plan should do more than merely avoid the obvious pitfalls?

Answers to the assessment questions

(1) A business plan is compiled by both start-up and existing businesses. An entrepreneur often compiles a business plan to ensure that the future growth of the firm is properly managed. Such a plan will also help him or her to avoid costly mistakes. It is a useful planning document and necessary to obtain funding.
(2) See Nieman and Nieuwenhuizen (2014:120).
(3) See section 5.4.3 in Nieman and Nieuwenhuizen (2014).
(4) See section 5.6 in Nieman and Nieuwenhuizen (2014).
(5) The business plan is also a selling document for potential investors and creditors and it should avoid the problems listed in table 5.2 in Nieman and Nieuwenhuizen (2014:132).

BUSINESS PLAN MULTIMEDIA ACTIVITY

MOGALE meets PULE

On this journey, you will learn about the things that you need to know when writing a business plan.

Mogale meets Pule about the preparations that need to be done to be able to write a business plan with substance.

Pule is enthusiastic and share his words of business wisdom without hesitance. Mogale is a graduate who is still searching for knowledge. He is eager to start his own business. He is a good listener and receptive to good advice.

Mogale goes to FNB to apply for a loan in order to start a business. He is not sure what business he wants to run, but feels that he will know exactly once the loan is approved.

When he arrives at the bank, the consultant tells him that nobody is born a businessperson. We are all born with potential but we are not always certain what we want. We are born with nil consciousness of what we want. Mogale is adamant that it is his birthright to be a businessperson. The bank consultant leads Mogale to a notice board to show him a list of names and profiles of business people who have received loans from the bank. The consultant helps Mogale to meet with Pule.

The day arrives and Mogale meets with Pule.

PULE: Why are you here?

MOGALE: All these years, all young people wanted were to become kwaito musicians. These days, all young people want to become hip-hop artists. But I want to become a **businessman**, work for myself and create jobs for my unemployed friends and relatives.

PULE: (**takes out a business self-evaluation scorecard):** Please fill in this scorecard. There are ten reasons provided on the business self-evaluation scorecard for why a person started or wants to start a business. You need to score each reason according to the value you attach to it.

PULE: Why do you want to start your own business?

MOGALE: I want to make money, enjoy life, be respected and employ my friends and relatives.

PULE: Really?

MOGALE: Yes, definitely!

PULE: Good. Your score confirms that. It is interesting but you have the wrong ideas about things.

PULE: If you want to make money and live large, you must play the lotto. With the lotto, the fate of your success lies within numbers; however, in business, the fate of your success lies within you. It lies within your eagerness to be in business. What I am saying may sound philosophical. In business, the fate of your success lies within your ability to turn uncertainties into certainties. It lies within the ability to research and learn.

MOGALE: This is giving me a different perspective

PULE: In South Africa, a huge number of small businesses are failing. Only five in every 100 entrepreneurs own or manage businesses younger than three and half years. People think that running a business is like being employed and that they have the right to get a salary at the end of each month. When they discover that a salary is not a right, they close shop and search for a job.

A business can never survive and succeed without sacrifices being made. Never! If you want a successful business, be ready to lose something. Be ready to lose sleep, leisure and other routines. Some people have lost cars, houses, marriages, lovers and health. What are you prepared to sacrifice?

MOGALE: You are right. I know of people who have suffered heart attacks because of their business.

PULE: Running a business is not an event; it is a journey.

After a week, the two met again.

Pule thanks Mogale for returning. They will now focus on compiling a business plan.

PULE: I hope you know that a business plan is not a business.

MOGALE: But why is it in fashion? These days if you say you want to start a business people always want to know if you have a business plan.

PULE: They are right to ask you about this. A business plan is a story about a business opportunity. To be a good story, it needs to be factual rather than fictional. It needs to be based on research. The business opportunity is the axis of your story because the business plan revolves around the business opportunity.

Remember also that a business plan is a vision. It will not make you a well-informed businessperson. It will help you get a loan and kick-start your business. To run a successful business, you need sound knowledge, resilience and a good strategy. If you want to succeed in business, know yourself, your business, your customers and your competitors.

MOGALE: Sure, I agree. One should know what the business entails. Not knowing what a business entails is like asking a born-again Christian woman to meet you at a nightclub.

PULE: I can see you understand the principle. When a business starts, it embarks on marketing to create curiosity about the business. People will come, see and decide to come back, or not to come back. What do you think will make people keep coming back?

MOGALE: Because of good marketing?

PULE: Marketing is good only when it leads to brand awareness. But for people to come back to your business, you need value in your product or service. Marketing creates curiosity and product exposure, and it attracts customers.

However, to attract and retain customers, the priority is not marketing but the quality of what you offer. No matter how good marketing is, it will not resuscitate a dead product or service.

In the beginning, the purpose of a marketing plan is to create awareness of products or services and business brand. When the business is up and running, the purpose of a marketing plan is to remind loyal customers that

the business still deserves their support, to target new customers and to introduce new and loyal customers to new offerings. It is more difficult for a new business to attract and retain customers. People love to stick with the "devil" they know.

MOGALE: But why do people prefer to stick with the devil they know?

PULE: People are afraid of change.

PAPI joins the two in their discussion. He is more knowledgeable about risk management.

MOGALE: I want to understand how business people deal with risk exposure.

PAPI: To understand the adventure of business, you have to understand many things, for example, survival tactics of street kids and sex workers. Street children and sex workers are the least protected citizens and they are ever-exposed to danger.

MOGALE: Why should anyone choose street children and sex workers to understand business risk?

PULE: Yes, we do understand that street children and sex workers are the least protected. But tell us why you chose them.

PAPI: I want you to understand how businesses know about their risks and how they deal with risk exposure. The best lesson on risk exposure and on how to deal with risk should come from the least protected.

PULE: What did you find?

PAPI: Street children and sex workers are business people. They work just like companies, because they budget, have financial discipline measures, and work as a team.

(Pause)

Street children scan their environment. They know where and when it is dangerous for them to sleep and when it is bad timing to beg for money. They also know their customers by calling them uncle and sister, which are names of respect. Street children prefer risk avoidance rather than risk containment. Some sex workers are sexually assaulted and their greatest concern is obsessive clients. Whenever there is an opportunity, sex workers would choose to humble enraged clients.

PULE: This is quite interesting. Risk identification, risk analysis, risk avoidance, risk prevention and risk transference – these are the hallmarks of risk management.

MOGALE: To run a business you need resources, for example, physical resources such as offices, material resources like computers, fax machines and telephones, and human resources such as staff.

PAPI: Furthermore, you need a financial plan to show the costs of running your

business as well as to show financial projections. Remember that there is no real profit until a business breaks even. There is no real profit until debts are reduced or settled.

PULE: Oh no, Mogale! I am only now remembering the business self-evaluation scorecard you filled in when we met. Do you know what I am talking about?

(Mogale nods his head.)

Here are the wrong versus the correct reasons to start a business:

WRONG REASONS	**STRATEGIC REASONS**
To take a chance	To become a business player through knowledge, skills and endurance
To make money	To overcome risks, survive, succeed and make money
To show friends and acquaintances that I can start a successful business	To apply the business skills I possess and to prove to myself that I can run a successful business
Due to frustration at work	I have gained enough knowledge from my workplace to start a business and solidly compete with my present employer
Because friends I grew up with have started businesses	Over the years, I studied the qualities of successful businesspeople, including friends and people I attended school with and I have discovered that I also have most of their qualities
People I know say I will make a good businessperson	I believe I can make a good businessperson, but to prove this, I need to research, learn and benchmark myself against businesspeople who are already successful, preferably against those in my line of business
I cannot stand to work with other people	I want to employ myself and employ other people should the business succeed
I come from a business-oriented family	I believe I have business talent and potential that need to be nurtured for me to run a successful business
A fortune-teller revealed that should I start a business, I shall become the most successful businessperson around	With the business knowledge and skills I have amassed, I have the potential to become the most successful businessperson around
Because people make a lot of money in this area of business	I have relevant expertise to do business in this area of business

MOGALE: May I ask a last question? What qualities do I need to make it in business?

PULE: You need a creative imagination, passion, self-confidence and self-discipline.

Meeting adjourned.

SUMMARY

This study unit introduced you to a vital document that most entrepreneurs will have encountered, namely the business plan. You should understand the importance and the standard layout of the document. The business plan is used to obtain funding and to identify and reduce risks. There are different types of business plans and each type should have a specific focus. We also looked at the common pitfalls in drawing up a business plan.

The next study unit will discuss the resource requirements, and legal and related factors. This will assist the new entrepreneur to pursue business opportunities with the necessary resources while complying with the many legal regulations.

Study unit 6

Resource requirements and legal and related aspects

Contents

Introduction
Travel pointers
6.1 Resource requirements for a new business
6.2 Legal forms a business can assume in South Africa
6.3 Intellectual property rights
6.4 Other legal requirements
6.5 Legal aspects in the normal flow of business
Assessment
Summary

INTRODUCTION

Resources are needed to start a business. The four main categories of resources are financial, human, physical and information. It is sometimes a challenge to acquire these resources and to comply with the many legal regulations applicable to a small business. This study unit will discuss the legal aspects of the establishment of a business as well as the considerations relating to the normal flow of business.

Study Nieman and Nieuwenhuizen (2014:141–173).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit.

- What resources are required to establish a business?
- What are the legal forms of business establishment?
- How does one register a new business?

Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign

country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- resource requirements
- legal requirements
- close corporation
- intellectual property rights: copyright, design, patents, trademarks and counterfeit goods
- SARS

Make a list of the above words in your journal and write down a brief explanation of each one as they occur in the prescribed book.

6.1 RESOURCE REQUIREMENTS FOR A NEW BUSINESS

Study Nieman and Nieuwenhuizen (2014:142–144).

To start a business, an entrepreneur needs

- money
- people to contribute skills and knowledge (entrepreneurs and staff)
- physical assets such as a building and equipment
- information (for decision making)

The entrepreneur is responsible for attracting these investments. Since resources are limited, he or she needs to make the right choice about which resources to invest in. The major types of resources are as follows:

6.1.1 Financial resources

Financial resources may be in the form of cash or can be converted to cash. These resources do not have a single purpose and can be used to buy other resources. Finance can be obtained from various sources. Nieman and Nieuwenhuizen (2014) discuss debt and equity financing and revenue.

Activity 6.1

As a prospective entrepreneur, identify the sources of financing that are legally available to you. In the table below, fill in the "Source of finance" column and place a tick under low, medium and high risk for each of the sources of financing. Once you have completed the table, explain in detail any two sources of financing available to entrepreneurs.

Table 6.1: Legal sources of financing

Source of finance	Low	Medium	High risk

Feedback

See Nieman and Nieuwenhuizen (2014:142).

Equity financing is money invested by the entrepreneur from (1) his or her personal finances, (2) taking in a partner or (3) selling shares to investors. These partners or shareholders become owners of the business. Equity financing thus involves the sale of some of the ownership of the business.

Debt financing is money loaned to the business by external sources such as the bank or other lending institutions. The borrower pays interest on the loan, and is required to pay back the loan within a reasonable period of time. The providers of the debt (lenders) do not become owners. Debt financing thus involves a payback period, plus a fee (interest) for the use of the money.

Other sources of finance include government support programmes, venture capital funds and companies (eg business partners).

6.1.2 Human resources

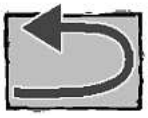
Human resources include all the people who contribute to the success of the business and can be divided into

- top management
- middle management/professional staff
- supervisory management
- nonmanagerial workers

The entrepreneur has to forecast human resource needs, recruit candidates and select the best person for the job. See Nieman and Nieuwenhuizen's (2014) discussion of these processes.

Activity 6.2

As a human resource manager in your business, what could you do to accurately recruit, select and appoint the best employee for your business?



Feedback

Possible answer: *List all the tasks that will have to be performed in the business; design the job description; determine the job specification; recruit potential candidates; interview the candidates on the shortlist; and appoint the best person for the job.*

6.1.3 Physical resources

Physical resources include fixed assets, raw materials and general supplies. Planning is important before acquiring these resources, because large sums of money may be required.

Before buying a building, the entrepreneur must first decide where he or she wishes to locate the business. According to Nieman and Nieuwenhuizen (2014:143), the following factors should be considered when deciding on a suitable location:

- access to the market
- the availability of raw materials
- the availability of labour and skills
- the infrastructure such as transport and water supply
- the climate

The location of a business will be discussed in the next study unit.

6.1.4 Information resources

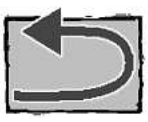
Information is needed to enable the entrepreneur to make informed management decisions. Firstly, the entrepreneur needs information about the external business environment such as international, economic, social and legal concerns. He or she also needs to know who the business's competitors and customers are.

Secondly, the entrepreneur requires information about the internal business environment, which will help him or her to run the business efficiently. This includes information about marketing, human resources, quality control, manufacturing and financing.

Activity 6.3

Access to information is one of the key principles for success in any business enterprise. Identify some of the sources in which information about businesses can be easily accessed.

Example: I am planning to open an Internet Café in Brits. The first thing I would do is to visit the DTI website to ascertain how many Internet Cafés are registered in Brits. Why do you think I visited the DTI website? This website has a register of all legally registered businesses in Brits.



Feedback

See Nieman and Nieuwenhuizen (2014:144).

Sources include the internet, government departments, chambers of commerce, educational institutions, independent organisations, and so on.

The next section discusses the legal requirements for establishing a business. It also looks at the legal forms a business can assume in South Africa, intellectual property rights, taxation, registration with the Department of Labour, trade licences and regional services levies.

Study Nieman and Nieuwenhuizen (2014:144–154).

6.2 LEGAL FORMS A BUSINESS CAN ASSUME IN SOUTH AFRICA

A South African small business can assume one of four legal forms, each with its own legal implications. These forms are a

- sole proprietorship
- partnership
- close corporation
- private company

Additional legal forms of business are a(n)

- public company
- business trust
- cooperative
- nonprofit organisation
- incorporated professional practice or section 53(b) company

The following concepts will give you an idea of the different forms of ownership:

- *Legal personality.* This indicates whether or not the owner and the business are separate legal entities. If the business has a legal personality, the owner and the business are two separate entities.
- *Liability*. This indicates whether the owners of a business will be held personally liable for the business's debts. When liability is *unlimited*, the owners' personal assets (eg homes or vehicles) may be sold to cover the business's debts. When liability is *limited*, the owners are not held liable for the debts of the business.
- *Continuity*. This refers to the lifespan of the business.

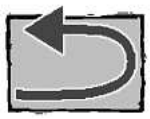
Activity 6.4

Study Nieman and Nieuwenhuizen (2014:144–154) and then complete the following table:

Table 6.2: Criteria for the different legal forms of business

CRITERIA	SOLE PROPRIETOR	PARTNERSHIP	PRIVATE COMPANY
Number of people involved			
Legal personality			
Taxation			

CRITERIA	SOLE PROPRIETOR	PARTNERSHIP	PRIVATE COMPANY
Liability			
Legal requirements			
Registration process			
Continuity			
Advantages			
Disadvantages			



Feedback

The following table is a summary of the section on the legal forms of a business:

CRITERIA	SOLE PROPRIETOR	PARTNERSHIP	PRIVATE COMPANY
Number of people involved	*One owner*	*2 to 20 partners*	*1 to 50 people (at least one person must be a director)*
Legal personality	*No*	*No*	*Yes*
Taxation	*Owner is taxed in his or her personal capacity on income generated by the business*	*Partners are taxed on their share of income from the business*	*The company is taxed; company tax rate applies*
Liability	*Unlimited liability*	*Joint and several liability*	*Limited liability*
Legal requirements	*Register for tax, pay regional services levies, contribute to the UIF and compensation fund)*	*Same as for a sole proprietor* *Partners also have to sign a partnership agreement and comply with sections 3, 4 and 5 of the Business Names Act 27 of 1960*	*Register with the Registrar of Companies, and the words "Proprietary Limited" or "PTY" Ltd must appear after the name of the business* *The business must have a certificate of incorporation*

CRITERIA	SOLE PROPRIETOR	PARTNERSHIP	PRIVATE COMPANY
Registration process	*There are no formal procedures relating to the formation of sole proprietors*	*There are no formal procedures relating to the formation of partnerships*	*For the incorporation of a company, the following forms must be completed:* • *CM5: reservation of name* • *CM7: reservation is extended* • *Power of attorney* • *CM22: notification of situation and registered and postal address* • *CM29: details of directors* • *CM1: certificate of incorporation* • *CM46: application for certificate to commence business* • *CM47: statement regarding adequacy of share capital* • *CM31: consent to act as an auditor* • *CM 44B & 44C: articles of association*
Continuity	*Limited (if the owner dies, the business closes down)*	*Limited. If a partner leaves, dies or if a new partner joins, the whole partnership is dissolved and a new agreement has to be concluded*	*Unlimited: The business continues to exist irrespective of the change in ownership*
Advantages	*Fairly easy to start (only a few legal requirements)*	*2 to 20 partners to contribute to the start-up capital* *A variety of skills and knowledge are available*	*This form is a legal entity and owners enjoy limited liability*
Disadvantages	*Owner is personally liable for all debts and liabilities*	*Partners take joint responsibility for any actions taken by individual partners*	*The registration process is complex and more expensive than any of the other forms of ownership*

Now that you have been introduced to the various legal forms a small business can assume in South Africa, you may be wondering about how to choose the right organisational form. There is no easy answer to this question, and one has to pay careful attention to all the options. To assist you, there are various considerations and circumstances that may influence your decision. These considerations are as follows:

- organisational requirements and costs – a partnership, for instance, is less expensive to form than a close corporation
- liability of owners – a sole proprietor may, for example, be required by creditors to sell personal assets if the business is unable to pay its debts, whereas the owners of a close corporation and company have limited liability
- continuity of the business – for example whether or not the owner wishes the life span of the business to be directly linked to his or her life span
- transferability of ownership – this is easy in a close corporation, whereas in a partnership, the partnership dissolves and a new partnership agreement is formed when a new partner joins the business
- management control – a sole trader has absolute control of the business, whereas in a partnership, control is normally based on the majority vote
- attractiveness for raising capital – the unlimited liability of a sole trader, for example, discourages new investors
- income taxes – in a sole proprietorship, for example, the owner's personal income and the firm's income are taxed together: in a close corporation and private company, the firm's income is taxed at the company tax rate and the owner and business are taxed separately

6.3 INTELLECTUAL PROPERTY RIGHTS

You were briefly introduced to copyright, patents, trademarks and designs in study unit 3.

According to Nieman and Nieuwenhuizen (2014:155), intellectual property refers to all creations or products of the mind that can be used for commercial gain. Intellectual property can be legally protected by the Companies and Intellectual Property Registration Office (CIPRO), by means of copyright, patents, trademarks and designs. The table below summarises information provided by Nieman and Nieuwenhuizen (2008) about copyright, patents, trademarks and designs.

Table 6.3: Criteria for the protection of intellectual property

CRITERIA	COPYRIGHT	DESIGNS	PATENTS	TRADEMARKS
Works that qualify	Literary works, films, musicals, art, sound recordings, broadcasts, etc	Aesthetic (eg shape) and functional (eg configuration) features of design	Inventions (eg a product, process or device applicable to trade, industry or agricultural improvements)	Any work, phrase, symbol, sound, smell, colour, etc
Can it be transferred?	Yes, but it has to be in writing	Protection in SA only An application has to be filed if one requires protection outside SA	Protection in SA only The patent protects the inventor who can assign someone else to be protected	Yes, the owner may allow a licensee to use the mark
Registration	Automatic, but registration with CIPRO has added benefits	Essential if it is a new design Necessary to register with Registrar of Designs	Apply and pay the registration fees in revenue stamps	Trademarks can be used without registration, but registered trademarks have added benefits
Duration of protection	Lifetime of the author/creator and for another 50 years after his or her death	15 years – aesthetic 10 years – functional	Provisional patent is valid for one year, and must be followed with a completed patent that covers the inventor for 20 years	10 years
Notice to public	Necessary to put one's name, date and copyright statement on original copy and the warning notice ©	Registered designs should be indicated as "Registered design" with the registration number	Inventions should be marked with "Patent applied for" or "Patent" with the relevant patent number	If a trademark is registered, it is indicated as "Registered trademark" and the ®

Read the section entitled "Counterfeit goods" in Nieman and Nieuwenhuizen (2014:158).

6.4 OTHER LEGAL REQUIREMENTS

6.4.1 Taxation

Taxes are levied by the central government and administered by the South African Revenue Service (SARS). You need to distinguish between direct tax (income tax, company tax, secondary company tax and tax on dividends) and indirect tax (value-added tax [VAT], excise and customs duties and stamp duties) (see Nieman & Nieuwenhuizen 2014:158).

For a discussion of SARS, PAYE and SITE, provisional tax and VAT, see Nieman and Nieuwenhuizen (2014:158–160).

Activity 6.5

As an entrepreneur starting a new business, you would have to know what payments needed to be made to SARS. You also need to be familiar with PAYE and VAT.

How does the government receive income through these tax systems?

Feedback

PAYE

This tax system is used by the employer who is obliged by law to deduct tax from employees' remuneration and pay such amounts over to SARS.

VAT

VAT is a special type of indirect tax in which a sum of money is levied at a particular stage in the sale of a product or service.

See Nieman and Nieuwenhuizen (2014:159–160).

6.4.2 Registration with the Department of Labour

As an employer, your business has to register with the Department of Labour and contribute towards the Unemployment Insurance Fund and the Compensation Fund (see Nieman & Nieuwenhuizen 2014:160–161).

6.4.3 Trade licences

Businesses require trading licences from their local authorities when conducting the following activities:

- the sale or supply of food
- the provision of health facilities
- the hawking of meals or perishable foodstuffs

6.5 LEGAL ASPECTS IN THE NORMAL FLOW OF BUSINESS

The following section explains the legal factors that the entrepreneur has to be aware of in the normal flow of the business. These include

- concluding contracts
- licensing
- labour legislation
- product liability
- standards
- fair trade, competition and consumer protection
- environmental legislation
- the Promotion of Access to Information Act 2 of 2000

Nieman and Nieuwenhuizen (2014) explain how the above factors affect a small business.

Activity 6.6

Indicate some of the "fine-print" clauses that a small business owner should be aware of before concluding a contract?

Feedback

The owner of a small business needs to check the small print for the terms and stipulations of an agreement. He or she should confirm the identity of the third party and check that all the pages of the contract are in place before signing it. It is essential to obtain legal advice if there are any incomprehensible or Latin terms in the agreement. A copy of the signed contract should be kept in a safe place.

See Nieman and Nieuwenhuizen (2014:162).

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

(1) What three requirements must a partnership agreement have for it to be legal?
(2) Explain how the Business Names Act 27 of 1960 applies to a partnership.
(3) Describe the different forms of companies.
(4) Explain what exactly falls under the protection of copyright law?
(5) Distinguish between a design patent and a utility patent.
(6) On the list below, place a C next to the items that define copyright or a T next to those that define a trademark:

_____ a distinctive name, mark, symbol or motto
_____ a bestselling novel
_____ a logo
_____ company initials (eg BMW)
_____ a motion picture

_____ *a word (eg Coke)*
_____ *a computer program*
_____ *a musical comedy*
_____ *a slogan*
_____ *a stage play*
_____ *a symbol*

Read the case study in Nieman and Nieuwenhuizen (2014:172) and then answer the following five questions:

(1) What legal difficulties did Peter probably have to face in turning around the almost bankrupt business?
(2) What resources, apart from financial, would Peter have needed to open another retail motor spares shop?
(3) How does a partnership work? Would this be an appropriate legal form for this business? Give reasons for your answer.
(4) What new legal form of business could Peter have considered as a growth option? Explain in detail.
(5) As an employer, Peter would have had to comply with various legal requirements. Explain these requirements.

Answers to the assessment questions

(1) The requirements are as follows: the partners must share a common purpose of financial gain; the partnership must be handled according to the common advantage of all its partners; each partner has to contribute (eg money or knowledge).
(2) See Nieman and Nieuwenhuizen (2014:145). The Business Names Act 27 of 1960 stipulates that a partnership may not issue any documentation without the name and location of the business as well as details of each partner.
(3) See Nieman and Nieuwenhuizen (2014:146). A company may have share capital, in which case it would be a profit-making company. Alternatively, it could be a nonprofit organisation, that is, an organisation with no share capital. Profit-making companies can be divided into private companies (shares are not sold to the general public) and public companies (shares are sold to the general public).
(4) See Nieman and Nieuwenhuizen (2014:155). This law protects the reputation and identity of the creator of the work, by providing a right of action against unauthorised distortion or mutilation of the work that is to the detriment of the honour or reputation of the creator.
(5) See Nieman and Nieuwenhuizen (2014:155). A design patent covers the appearance of a product and everything inseparable of the product. A utility patent covers a new process or functions of a product.
(6) Defining a trademark or copyright:

T – a distinctive name, mark, symbol or motto
C – a best selling novel
T – a logo
T – company initials (eg BMW)
C – a motion picture
T – a word (eg Coke)
C – a computer program
C – a musical comedy
T – a slogan
C – a stage play
T – a symbol

Answers to the case study questions

(1) Peter has to register with SARS for VAT and Skill Development Levies if the firm's income is large enough and for income tax for himself and his employees.

He has to register with the Department of Labour for the Unemployment Insurance Fund and the Compensation for Occupational Injuries and Diseases Fund.

He has to register with the Regional Services for a monthly payment for services, and for special licences when trading in, say, foodstuffs.

(2) Regarding human resources, Peter has to employ more people in his shop.

Peter is planning to open another retail motor spare next year. He may therefore require fixed assets such as buildings and equipment and material such as products or parts.

(3) See section 6.3.1, "Legal forms a business can take in South Africa", under the heading "Partnership".

Note the following requirements for a partnership:

- *It requires a minimum of two and a maximum of 20 people.*
- *There are no major formalities for establishment.*
- *It does not have to be registered and agreement can be by word of mouth.*
- *The partners must share a common purpose of financial gain.*
- *The business must be handled to the common advantage of all the partners.*
- *Each partner has to contribute to the partnership.*
- *A written partnership agreement must be drawn up by an attorney.*
- *The partners do not have protection of limited liability and bear joint and several responsibility for any action taken by individual members.*
- *The partners may be held personally liable for all the business's debts.*
- *The partners are taxed individually.*
- *If one partner leaves the partnership, the whole partnership is dissolved and a new partnership has to be concluded.*

This would not be an appropriate form of business because Saratti Motor Spares is a one-man business.

(4) A close corporation would be best for Peter because it would help him not to be legally liable for the actions of the business. The member enjoys limited liability because his or her business and personal assets are separated. In the event of the business becoming insolvent, the member's personal assets will be protected. Any dividends to the member are tax free because a close corporation is taxed as a separate entity. There are few formal and administrative requirements. A close corporation, unlike a sole proprietorship and partnership, can be sold as an entity.

(5) See sections 6.3.4, "Registration with the Department of Labour" and 6.4.3, "Labour legislation governing employment in South Africa".

Note the following legal requirements for employers:

- *They must register with the Department of Labour for*
  - *the UIF*
  - *the Compensation Fund*
- *They must adhere to the following labour legislation governing employment in South Africa:*
  - *the Labour Relations Act 66 of 1995*

- *the Basic Conditions of Employment Act 75 of 1997*
- *the Occupational Health and Safety Act 85 of 1993*
- *the Skills Development Act 97 of 1998*
- *the Skills Development Levies Act 9 of 1999*
- *the Employment Equity Act 55 of 1998*

SUMMARY

This study unit explored the major resources required when starting a business. This includes financial, physical, human and information resources. The remainder of the study unit focused on the legal aspects of establishing a new business and legal factors in the normal flow of business.

Revise this study unit by working through the "Looking back" section at the end of the chapter in Nieman and Nieuwenhuizen (2014:169).

The next study unit looks at how an entrepreneur starts a business.

Study unit 7

Getting started

Contents

Introduction
Travel pointers
7.1 Countdown to start-up
7.2 Location of the business
7.3 Risk management
7.4 Quality management
7.5 Ethics
7.6 Record-keeping and internal control
Assessment
Summary

INTRODUCTION

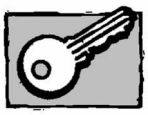
You should now have a good idea of the process of idea generation and how to evaluate an opportunity. You should be familiar with the business plan, what resources a small business requires and the legal aspects of establishing a business. This study unit looks at what needs to be done prior to starting the business and what the entrepreneur should focus on at this stage. As an entrepreneur, you need to know what factors will influence your decision about where to locate your business, how to evaluate and manage risks and the vital matter of quality management. The entrepreneur also needs to focus on the ethical considerations involved in starting a business and internal control measures.

Study Nieman and Nieuwenhuizen (2014:175–185).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit.

- What do I need to do before starting my business?
- What are necessary requirements for starting a business?
- Where should I locate my business?
- What are risks involved in running a business?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- target market
- infrastructure
- risk management
- ethics

7.1 COUNTDOWN TO START-UP

According to Nieman and Nieuwenhuizen (2014:175), the start-up process is based on the fundamentals of management. These fundamental management principles include planning, organising, leading and control.

7.1.1 Planning

Most of the business planning was done when drafting the business plan. The entrepreneur is now required to convert the business plan into action plans with deadlines and the resources required to execute these plans.

Examples of planning documents in a small business include a budget (financial plan) and business strategies. Many small business owners claim they are too busy to plan, but managers who fail to do so, may be overwhelmed by the competition.

7.1.2 Organising

Apart from gathering the necessary resources and meeting legal requirements, organising also involves formulating policies, organising the labour force and dealing with matters such as ethics and quality assurance.

7.1.3 Leading

Leadership is required as soon as staff have been appointed because they need to be motivated, coordinated and controlled. The entrepreneur needs to create an environment that promotes teamwork among all employees. As soon a solid employer-employee relationship has been established, the employees should develop strong feelings of loyalty to their employer.

It is imperative for a small business owner to learn how to delegate as soon as the business starts to grow. Delegation will grant subordinates the right to act or make decisions, and this should give the entrepreneur more time to focus on the key issues of the business.

7.1.4 Control

This involves record keeping, risk management, quality, ethics and internal control systems. It is critical that entrepreneurs make all the logistical arrangements for starting their business before opening its doors.

See the check list in table 7.1 in Nieman and Nieuwenhuizen (2014:177), which outlines the matters that have to be addressed before starting a business.

7.2 LOCATION OF THE BUSINESS

The location of the business could play a huge role in its success or failure. The business plan and, more specifically, the marketing plan will determine the factors to consider in choosing a location.

7.2.1 Factors to consider in choosing a location

Nieman and Nieuwenhuizen discuss the following general factors that should be considered when choosing a location:

- access to the target market (eg convenience stores such as Spar need to be close to their customers)
- the availability of raw materials (transport costs will determine whether the business should be close to the source of raw material)
- the support and technical infrastructure
- the transport infrastructure
- the availability of labour and skills
- the climatic conditions (certain products can only be produced in a specific climate)
- political and social stability

Activity 7.1 self-reflection (journal)

What legislative drawbacks do entrepreneurs encounter in their decision to find the correct location for their business?

Think about zoning restrictions on land use and how they influence business location.

7.2.2 Home-based businesses

This type of business is located in the entrepreneur's residence (say, in a residential area). Technological developments (eg computers, the internet and fax machines) have made working from home possible. Sufficient parking, zoning and growth potential are key factors to consider when one wishes to locate one's business in a residential area. Entrepreneurs who work from home should try to keep their work separate from their personal life.

7.2.3 Residential area-based businesses

Entrepreneurs sometimes buy residential houses along main roads and convert them into offices with parking. These businesses are generally in the service industry (eg medical practitioners, accountants, lawyers and consultants).

7.2.4 Shopping centres

Retailers in the fast-moving consumer goods (FMCG) industry prefer to rent shops in shopping centres.

Activity 7.2

Your entrepreneur friend wishes to open her own beauty salon in a newly built shopping centre. Explain to her what factors she would need to consider before choosing a specific location for her business.

Feedback

Since this is a new shopping centre situated in a new area, she should pay close attention to the following factors:

- *feet count – what is the anticipated number of consumers who will visit her salon on a weekly or monthly basis?*
- *parking – will there be sufficient parking for her clients and what is the parking fee per hour?*
- *maintenance – although all the shops are new and neat, it is vital for the centre management to implement a regular maintenance plan*
- *the conditions of the lease agreement – this relates to matters such as the trading hours, shop fittings, the appearance of the shop, etc*
- *security – will the shopping centre provide security guards?*
- *the attitude of the centre management – will the centre management welcome your friend as a tenant?*
- *location in the centre (your friend should try to find a prime spot or be close to national chain stores)*

7.3 RISK MANAGEMENT

What is risk? It is the chance that a situation may end in loss or misfortune. Risk involves uncertainty of outcomes. Every business faces two types of risks, namely controllable and uncontrollable risks. Controllable risks such as fires may not be preventable, but the financial loss can be minimised by purchasing insurance. Uncontrollable risks have a huge financial impact on a business, but cannot be covered by insurance. These risks include new competition, a recessionary economy and changes in consumer tastes.

7.3.1 Types of risk

Nieman and Niewenhuizen (2014:181) identify the following three categories of risk:

(1) Business risk arises from the macroenvironment, the market environment and the microenvironment, and may be affected by price changes, technological changes, changes in consumer preferences and new competition.

(2) Financial risk includes risk resulting from the financial structure of the business, such as profitability, liquidity and debt levels. Management must evaluate these at regular intervals and take corrective action if necessary.

(3) Personal risk may include personal financial losses if the business should fail.

7.3.2 Management of risk

So what can an entrepreneur do about these risks? Risks need to be managed in order to preserve the firm's assets and earning power. Note the following possible strategies:

– retention – bear or accept the risk
– reduction – reduce the impact of the risk
– avoidance – do not start the business
– transfer – transfer the risk to another party

7.4 QUALITY MANAGEMENT

Quality involves the features of a product or a service that will meet the expectations of the customers and satisfy their needs. Customers will base their perception of a hotel's quality, for example, on the décor, cleanliness of the room, the facilities at the hotel and the friendliness of staff. The hotel should therefore set a level of quality at which the service must be provided. Quality should always be the primary focus of the business.

According to Nieman and Nieuwenhuizen (2014:182), quality system standards identify features that can help a business to consistently meet its customers' requirements. The SABS will assist new and existing businesses to set up a quality system.

In this section, Nieman and Nieuwenhuizen (2014) discuss quality systems, the reasons for having one and how to one in place.

Activity 7.3

(1) Explain to an entrepreneur why he or she should have quality systems in his or her business.

(2) Discuss some of the principles involved in putting a quality system in place.

Feedback

See Nieman and Nieuwenhuizen (2014:183).

(1) The reasons are as follows:

- *improved performance and productivity*
- *a focus on business objectives and customer expectations*
- *the maintenance of quality in order to meet the customers' needs*
- *confidence on the part of management that quality is being maintained*

- *evidence among the customers of the organisation's capabilities*
- *opening up new market opportunities*
- *proof of quality required for certification and registration*
- *the ability to compete on the same basis as larger organisations*

(2) Putting a quality system in place:

- *Ensure that the quality system provides value in terms of the money spent and the effort put into developing and implementing the system. The system should improve the business's marketability and internal efficiency.*
- *Include specific tasks and monitoring systems.*
- *Have a philosophy of total quality management.*
- *Ensure that tasks are well planned and responsibility for tasks is assigned to employees. This will ensure compliance with quality standards.*

Activity 7.4 self-reflection (journal)

(1) Explain briefly what you would do if confronted with the following three situations?

(2) Your business has been asked to pay a nonreceipted gratuity in Nigeria to speed up the process of acquiring an important permit.

(3) You are the accountant of a division that is R15 000 below profit targets. Another invoice for expenses incurred by the division lands on your desk. The accounting rule is to pay expenses when they are incurred. The division manager asks you not to record the invoice until the end of February next year.

(4) Your company's policy on payment is strictly internet/bank transfers or cheque payments. Your CEO asks you to do him a favour and pay a debtor in cash.

The above situations are the kinds of issues with which managers have to deal on a daily basis. Such issues fall squarely in the domain of ethics.

7.5 ETHICS

Ethics are a set of principles or a behavioural code that explains what is good and right, bad and wrong. A business needs to have an ethical charter and a values statement to ensure that everybody understands the values underpinning the business. This is referred to as a code of conduct, which is a statement of ethical practices to which the business adheres. These codes could, for example, cover misuse of corporate assets, integrity and honesty.

Note the following examples of unethical behaviour in a business:

– skimming or concealing income to avoid taxes
– deception of consumers through advertisements or claims
– inaccurate reporting of financial information

Entrepreneurs should be ethical leaders because they are more exposed in a small business than in a large organisation where the manager's leadership can be diffused

through layers of management. The staff in a small business tend to monitor the entrepreneur's behaviour critically. This allows the entrepreneur to establish high ethical standards and set an example of ethical behaviour.

7.6 RECORD-KEEPING AND INTERNAL CONTROL

Entrepreneurs need information to make decisions and records need to be kept for a few years. Nieman and Nieuwenhuizen (2014:184) explain what is required of an accounting system.

Record-keeping and accounting can easily be outsourced because these are extremely time-consuming functions. Internal control systems need to be put in place to safeguard a firm's assets and enhance the accuracy and reliability of the financial statements. The absence of internal control systems increases the chances of fraud and theft.

ASSESSMENT

(1) Consider a franchised fast-food business such as McDonald's, and identify some of the major uncontrollable risks.
(2) Explain the process of risk management.
(3) Why do businesses find it difficult to put a quality system in place?
(4) What unethical behaviour do small businesses encounter?
(5) What are the key attributes of a good business location?
(6) How would you ensure that pilferage and theft do not take place in a store?
(7) Make a few suggestions for the record-keeping process and how this could assist with the decision-making process in terms of new stock and purchases.
(8) How would you ensure that your staff are ethical in their dealings with customers?
(9) Should entrepreneurs request an outside specialist to set up an accounting system for their new venture or should they do it themselves? Give reasons for your answer.
(10) The basic requirement for an accounting system is to meet certain objectives. What are these objectives?

Answers to the assessment questions

(1) Some of the major uncontrollable risks could include

- *a new competitor locating nearby (eg King Burger)*
- *a recessionary economy in which customers' disposable income decreases and they have less money to spend on takeaways*
- *changes in consumer tastes (eg consumers becoming more health conscious)*
- *a price war by competitors (eg Steers)*

(2) See Nieman and Nieuwenhuizen (2014:182). The risk management process entails

- *identifying risks*
- *evaluating risks*
- *selecting methods to manage risks*

- *implementing the decision*
- *evaluating and reviewing at regular intervals*

(3) See Nieman and Nieuwenhuizen (2014:183). The difficulty lies in the following:

- *The available resources are limited.*
- *It is difficult to understand the standards.*
- *The costs involved in setting up a maintenance system should be considered.*

(4) See Nieman and Nieuwenhuizen (2014:184). This behaviour includes

- *skimming (eg concealing income)*
- *deceiving consumers*
- *reporting information inaccurately*

(5) See section 7.3.1 in Nieman and Nieuwenhuizen (2014:179) entitled "Factors to consider in the physical establishment of a business".

(6) Create an awareness of security issues, keep track of consumers loitering in the store, clean and repack the shelves regularly.

(7) See section 7.7 in Nieman and Nieuwenhuizen (2014:184) entitled "Record keeping and internal control". Keep the system simple at the start. Appoint a part-time bookkeeper to assist.

(8) See section 7.6 in Nieman and Nieuwenhuizen (2014:183) entitled "Ethics".

(9) See section 7.7 in Nieman and Nieuwenhuizen (2014:184). It depends on what the firm can afford. As the firm grows, it would be wise to consult a specialist.

(10) See Nieman and Nieuwenhuizen (2014:184). The objectives are to

- *provide an audit trail and maintain source documents*
- *provide an accurate picture of operating results*
- *provide a quick overview of present and past operating results*
- *facilitate the prompt filing of reports and tax returns*
- *offer financial statements for use by management and stakeholders*

SUMMARY

This study unit gave you an idea of what entrepreneurs need to focus on prior to starting a business. Entrepreneurs have certain managerial responsibilities such as planning, organising, leading and controlling. They also have to decide where to locate the business and whether or not it will be home based or located in a residential area or a shopping centre. Every business faces risks – both controllable and uncontrollable – and the entrepreneur needs to manage them, either by avoiding them, reducing them or transferring them to a third party.

Entrepreneurs should also focus on quality management and the implementation of quality control systems. A minimum level of quality is needed to meet customers' expectations and needs.

As a small business owner, one may be tempted to behave unethically or allow one's employees to behave unethically, but it is essential to establish a code of conduct. Lastly, this study unit explained the concept of internal control and the importance of record keeping.

In the next study unit, we will discuss how one finances an entrepreneurial venture. Finding finance or financial support is one of the greatest challenges facing entrepreneurs.

Do the revision questions at the end of this chapter in Nieman and Nieuwenhuizen (2014:185) under the heading "Looking back".

Study unit 8

Financing an entrepreneurial venture

Contents

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8.1 Determining the financial requirements of a business venture
8.2 Sources of short-term finance
8.3 Sources of medium-term finance
8.4 Sources of long-term finance
8.5 Institutions that support small businesses and new ventures
8.6 Informal sources of finance
8.7 Venture capital and the private equity market
8.8 Attracting investors and the private placement of shares
8.9 The cost of raising finance
8.10 The initial public offering
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INTRODUCTION

In the previous study units, we looked at what needs to be done before starting a business. We now consider how this business will be financed.

The entrepreneur should identify what type of financing he or she will use to finance the business. If he or she decides to borrow a large sum of money, the business will have substantial loan repayments every month. Should the entrepreneur, however, use personal finance and assets to finance the business, he or she could lose everything if the business fails.

In South Africa, banks still view small businesses as high-risk entities, and a bank will probably not provide all the financing for the business. The owner(s) will have to invest some of his/her/their own money in the new small business and the rest will come from debt, which should be kept to a minimum.

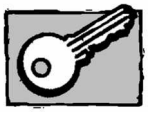
This study unit will introduce you to the various sources of finance and how to attract investors.

Study Nieman and Nieuwenhuizen (2014:191–206).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit.

- How can I obtain funds for my business?
- What sources of funds are available?
- What is a financial plan?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- entrepreneurial venture
- financial plan
- budget
- trade credit
- factoring
- leasing finance
- equity capital
- debentures

Make a list of the above words in your journal and write down a brief explanation of each one as they occur in the prescribed book.

8.1 DETERMINING THE FINANCIAL REQUIREMENTS OF A BUSINESS VENTURE

What are the capital requirements for a new business? New firms typically need money to hire staff, buy/rent office space and pay for equipment, training, research, marketing and the initial launch of the product/service. Funding for a new business should cover its asset requirements as well as the entrepreneur's personal living expenses.

The financial plan is an integral part of the business plan and banks will require a proper financial plan and budget before approving a bank loan. An increase in sales, for example, will result in an increase in asset requirements that, in turn, will result in an increase in financial requirements. The entrepreneur therefore has to submit pro forma financial statements (based on estimations) to indicate projected sales levels, how much and what type of financing are needed, and whether or not the business will have adequate cash flow.

Incorrect financial performance targets and an incorrect estimation of financial needs will lead to incorrect financing and investment decisions that could bankrupt the firm. Nieman and Nieuwenhuizen (2014) explain the importance of financial planning and the financial planning process.

Study figure 8.1 in Nieman and Nieuwenhuizen (2014:192).

Once the entrepreneur has determined the financial requirements of his or her business, he or she then has to determine where to obtain the necessary finance. The following sections discuss short-, medium- and long-term finance.

8.2 SOURCES OF SHORT-TERM FINANCE

Short-term finance is finance that is repayable within 12 months. Nieman and Nieuwenhuizen (2014:193) explain the following sources of short-term finance:

- trade credit
- bank credit
- bills of exchange
- acceptance credits
- factoring
- customer advance payments
- shipper's finance

8.3 SOURCES OF MEDIUM-TERM FINANCE

Medium-term finance is repayable between one and three years.

Nieman and Nieuwenhuizen (2014:195) describe three sources of medium-term finance:

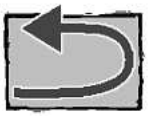
(1) instalment sale transaction (hire purchase)

(2) leasing finance

(3) medium-term loans

Activity 8.1

Your mom and dad wish to purchase a new car. They are in two minds whether to buy the new car on hire purchase or lease finance. Kindly explain to them the difference between hire purchase and lease finance.



Feedback

- Hire purchase. *Hire purchase is a credit sale (eg a motor vehicle) in which it is agreed that the purchase price will be paid in instalments. Ownership will only be transferred to the buyer once the final instalment has been paid.*
- Leasing finance. *Some businesses prefer to lease rather than purchase fixed assets such as office equipment. The owner of the asset (the lessor) grants the use of the property to another person (the lessee), under certain conditions and for a certain period of time. The lessee has to make a payment for the use of the asset and he/she will never actually own the asset.*

8.4 SOURCES OF LONG-TERM FINANCE

Long-term finance is capital provided to the business for a long period of time, usually the entire life span of the business. Long-term finance takes the form of shares, loans and/or capital.

The following specific sources have been identified as long-term finance:

- equity capital
- debentures
- retained earnings (internal financing)
- long-term loans/mortgage bonds

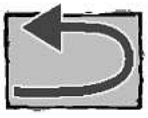
8.5 INSTITUTIONS THAT SUPPORT SMALL BUSINESSES AND NEW VENTURES

There are a number of institutions that finance and support new business ventures. According to Nieman and Nieuwenhuizen (2014), these include

- commercial banks
- merchant banks
- Business Partners
- The Small Enterprise Finance Agency (SEFA)
- the Industrial Development Corporation
- the Ithala Finance Corporation
- local business support centres (a list of these and their locations can be obtained from the Small Enterprise Development Agency [SEDA])

Activity 8.2

Visit the SEDA website (www.seda.org.za) and identify different local business support centres in South Africa. Name the one that is closest to your area of residence.



Feedback

Visit the SEDA website at http://www.seda.org.za/Affiliate_search.asp. *Choose the province in which you reside and the website will give you the number of your local business support centre.*

8.6 INFORMAL SOURCES OF FINANCE

Many small businesses have to rely on friends and family for financial support. To avoid future problems, these transactions should be treated as business deals and a written agreement should specify the term of the loan. It is essential that the entrepreneur should pay back the loan as soon as possible.

8.7 VENTURE CAPITAL AND THE PRIVATE EQUITY MARKET

Entrepreneurs can approach venture capital firms for finance. Venture capitalists are investors or investment groups that commit money to new business ventures. Nieman and Nieuwenhuizen (2014) discuss venture capital as a source of finance and what venture capitalists look for in a business before they are willing to invest in it.

8.8 ATTRACTING INVESTORS AND THE PRIVATE PLACEMENT OF SHARES

Entrepreneurs sell an investment opportunity, whereas investors look for an opportunity that offers a good return. When approaching investors, an entrepreneur has to be aware of their information needs. Nieman and Nieuwenhuizen (2014:203) highlight the following five stages in the process of raising investment capital:

- stage 1: making contact
- stage 2: deal screening
- stage 3: deal evaluation
- stage 4: deal structuring
- stage 5: postinvestment activity

8.9 THE COST OF RAISING FINANCE

Raising finance can be a timely and costly process. Firstly, the entrepreneur has to prepare a proposal, and an external consultant (eg a financial consultant) will usually assist him or her with this. Secondly, the investment opportunity has to be marketed and the entrepreneur has to advertise, print brochures, and so on. Lastly, the entrepreneur may incur banking costs and legal fees. See figure 8.4 in Nieman and Nieuwenhuizen (2014).

8.10 THE INITIAL PUBLIC OFFERING

Offering shares to the public is a means of raising a large amount of interest-free capital for the business. This also involves listing on the JSE Securities Exchange and abiding by its rules for listing. In this section, Nieman and Nieuwenhuizen (2014) discuss the initial public offering.

Activity 8.3 self-reflection (journal)

The National Credit Act (which came into effect in 2007) has become a topical issue in business. Some argue that it is an excellent piece of legislation because it discourages individuals from spending more than they earn. There are other critics who claim that the Act is extremely cumbersome and results in loss of business because the man on the street cannot access credit. What is your view of the National Credit Act? Is it effective or poor legislation? Give reasons for your answer.

ASSESSMENT

(1) Explain the basic steps in predicting the financial needs of a small business.
(2) What are the legal requirements for a hire purchase or credit sale agreement?
(3) Explain the different sources of short- and medium-term finance.
(4) Different forms of businesses have different abilities to attract finance. Discuss this concept by referring to the

- *sole proprietor*
- *partnership*
- *close corporation*
- *company*

(5) Venture capital firms consider certain factors before providing funds. What are these factors?
(6) If a new business has a choice between equity financing and long-term debt, which would you recommend and why?

Answers to the assessment questions

(1) The steps are to

- *project the firm's sales, revenue and expenses over the planning period*
- *estimate the levels of investment in current and fixed assets to support the projected sales*
- *determine the firm's financing needs throughout the planning period*

(2) The legal requirements are as follows:

- *All agreements must be in writing and signed by all parties.*
- *All agreements must state the amount of the initial payment (deposit).*
- *All agreements must include a description of the goods being purchased.*
- *All agreements must include the names and addresses of the credit grantor and credit receiver.*

(3) See Nieman and Nieuwenhuizen (2014:193–196).
(4) See Nieman and Nieuwenhuizen (2014:198–200).
(5) The venture capitalist will consider the track record of the management team, the potential of the business opportunity, growth potential and the exit options from and strategic fit with the fund/portfolio.
(6) Equity financing is money invested in the business, with no legal obligations for the entrepreneur. Equity funding requires no repayment. It does, however, require sharing the ownership of the business with the funding source. If the entrepreneur is willing to give up a percentage of ownership (in return for funding), equity financing is much safer for small businesses than debt financing.

SUMMARY

This study unit looked at the challenges facing entrepreneurs in terms of finding finance to start new businesses. As discussed in the preceding study units, an entrepreneur faces many challenges and if he or she has no previous business or managerial experience, starting a business may well be overwhelming. This is why the next study unit deals with the vital concept of networking and support.

Do the revision questions in Nieman and Nieuwenhuizen (2014:206).

Study unit 9

Networking and support

Contents

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9.2 Business support required by emerging entrepreneurs
9.3 The role of the National government in developing an enabling small business environment
9.4 The role of the Department of Trade and Industry
9.5 The role of Business Partners
9.6 The role of commercial banks
Assessment
Summary

INTRODUCTION

An entrepreneur starting a business has many responsibilities and faces many challenges. Small, medium and microenterprises (SMMEs) are one of the key mechanisms for job creation in South Africa – hence the South African government's focus on developing and promoting small businesses in the country.

Government has spent the past few years attempting to create an enabling environment for small businesses. Its ten-year review has indicated that there are still many needs in this sector:

– Entrepreneurs need access to business opportunities in both the public and private sectors.
– Statistics show that 90% of business plans are rejected by financial institutions – the majority of entrepreneurs thus have to rely on their friends and family for financial support. Hence, there is a huge need for access to finance.
– The market needs mentors who will be able to successfully guide SMMEs through the first year of business.

Entrepreneurial roles and the operating environment can lead to stress. Entrepreneurs face many risks (as mentioned earlier) such as financial, family and career risks. In addition, they have to engage in constant communication and interact with external stakeholders such as customers, suppliers and accountants. Owning a business requires a large commitment in terms of time and energy, and entrepreneurs often work alone because they cannot rely on the support of colleagues. Entrepreneurs thus need business support.

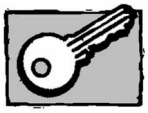
This study unit outlines the various roleplayers tasked with creating an enabling small business environment and the different forms of business support for the small business owner.

Study Nieman and Nieuwenhuizen (2014:211–226).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit:

- What is networking?
- What is an enabling small business environment?
- What is business mentoring?
- What is business incubation?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- networking
- business mentoring
- business incubation
- enabling environment
- SMME support services

Make a list of the above words in your journal and write down a brief explanation of each one as they occur in the prescribed book.

9.1 NETWORKING AND NETWORKS FOR ENTREPRENEURS

Networking is an active process of establishing mutually rewarding relationships with other businesspeople who can offer critical support for the growth and development of the business.

Networking involves talking to people, learning from them and solving problems in one's business.

Nieman and Nieuwenhuizen (2014) explain networks in detail. This section deals with

- definitions of networking and networks

– types of networks
– networking principles
– developing effective networks
– functions of networks in the growth of business ventures

Activity 9.1

Consult various sources such as newspapers, journals and textbooks or do a Google search and write down at least three different definitions of a network. After writing your definitions, you must also identify the various types of networks that exist in business.

Feedback

Networking is a process in which businesspeople build and maintain relationships with others whose interests are similar or whose relationships could have advantages for a firm.

According to Kuratko and Hodgetts (2007:126), networking is a way to relieve the loneliness of running a business. Networking is a process of sharing experiences with other business owners. The objectivity gained from hearing about the triumphs and errors of others is therapeutic.

Nieman and Nieuwenhuizen (2014:213) identify the following four types of networks:

(1) social networks (communication between different parties which results in an exchange of information)
(2) personal networks (individuals with whom the entrepreneur has a direct relationship or links with others in a similar field)
(3) extended networks (a network of organisations [not individuals], such as the South African Chamber of Business [SACOB])
(4) other networks (including the internet, attorneys, bankers and outside consultants)

9.2 BUSINESS SUPPORT REQUIRED BY EMERGING ENTREPRENEURS

Different entrepreneurs face different challenges. Business support, such as counselling, mentoring, networking and incubation will assist all entrepreneurs, irrespective of the type of business they start and the challenges they face. Nieman and Nieuwenhuizen (2014) discuss business counselling, mentoring and incubation to support entrepreneurs.

9.2.1 Business counselling

This is a process whereby business problems are identified and resolved and the entrepreneur is taught how to handle similar situations in future. The aim is to maximise the performance of individual firms. Nieman and Nieuwenhuizen (2014) highlight the importance of business counselling and mentoring, and discuss the objectives of business counselling.

9.2.2 Business mentoring

Business mentoring is an ongoing, long-term business counselling relationship between an experienced business adviser and a client throughout the various stages of a business venture's growth. The aim is to develop both the managerial and entrepreneurial skills of an individual to enable him or her, as an emerging entrepreneur, to grow into a long-term sustainable entrepreneur.

9.2.3 Business incubation

Often when entrepreneurs start businesses, they lack the necessary knowledge and managerial experience. They frequently need marketing, management and financial advice. The primary aim of business incubation is to assist entrepreneurs to start and develop successful businesses, which promotes economic development.

A business incubator is a facility and set of activities through which entrepreneurs can receive essential information and value-added services (Nieman & Nieuwenhuizen 2014:215). Business incubation provides an environment in which small business owners are not alone – it thus reduces the anxiety of starting a new business (Kuratko & Hodgetts 2007:222). Incubators are targeted at providing benefits for small businesses incapable of generating their own managerial, financial, technical or administrative services.

The Gauteng Enterprise Propeller (GEP) is an agency that falls under the jurisdiction of the Department of Finance and Economic Affairs in Gauteng. GEP offers a range of services and support to the start-up business owner, including an incubation programme at the Innovation Hub.

This incubation programme fosters an enabling environment in which start-ups from the knowledge-intensive sectors (including information and communications technology, biosciences, electronics and advanced materials and manufacturing) are fast-tracked to compete in the business world. Processes and outputs are continually benchmarked against international best practice.

Why do we need business incubation?

- Incubation fast-tracks the growth of early stage businesses.
- Incubation improves the survival rate of start-up companies by helping them to become financially viable, usually within two to three years.
- It creates a synergistic environment in which entrepreneurs can share learning, create working partnerships and do business together.
- It opens doors to markets and resources.

Visit GEP's website for more information: *www.gep.co.za*

9.3 THE ROLE OF THE NATIONAL GOVERNMENT IN DEVELOPING AN ENABLING SMALL BUSINESS ENVIRONMENT

9.3.1 The role of the government from 1995 to 2004

The purpose of the National Small Business Enabling Act is to create a positive enabling environment for SMMEs. Nieman and Nieuwenhuizen (2014:217) list the key objectives of this Act as

- creating an enabling environment for small enterprises which includes government support, legislation, access to finance, access to markets and access to training and technology
- facilitating greater equalisation of income, wealth and earning opportunities
- strengthening the cohesion between small enterprises
- assisting small businesses to comply with the challenges of an internationally competitive economy
- addressing the legacy of apartheid-based disempowerment of black businesses
- supporting the advancement of women in all business sectors
- creating long-term jobs
- stimulating sector-focused economic growth
- levelling the playing field between large and small business and rural and urban businesses

What does an enabling business environment mean for small business and entrepreneurs?

9.3.1.1 Defining an enabling small business environment

An enabling environment is a supportive environment for emerging entrepreneurs. The government's support is needed in terms of legislation and policies. Such an environment will provide entrepreneurs with

- access to finance by ordinary financial institutions
- access to venture capital
- training and development programmes to encourage entrepreneurship
- infrastructural development
- legal regulations relating to economic activities

In addition, a cooperative environment that fosters and supports entrepreneurship should also be actively promoted. Examples of institutions that support entrepreneurs include universities and SMME development units.

Entrepreneurs are key roleplayers in the development of South Africa's economy. The question is: What support is required by emerging entrepreneurs?

9.3.2 The role of the government from 2005 to 2014

The aim of the National Small Business Act of 1996 and the Accelerated and Shared Growth Initiative (AsgiSA), which commenced in 2005, was to bridge the gap between

the first and second economies and address the inequalities between them. AsgiSA focused on ensuring that economic growth should be accelerated to an average 4,5% in the next five years (2005–2009) and to an average of 6% between 2010 and 2014 (South Africa Yearbook 2006/2007).

The key objectives of the Integrated Small Enterprise Development Strategy are to

- increase the contribution of small enterprises
- create an enabling environment for small enterprises
- create sustainable long-term jobs
- ensure equitable access and participation
- increase the competitiveness of the small enterprise sector and its enabling environment

9.4 THE ROLE OF THE DEPARTMENT OF TRADE AND INDUSTRY

The role of the Department of Trade and Industry (DTI) is to create wealth and promote job creation in South Africa. It must deliver programmes that will contribute to economic growth. It therefore has established institutions for SMME development such as the Small Enterprise Development Agency (SEDA) and Khula Enterprise Finance. The DTI currently offers the following assistance to small and medium business owners:

- access to technology through its Access to Technology Programme (offered by SEDA)
- business referrals, advice and information networks (BRAIN) to improve the competitiveness and growth of small businesses through the supply of value-added business information
- business regulatory compliance advice to help businesses gain a better understanding of the laws that apply to their businesses
- the Local Business Support Centre (LBSC) Programme which is central in promoting small, medium and microenterprises (SMMEs)
- Khula, which offers mentorship for small business owners to ensure the transfer of skills on a one-on-one basis; entrepreneurs are assisted with advice, counselling and the development of business plans, and advice on how to successfully manage a business
- Targeted assistance through Ntsika (now call SEDA), which is available for disabled people, youth and women entrepreneurs, the aim of which is to create an enabling environment to promote and grow the enterprises owned by these groups of people, and to promote the development of rural entrepreneurs
- SEDA's trade and investment development programme, which focuses on small businesses in South Africa to develop their ability to compete in the international marketplace

You can access the DTI's website (www.dti.gov.za) for more information.

Study the role and functions of both SEDA and SEFA in Nieman and Nieuwenhuizen (2014:220).

9.5 THE ROLE OF BUSINESS PARTNERS

Business Partners invests in viable small and medium enterprises in the commercial, manufacturing and services sectors. Investments range from R150 000 to R15 million. Not only does it provide financial support, but it also gives advice and guidance on business-related issues. Study section 9.6 in Nieman and Nieuwenhuizen (2014), which describes the offering of Business Partners in more detail.

9.6 THE ROLE OF COMMERCIAL BANKS

In South Africa, the major commercial banks are Standard Bank, ABSA, First National Bank and Nedbank. Although they do manage their risks, these banks offer financial support to small businesses.

Nieman and Nieuwenhuizen (2014:224–226) explain how the major commercial banks in South Africa support small businesses.

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

(1) Explain to a new entrepreneur what the principles of networking are and how to develop an effective network.
(2) Describe business incubation in your own words.
(3) Identify the advantages of business incubation.

Answer the following multiple-choice questions

(4) A(n) _____ environment is created when institutions such as NGOs and tertiary institutions work actively at promoting entrepreneurship.

(a) training
(b) supportive
(c) cooperative
(d) entrepreneurship

(5) What do we call the process in which business problems are diagnosed and resolved?

(a) business counselling
(b) business mentoring
(c) incubation
(d) networking

(6) This is an ongoing long-term business counselling relationship between an experienced business adviser and a client, which covers a diverse range of topic.

(a) entrepreneurial networking
(b) incubation
(c) business counselling
(d) business mentoring

(7) *Personal networks focus on the individual whereas extended networks focus on ..*

(a) organisations
(b) family members
(c) customers
(d) partners

(8) *According to ABSA, the following is/are the vital pillar(s) of entrepreneurial ventures:*

(a) innovation
(b) strategic objectives
(c) growth potential
(d) All of the above

Answers to the assessment questions

(1) *See Nieman and Nieuwenhuizen (2014:213). The three principles are*

- *reciprocity*
- *friendship, humour and mutual interests/activities*
- *maintaining the relationship*

One can develop an effective network by identifying people who have close links with key contacts/shareholders and seek advice from these people. One should always thank them for their advice or for linking one up with a key contact..

(2) *The answer will differ from person to person, but consult section 9.3.3 in Nieman and Nieuwenhuizen (2014:215).*

(3) *The advantages include the following:*

- *It nurtures start-up and early stage enterprises in a managed workspace.*
- *Entrepreneurs can receive essential information and assistance, value-added shared services and equipment that may have been otherwise unaffordable, inaccessible or unknown to them.*
- *It provides an entrepreneurial and learning environment with access to mentors and investors, as well as visibility in the marketplace.*

Multiple-choice answers

(4) *(c)*
(5) *(a)*
(6) *(d)*
(7) *(a)*
(8) *(d)*

SUMMARY

Entrepreneurship cannot develop on its own – it needs business support and networks. The aim of this study unit was to introduce you to the concept of networking and to outline the various support activities/institutions available for entrepreneurs in South Africa.

Do the revision questions at the end of this chapter in Nieman and Nieuwenhuizen (2014:226).

TOPIC SUMMARY

The aim of this topic was to introduce you to the entrepreneurial process. The topic started with a study unit on creativity and business opportunity to familiarise you with the creative process; the focus was on the fact that not all ideas are ideal business opportunities. Potential entrepreneurs need to be able to evaluate a business opportunity to ensure that they are pursuing a viable business idea and enter the market at the right time. It is for this reason that you were introduced to the concept of a window of opportunity. Once an entrepreneur knows what business idea to pursue, he or she needs to write a business plan to outline the key aspects of the proposed business, such as the marketing plan, financial plan, operational plan and management plan. The business plan will highlight what resources are required and the entrepreneur will have to plan how to acquire these resources and finance the business venture. Various sources of finances were discussed in study unit 8.

Further emphasis was placed on certain legal considerations that an entrepreneur needs to be aware of. The legal forms a business can assume, taxation, labour law issues, levies, contractual agreements and licensing, *inter alia*, were discussed.

Once the entrepreneur has decided on a legal business form and how to finance the business, he or she has to decide where to locate the business. Various factors need to be considered here, such as access to the market, infrastructure and access to raw materials. Entrepreneurs have to identify the potential business risks and make a decision on how these risks will be managed. Entrepreneurs must always conduct their business ethically.

Lastly, the entrepreneur does face a few challenges if one considers all the essential decisions that have to be made before starting a business. It is therefore crucial for an entrepreneur to have support. The topic introduced the various networks and support systems available to entrepreneurs in South Africa. Entrepreneurs need to know about business counselling, business incubation and business networks.

It is the role of the government to create an enabling environment for entrepreneurs and to promote more small business development in this country, because this will create jobs and ultimately ensure economic growth.

Mementoes and skills to take home

Since you have now completed topic 2 (The entrepreneurial process), this would be an opportune moment to look back and see what you have experienced and acquired during your journey so far. Read the following list of skills and make a tick [✓] in the box if you feel that you are able to

- explain to a colleague what it is to be creative and what can prevent one from being creative ☐
- advise a local business owner on how to protect a product legally ☐
- explain to a friend the difference between an idea and an opportunity ☐
- write an article on the criteria that can be used to screen an opportunity ☐

- explain to a fellow student what a business plan is and the reasons for drawing up a business plan ☐
- advise a fellow student about the required resources for a new business and the factors to consider when choosing a location for a business ☐
- write an article to a local newspaper about the sources of finance available for businesses ☐

Topic 3

Alternative routes to entrepreneurship

INTRODUCTION AND AIM OF THE TOPIC

The high unemployment situation in South Africa and the limited number of job opportunities available for school-leavers and other job seekers, compel people to start their own businesses. The aim of this topic is to introduce you to the alternative options to starting a business, namely to enter a family business, buy a franchise or buy an existing business.

You need to understand that there are various opportunities but also challenges and problems associated with a family business. The topic introduces you to the vital concepts of franchising, types of franchises and how to evaluate a franchise opportunity. Before buying a franchise, the entrepreneur needs to be aware of the advantages and disadvantages of franchising.

Lastly, this topic focuses on the business buyout and how to evaluate the option of buying an existing business. You will also be introduced to the various methods for determining the value of a business and problems to avoid when buying an existing business.

Learning outcomes

After working through this topic, you should be able to

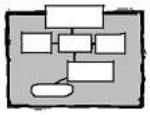
- demonstrate an understanding of the nature of a family business
- explain how to implement succession in a family business
- demonstrate an understanding of certain franchising concepts such as franchise, franchisee and franchisor
- evaluate franchising as a business start-up option
- evaluate an existing business to determine whether or not it is viable

EMERGING ISSUES

– What is a family business?
– What are the problems and benefits of being involved in a family business?
– What do you understand by succession in a family business?
– What is a franchise?
– What are the advantages and limitations of franchising?
– What are the pitfalls of buying an existing business?
– How do you determine the actual value of a business?

CONTENT OF THE TOPIC

Topic 3 comprises the following study units:



TOPIC 3		
Study unit 10	**Study unit 11**	**Study unit 12**
Entering the family business	Buying a franchise	The business buyout

Study unit 10

Entering the family business

Contents

Introduction
Travel pointers
10.1 Defining family businesses
10.2 Systems in family businesses
10.3 Problems in family businesses
10.4 Succession
10.5 Advisory boards
10.6 Family councils
Assessment
Summary

INTRODUCTION

People who have parents/grandparents with an operating business usually have the option of joining the family business. In addition, a family business can be defined as a business in which the owner intends to pass ownership on to a close relative. Family businesses play a substantial role in the USA – because over 80% of all businesses there are family owned. Family businesses account for 78% of all new job creation and 60% of the nation's employment in the USA.

Family businesses are normally small but may grow into large organisations. Consider, for example, the Ford Motor Company, which started as a small family business and is now a large famous company. The founding family is still involved in the ownership and operation of the business.

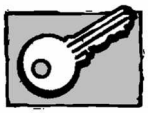
In South Africa, family-owned businesses make up about 80% of South African businesses, while 60% of companies listed on the JSE are family businesses. One of our well-known family businesses, Pick n Pay, belongs to the Ackerman family. Can you name any other South African businesses that are family owned?

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit:

– What is a family business?
– Who should be in family business?
– What problems are experienced in family businesses?

– What is the meaning of the concepts of succession, advisory board and family council?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

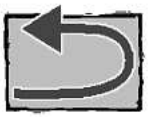
– family business
– succession planning
– advisory board
– family council

Make a list in your journal of the above words and write down a brief explanation of each as it occurs in the prescribed book.

Study Nieman and Nieuwenhuizen (2014:235–247).

Activity 10.1

From your knowledge and understanding of family business, what are some of the striking characteristics of a family business?



Feedback

The following are some of the things you would find in all family businesses:

– *family members who are involved in the business*
– *family members who participate in strategic decision making in the business*

10.1 DEFINING FAMILY BUSINESSES

In a family business, two or more members of the same family share ownership or work together in its operation. A business can also be considered a family business if it passes from one generation to the next.

According to Nieman and Nieuwenhuizen (2014:236), a family business is influenced by family ties in order to achieve the vision of the family. The following characteristics are associated with a family business:

– The family is actively involved in the operation of the business.
– Family members provide input into the strategic direction of the business.
– More than one family member is involved.
– The intention is to continue the family business over time.

Husband and wife teams are often found in business, but unless more family members are involved in the business this is not regarded as a family business in the true sense of the word. Husband and wife teams are regarded as so-called "*co-preneurs*" until such time as more family members or their children join the business.

10.2 SYSTEMS IN FAMILY BUSINESSES

A family is based on emotion, nurturing and security, while a business is focused on productivity, profit, goal achievements and growth. One therefore needs to distinguish between the family system and the business system.

The family system cares for its members. It is an emotional system and since the focus is on the family and their interests, not all new ideas are exploited, which could lead to business stagnation.

A *business system* is task oriented and focuses on turning ideas into opportunities. Productivity is critical.

For the business to operate successfully, there should be a balance between the two systems. Any imbalances could lead to conflict, which will have a negative effect on productivity and staff morale.

See figures 10.1 and 10.2 in Nieman and Nieuwenhuizen (2014:237).

10.3 PROBLEMS IN FAMILY BUSINESSES

According to Nieman and Niewenhuizen (2014:238), the average life span of a family business is 24 years – the average time the founder member stays in the business. The family business also becomes less entrepreneurial when the family system is dominant. Furthermore, only 30% of family businesses are successful into the second generation. This section highlights the problems that family businesses encounter.

Activity 10.2

Your friend is thinking of joining his father and uncle in their family business, and he wishes to become involved in the operations of the business. Explain to your friend some of the typical problems that he is likely to encounter.

Feedback

See Nieman and Nieuwenhuizen (2014:238). Some of these problems include favouritism, family conflict, lack of entrepreneurial initiative, divorce and the emigration of family members.

Activity 10.3

Because of the problems you highlighted in activity 10.2, your friend is now convinced that he should not join the family business. Now explain to your friend some of the positive aspects of a family business.

Feedback

See Nieman and Nieuwenhuizen (2014:238). Some of the positive aspects include a sense of community in the business, job creation, the transfer of specialist knowledge from one generation to the next and quick decision making owing to the size of the family business.

Additional advantages include stability, trust and resilience.

10.4 SUCCESSION

Nieman and Nieuwenhuizen (2014:238) explain that succession is the process through which the leadership of the business is transferred to a family member or nonfamily member. It is imperative that the whole family (all the stakeholders) are satisfied with the process.

It is also important that the leader transfers more than only the assets and operations, but also values and leadership philosophy. This section explains the problems relating to succession as well as how leadership should be transferred.

The following may be obstacles to succession:

- An autocratic founder may not wish to transfer leadership.
- The existing leader may think that he will never die.
- The leader is not convinced that his or her child is ready to take over.
- The leader does not implement changes in time.
- The leader does not wish to make a choice about the business's successor.
- The leader chooses a successor that will be his or her "puppet".

Lank (in Nieman & Niewenhuizen 2014:239) identifies the following leadership styles that can influence succession:

- the monarch: a leader who is forced out of office through, say, death
- the general: a leader who comes out of retirement to "save" the business
- the ambassador: a leader who leaves the business and acts as a post-retirement mentor
- the governor: a leader who retires and focuses on other vocational outlets

Once the leader has decided to go ahead with succession, he or she has the following options:

- Appoint a family member.
- Appoint a caretaker manager until such time as a family member is ready to take over.
- Appoint a professional (nonfamily) manager.
- Liquidate the business.

– Sell the business.
– Adopt a wait-and-see approach.

Nieman and Nieuwenhuizen (2014:240) explain how succession should be transferred.

The next section explains the concept of an advisory board, which focuses mainly on business and management considerations.

10.5 ADVISORY BOARDS

The role of the board is to ensure that the business stays entrepreneurial, that conflict is managed and that decisions are in line with the family value system. The board consists of family and nonfamily members who convene formal meetings on a regular basis. Nieman and Nieuwenhuizen (2014:241) explain the concept of advisory boards in family businesses in more detail.

In addition to an advisory board, a family business can also establish a family council.

10.6 FAMILY COUNCILS

The family council oversees family matters and the members draw up a family creed which covers matters such as the business's management philosophy and objectives, the jobs and remuneration for family members, leadership and succession, shareholding, the board of directors, communication, the employees and changes in the family constitution.

Study the role of the family council in Nieman and Nieuwenhuizen (2014:242).

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

(1) What is the difference between a family business and any other small business? In other words, what makes a business a family business?
(2) Explain why succession planning is not well supported in South Africa.
(3) Identify the five critical steps in succession planning.
(4) Distinguish between the two systems in a family business.
(5) What could one do to ensure that a family business will be successful?
(6) What could one do to ensure that family values are in line with business activities?

Answers to the assessment questions

(1) See Nieman and Nieuwenhuizen (2014:236) and include the definitions of a family business in your answer.

(2) *See Nieman and Nieuwenhuizen (2014:240). Possible reasons might be that the business is not large enough, the children are not interested in the business and the family is concerned about possible family conflict if a successor were to be selected.*

(3) *See Nieman and Nieuwenhuizen (2014:241). The five steps are*

(4) *See Nieman and Nieuwenhuizen (2014:236). You need to be able to distinguish between the family system and the business system.*

(5) *Research has shown that businesses that apply strategic management fare better than those that fail to do so. In the context of family businesses, strategic management is influenced by family affairs. The family affairs could place a damper on the strategic aggressiveness of a business if they are deemed more important than a business system. Hence the first critical task for a successful family business is to ensure that a strategic plan exists which combines family and business issues effectively. Secondly, the people in the family business should be trained for the challenges of the modern era. This includes skills training, management training and creativity training. Lastly, family harmony should be the order of the day, for without it, no plan will ever work.*

(6) *A family creed should be created and openly discussed and debated by all family members. This creed should also be analysed against the critical success factors of the industry in which the family business is involved. The assistance and services of an outside independent facilitator should be enlisted for this purpose.*

(7) *Define what the owners want to happen, now and in the future. A number of meetings are necessary to obtain clarity from each person about where they see themselves in the future of the business. Do they wish to stay in business? Will there be family members who are able to succeed? Personal goals should be evaluated alongside business goals in order to determine compatibility.*

(8) *Evaluate and test the succession goals to confirm that they are feasible. Financial goals and leadership requirements should be evaluated. Alternatives should also be developed in case the original plans fail to materialise.*

(9) *Develop a preliminary succession plan. It is necessary to identify the future leadership requirements and ways of fulfilling them (eg training programmes for a family member or advertising for a nonfamily member). The retirement of the existing owners should be mapped so that retirement is not a burden on the business.*

(10) *Communicate the plan. The preliminary plan should be openly communicated to all family members involved so that consensus can be reached. External advice should also be encouraged.*

(11) *Implement the plan. Because succession takes time, the implementation thereof should start well in advance.*

SUMMARY

Although family business in South Africa is a growing sector, there is concern about the level of management skills in a family business. This could harm a business's ability to grow and expand. Various problems are associated with a family business and one needs to be able to discuss these problems and resolve them. It is absolutely essential to plan for succession in the business. It is therefore recommended that every family business should establish an advisory board and a family council.

The next study unit will discuss the alternative route to entrepreneurship, namely franchising.

Do the revision questions in "Looking back" at the end of the chapter in Nieman and Nieuwenhuizen (2014:244).

Study the case study entitled: "Westvaal Group" in Nieman and Nieuwenhuizen (2014:245).

Study unit 11

Buying a franchise

Contents

Introduction
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11.1 Definition and characteristics of the franchise concept
11.2 Important concepts in franchising
11.3 The structure of the franchising industry in South Africa
11.4 Types of franchising
11.5 The advantages and limitations of franchising
11.6 Evaluating franchise opportunities
11.7 Complying with ethical and legal requirements
11.8 Selecting franchise opportunities
11.9 The franchise contract
11.10 The potential of franchises in the emerging entrepreneurial sector
Assessment
Summary

INTRODUCTION

The previous study unit introduced you to the concept of a family business as an alternative route to entrepreneurship. This study unit discusses another option in entrepreneurship, namely franchising.

Franchising involves the sharing of knowledge between the franchisor and the franchisee. The franchisor gives the franchisee the right to operate the business using the business name and systems and the franchisee pays a royalty to the franchisor. The franchisee acquires the right to use the franchisor's brand and advertised trademark. Being part of a franchise chain has numerous advantages for the entrepreneur. Examples of successful franchises include PG Autoglass, Spur and Spar.

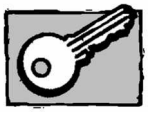
Study Nieman and Nieuwenhuizen (2014:249–265).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit.

– What is a franchise?

– What is the difference between a franchisor and a franchisee?
– What are the types of franchising?
– What are the advantages and disadvantages for a franchisee and a franchisor?
– How do you know if a particular franchise presents a good business opportunity



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

– franchise
– franchisee and franchisor
– South African Franchise Association
– royalties
– franchise agreement

Make a list in your journal of the above terms and write down a brief explanation of each as it occurs in the prescribed book.

Activity 11.1

Write three to four lines on your understanding of the concept "franchise". Give an example of a food franchise and a tyre franchise that you are familiar with in your village/town/city.

Feedback

Study section 11.2 in Nieman and Nieuwenhuizen (2014:249–253).

A franchise is a form of business organisation in which a firm that already has a successful product or service licenses its trademark and methods of doing business to other business in exchange for an initial franchise fee and ongoing royalties. Examples of franchises are Kentucky Fried Chicken, Chicken Liken; Nando's and Tiger Wheel and Tyre.

11.1 DEFINITION AND CHARACTERISTICS OF THE FRANCHISE CONCEPT

Franchising is a marketing system that involves a legal agreement whereby the franchisee conducts business according to terms specified by the franchisor.

According to Barringer and Ireland (2006:357), franchising is a form of business organisation in which a firm that already has a successful product/service licenses its trademark and method of doing business to other businesses (franchisees). The franchisee is required to pay a fee for the right to use the franchisor's systems and brand.

Activity 11.2

Use your local newspaper, the internet or any other source material to find an advertisement for a franchise opportunity or interview any franchisee in your area. Identify the characteristics of the franchise concept.

Feedback

See Nieman and Nieuwenhuizen (2014:250). Characteristics could include the use of intellectual property, support services, control by the franchisor, a franchising agreement and operating manuals.

11.2 IMPORTANT CONCEPTS IN FRANCHSING

To understand the nature of franchising, you need to study the following concepts in Nieman and Nieuwenhuizen (2014:253):

- the franchisee
- the franchisor
- the franchise contract/agreement
- royalties
- the advertising fee
- the franchise fee

11.3 THE STRUCTURE OF THE FRANCHISING INDUSTRY IN SOUTH AFRICA

Read about the franchising industry in South Africa in Nieman and Nieuwenhuizen (2014:254).

11.4 TYPES OF FRANCHISING

This section discusses the following three types of franchising:

(1) *The dealership*. Dealerships are commonly found in the car industry, where the franchise system is used to distribute product lines.

(2) *Business format franchising*. This type of franchising offers a name, an image and a method of doing business. KFC is a case in point.

(3) *Service franchises*. This type of franchise offers services such as personnel agencies and estate agents (eg Pam Golding).

11.5 THE ADVANTAGES AND LIMITATIONS OF FRANCHISING

Franchising is not the ideal choice for all prospective entrepreneurs and one needs to consider both the advantages and the disadvantages of this option.

11.5.1 The advantages and disadvantages for the franchisee

The advantages of buying a franchise are as follows:

- The franchisee buys a proven system and a well-known concept.
- The franchisor assists the franchisee at start-up.
- The franchisor also provides ongoing support and assistance to the franchisee.
- The advertising and purchasing may be done by the franchisor.
- It may be easier for the franchisee to obtain finance to start the business.

The disadvantages of buying a franchise are as follows:

- There may be increased set-up costs.
- The franchisee has to abide by rigid operating procedures.
- The franchisor could make mistakes.

11.5.2 The advantages and disadvantages for the franchisor

The advantages of franchising for the franchisor are as follows:

- Franchisors can rapidly expand their business with the capital and human resources provided by the franchisee.
- The franchisee is an owner operator and is dedicated to the success of the business.

The disadvantages of franchising for the franchisor are as follows:

- It could be costly to set up and operate a head office structure.
- There could be reduced income per unit.
- The franchisor has to secure the cooperation of franchisees before making changes, and this may restrict the franchisor's freedom to act.

The next question is: How does one evaluate a franchise opportunity? How does the potential franchisee know whether it is a sound investment? The next section will identify the factors one needs to consider before buying a franchise.

11.6 EVALUATING FRANCHISE OPPORTUNITIES

Before investing money in a franchise opportunity, the buyer (franchisee) should do the following:

- Evaluate the franchise as a business opportunity. See the list of questions in Nieman and Nieuwenhuizen (2014:256).
- Review the disclosure document that contains information about the franchisor and the franchise system.
- Speak to current and previous franchisees to determine their views on the franchise system and the franchisor.

Also refer to the list of questions to ask the franchisor and existing franchisee, in Nieman and Nieuwenhuizen (2014:260).

11.7 COMPLYING WITH ETHICAL AND LEGAL REQUIREMENTS

It is necessary to determine whether the franchisor abides by the ethical requirements of the franchise industry. As the potential franchisee, you need to have the assurance that you are in no danger of losing your investment in the franchise as a result of unethical practices on the part of the franchisor.

It is imperative for the franchisor to comply with the requirements of the:

- the Consumer Protection Act
- the FASA code of ethics
- FASA's disclosure document requirements
- advertising practice

11.8 SELECTING FRANCHISE OPPORTUNITIES

Nieman and Nieuwenhuizen (2014:260) list the questions that should be addressed to the franchisor and the questions that should be addressed to existing franchisees.

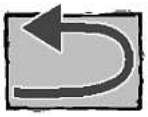
11.9 THE FRANCHISE CONTRACT

This agreement is used to regulate the franchisor/franchisee relationship and maintain standards in the franchise network.

What aspects of the franchisee/franchisor relationship does the agreement cover?

Activity 11.3

Interview an existing franchisee in your local town/city and ask him or her about the content of the franchise agreement he or she signed when purchasing the franchise. What matters should a contract of this kind cover?



Feedback

See Nieman and Nieuwenhuizen (2014:261–263).

A franchise agreement should cover the following vital matters at least:

- *the duties of the franchisor, for example, providing start-up assistance such as finding a site, assistance with the design, buying of stock, training, marketing, development of the business and ongoing support once the business has been established*
- *the duties of the franchisee, for example, conducting the business according to the operation manual, conducting the business from premises approved by the franchisor, adhering to specified operating hours and obtaining the franchisor's approval of marketing material*
- *protection of the franchisor's intellectual property and an understanding that the franchisee will at no stage own the intellectual property*

- *restraints of trade, for example, territorial restraint, price restraints, restraint of the right to advertise and competition restraint; the franchisor may even be obliged to provide products/services to franchisees only*
- *the payment obligations regarding the franchise fee, other levies and royalties*
- *termination of the agreement – the contract needs to specify what the duration of the contract is, what will happen to the franchise in the event of the death, insolvency or incapacity of the franchisee*

11.10 THE POTENTIAL OF FRANCHISES IN THE EMERGING ENTREPRENEURIAL SECTOR

It is now possible for an emerging entrepreneur to become a franchisee and receive the necessary support from the franchisor, support that would not have been available if the emerging entrepreneur had started his business from scratch. Emerging entrepreneurs will enjoy great consumer loyalty if the franchisee originates from the area in which the business is set up.

Read the section on "The potential of franchises within the emerging entrepreneurial sector" in Nieman and Nieuwenhuizen (2014:264).

ASSESSMENT

After studying this study unit, you should be able to answer the following questions:

(1) Explain the concept of franchising.
(2) What are the advantages of buying a franchise?
(3) What is the purpose of the franchise agreement and what matters does it cover?

Read the case study: "Franchising: a preferred vehicle" in Nieman and Nieuwenhuizen (2014:266) and answer the following questions:

(4) Do you think that the 7-Eleven franchise would satisfy the evaluation and selection criteria of a preferred franchise? Explain in detail.
(5) Why do you think that the failure rate of convenience stores in South Africa is relatively low?

Answers to the assessment questions

(1) Franchising is a legal agreement between the franchisor and the franchisee and describes a certain way of operating a small business. The two parties in the contract are the franchisor and the franchisee. The franchisee acquires the right to use the business's name, systems and brand, and in exchange, he or she has to pay royalties to the franchisor.
(2) The advantages are discussed in Nieman and Niewenhuizen (2014:255). Some of these advantages include a proven system, an established trademark, support from the franchisor and a marketing network.
(3) The franchise agreement explains the terms and conditions under which the franchise is bought. It also outlines the roles and responsibilities of the parties involved. See Nieman and Nieuwenhuizen (2014:261) which provides details of what is included in the franchise agreement.

Answers to the case study

(4) The franchise does comply with certain criteria, as highlighted below.

- *It is in an excellent financial position.*
- *The company has been operating for the past 15 years.*
- *It is easy to obtain trade or bank references.*
- *Details of the background of the directors are transparent and accessible on the company's website.*
- *The company operates the franchise format in many local and international locations.*
- *The franchise has company-owned units in operation.*
- *Although up to 70% of all new start-up businesses in South Africa fail, the failure rate for 7-Eleven franchises has been only 16%.*
- *The company is a member of FASA.*
- *The demand for 7-Eleven stores is ongoing despite strong competition in the marketplace.*

(5) There are various reasons for this. Some of these are primarily linked to the franchise concept per se, but in the case of South African convenience stores, this type of franchise is extremely popular because the stores

- *are conveniently situated, which cuts travelling costs and time for customers*
- *stay open relatively late at night*
- *cater for the specific needs of their target markets*
- *are tightly run by owners who are suitably trained and guided by their franchisors*
- *sell (mainly) standardised products with which their customers are familiar*

SUMMARY

Franchising has made entrepreneurship possible for many individuals who were unable to enter the world of entrepreneurship in other ways. Franchising allows individuals to break free from a salaried career.

This study unit introduced you to the concept of franchising and the various types of franchises. You should be familiar with the advantages and disadvantages of franchising. It is essential to evaluate a franchise opportunity before investing money in it. This study unit explained some of the factors to consider when evaluating both the opportunity and the franchise agreement. You were also made aware of what such an agreement should cover.

Potential franchisors must comply with certain legal and ethical requirements such as the Consumer Code for Franchising, the Disclosure Document and FASA membership.

Franchising is a growing industry and creates many job opportunities in this country.

Do the revision questions (''Looking back'') in Nieman and Nieuwenhuizen (2014:265).

Study unit 12

The business buyout

Contents

Introduction
Ttravel pointers
12.1 Evaluating the option of buying an existing business
12.2 Finding a business to buy
12.3 Evaluating available businesses for sale
12.4 Methods to determine the value of the business
12.5 The negotiation process
12.6 Traps to avoid when buying an existing business
Assessment
Summary

INTRODUCTION

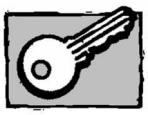
The previous study units introduced you to alternative options to entrepreneurship, namely joining a family business or buying a franchise. This study unit discusses another option, namely the business buyout. Compared to starting a business from scratch, buying an existing one can be less expensive and risky and demands less time and effort from the entrepreneur. A business buyout is a lengthy process. In this study unit, we will guide you through the process of evaluating the option of buying an existing business, finding such a business, determining the value of the business and avoiding certain problems when buying an existing business.

Study Nieman and Nieuwenhuizen (2014:269–284).

TRAVEL POINTERS

Use the following questions as your travel pointers to ensure that you remain focused on the key issues in this study unit.

- What is a business buyout?
- How would one evaluate a business before buying it?
- What methods are used to determine the value of a business?



Key concepts

Picking up useful terms

In the same way as it is useful to know a few key words when travelling in a foreign country, it is a good idea to learn a few basic words before studying a new field. While working through this study unit, look out for the following key terms and make sure that you know what they refer to and how they are used:

- existing business
- profitable business
- market-based, asset-based and earning-based methods

Make a list in your journal of the above terms and write down a brief explanation of each as it occurs in the prescribed book.

12.1 EVALUATING THE OPTION OF BUYING AN EXISTING BUSINESS

The entrepreneur must first decide why he or she wishes to buy a business. He or she should be aware of the advantages and disadvantages of buying an existing business.

Why would an entrepreneur want to buy an existing business? First, the entrepreneur chooses to buy an existing business to reduce some of the uncertainties that he or she would face when starting a business from scratch. Second, when an entrepreneur buys an existing business, he or she buys ongoing operations and established relationships with customers and suppliers. Third, when buying an existing business, an entrepreneur may obtain an established business at a price below what it would cost to start a new business.

Activity 12.1

Interview an entrepreneur who bought an existing business and ask him or her to talk you through any advantages and disadvantages he or she has experienced thus far.

Feedback

The entrepreneur would probably have mentioned some of the following advantages:

- *The business is a going concern.*
- *There is an existing location that has been proven to be an ideal location for the business.*
- *The employees are experienced and reliable.*
- *There are established suppliers.*
- *Inventory is in place.*
- *The necessary equipment has been installed.*
- *It may have been possible to buy the business at a bargain price.*

The entrepreneur might have mentioned some of the following disadvantages:

- *The business was unprofitable, and the owner failed to disclose this financial information.*
- *Sales volumes may be inadequate.*
- *The business could have a poor reputation.*
- *Employees who were inherited with the business may be unsuitable.*
- *The location of the business was inappropriate.*
- *The equipment, facilities and inventory may be obsolete.*
- *The business may have been overpriced and therefore a poor buy.*

See Nieman and Nieuwenhuizen (2014:270) for a complete list of the advantages and disadvantages.

12.2 FINDING A BUSINESS TO BUY

Before finding a business to buy, the potential entrepreneur needs to know what type of business he or she would be interested in. Nieman and Nieuwenhuizen (2014) provide a list of questions that the entrepreneur should answer to determine whether there is a good fit between him or her and the business.

Businesses that are on the market will be advertised in the newspapers, through business brokers or will be sold by the owner personally.

You need to be aware of the so-called "hidden market" (Nieman & Nieuwenhuizen 2014:274). These are businesses that are not advertised as being for sale, although the owner is thinking about selling the business. Finding a business in the hidden market is an attractive option because these businesses are not necessarily in trouble or struggling. Sources of information include suppliers, word of mouth, financial institutions and other trade organisations such as SACOB.

Once you have found a suitable business for sale you have to evaluate the business opportunity.

12.3 EVALUATING AVAILABLE BUSINESSES FOR SALE

In evaluating and investigating any business that is for sale, an entrepreneur would need to find answers to the following questions:

- Why is the business for sale?
- Is the business profitable?
- What skills and competencies would be needed to manage the business?
- What is the history of the business in terms of its previous owners, reputation and public image?
- What is the physical condition of the business, its facilities and all its other assets?
- What are the degree and scale of competition?
- What is the existing and potential market size?
- What vital legal factors should be considered?
- What would be the situation regarding employees when a new owner takes over?

The entrepreneur must know exactly what the legal obligations are in relation to matters such as ongoing contracts and liabilities.

12.4 METHODS TO DETERMINE THE VALUE OF THE BUSINESS

After evaluating the business, the next step would be to determine a fair price for it. The market price is the price for which the business can be purchased, while the marketable price is the monetary worth of the business, that is, its value.

Price and value are not necessarily the same thing. The value of a business is influenced by the market, the competition and the social and economic environment. It is imperative that both the buyer and the seller should be satisfied with the transaction. The seller must be satisfied with the price received and the buyer must ensure that he or she will be able to pay for the business.

The different methods that can be used to determine the value of a business will now be discussed.

12.4.1 The asset-based method/balance sheet method

The asset-based method = total assets – liabilities

The value of the assets can be taken as either the book value or the replacement value.

12.4.2 The market-based method

The actual market price of similar businesses is used as a yardstick. Provision should be made for differences such as the location, size, quality of service and image.

Another market-based approach is to calculate the price-to-earnings ratio.

$$\text{Price-to-earnings ratio} = \frac{\text{market price}}{\text{after-tax earnings}}$$

Thus market price = price-to-earnings ratio $\times$ after-tax earnings

Consider the following example:

The adjustable tangible net worth of a business is R280 500.

The required rate of return is 25%.

The price-to-earnings ratio is 2,9.

The average growth rate in net income is 28,5%.

The previous year's net income was R104 550.

The prospective entrepreneur is currently earning a salary of R60 000 per annum.

Calculate the value of this business using the price-to-earnings ratio.

An effective starting point would be to calculate this year's net income:

Net income = R104 550 + (28,5% of 104 550)

= R134 347

$$\text{Price-to-earnings ratio} = \frac{\text{market price}}{\text{after-tax earnings}}$$

$$2{,}9 = \frac{\text{market price}}{\text{R134 ,347}}$$

Market price = price-to-earnings ratio x after-tax earnings

= 2,9 × R134 347

= R389 606

12.4.3 The earnings-based approach

This method considers the business's future income potential. The various earnings-based approaches are as follows:

– *The excess earnings method*. This method calculates the value of the business by adding the value of tangible net worth to goodwill. See Nieman and Nieuwenhuizen (2014:280) for an example of this calculation.
– *The capitalised earnings approach*. This method is a variation on the excess earnings method.
  The value of the business is calculated as follows:

$$\text{Value} = \frac{\text{net earnings (after deducting the owner's salary)}}{\text{rate of return}}$$

The higher the risk, the lower the value of the business will be.

See the above example of the price-to-earnings approach and use the information to calculate the value of the business using the excess earnings method and the capitalised earnings approach.

Excess earnings method:

The opportunity cost (the return on investment is 25%)

Thus 25% of R280 500 = R70 125

It is also vital to remember that the person buying the business is forgoing a salary. Provision must therefore also be made for the salary of R60 000 (this is also an opportunity cost).

The total opportunity cost for the choice of buying the business will be R130 125 (70 125 + 60 000).

Opportunity cost	=	R130 125
Net earnings for the coming year	=	R134 347
Extra earning power	=	R134 347 – R130 125
	=	R4 222

– If one expects a return of at least 25% on goodwill, the value of goodwill will be

  R4 222/0,25 = R16 888

  This actually means you could invest R16 888 in goodwill and expect a return of R4 222 (the extra earning power) on your investment.

  Value of the business = R280 500 + R16 888
  = R297 387

  Capitalised earnings approach:

  $$\text{Value} = \frac{\text{net earnings (after deducting the owner's salary)}}{\text{rate of return}}$$

  $$\text{Value of business} = \frac{\text{R134 347} - \text{R60 000}}{0{,}25}$$

  = R297 388

– *The discounted future earnings approach*. Read up on this approach in Nieman and Nieuwenhuizen (2014:282).

It is necessary for you to study all the approaches used to determine the value of a business that is for sale.

12.4.4 Nonquantitative factors in evaluating a business

In addition to the above quantitative methods of evaluating a business, the following qualitative factors also need to be considered:

– competition
– future community developments
– legal commitments
– employee contracts

12.5 THE NEGOTIATION PROCESS

Negotiations are necessary to determine the final price between the buyer and seller. Nieman and Nieuwenhuizen (2014) explain the steps that the negotiation process should follow before the entrepreneur can become a business owner.

12.5.1 Price versus value

Bear in mind that the price and value of the business are two different things. Nieman and Nieuwenhuizen (2014) explain the factors that contribute to the difference between price and value.

12.5.2 Source of power in negotiation

Information is vital to a strong bargaining position. The buyer should do his or her homework and never rely on the seller for information about key issues such as the market and industry.

Timing also influences negotiations. For example, if the seller has already bought another business and is in a hurry to sell, the buyer is in a favourable position. Neither the buyer nor the seller should ever come across as desperate or too eager.

Other people involved in the negotiation could also influence the outcome. For example, if the business has more than one owner, one owner could put pressure on the other to strike a deal.

12.6 TRAPS TO AVOID WHEN BUYING AN EXISTING BUSINESS

There are a number of pitfalls to avoid when buying an existing business. These include the following:

- The buyer must ensure that he or she fully understands the terms of the contract of purchase. It is advisable to enlist the services of a lawyer for assistance in this regard.
- Not all large and prestigious businesses are sound investments
- A fit between the business and the entrepreneur's skills, experience and interests is essential.
- All opportunity costs should be considered.
- When buying a business, there are many hidden costs, such as legal fees, insurance premiums and auditor's fees. The buyer should budget for these additional costs.
- The buyer should not be greedy.
- The buyer should not be anxious and impatient.

ASSESSMENT

After working through this study unit, you should be able to answer the following questions:

(1) What information should one study before purchasing a business?

(2) Your brother wishes to buy an existing business and feels that conducting a business valuation would be a complete waste of time. You need to convince your brother of the benefits of such a valuation. What would you tell him?

(3) Identify qualitative factors that should be considered when evaluating an existing business.

(4) Briefly discuss the steps in the negotiation process.

(5) Name some sources of information on businesses that are for sale but not advertised.

(6) Contrast the asset-based method with the market-based method in determining the value of a business.

(7) Explain why the excess earnings approach may be the best method to use in determining the value of a business.

Read case study 2 (on Susan and Martha) in Nieman and Nieuwenhuizen (2014:287), and answer the following questions:

(8) What would be the advantages and disadvantages for Susan and Martha of buying this bakery?

(9) *Explain to them the negotiation process they would have to follow if they were to decide to buy the bakery.*
(10) *What quantitative technique would you recommend they use in the valuation of the business?*

Answers to the assessment questions

(1) *See table 12.2 in Nieman and Nieuwenhuizen (2014:277). The information that should be studied includes the balance sheet, income statements, cash-flow statements, income tax returns, records of maintenance on fixed assets and proof of all payments to SARS.*
(2) *See Nieman and Nieuwenhuizen (2014:277). The benefits are as follows:*

- *A business loan is easily secured if a quality business evaluation has been conducted.*
- *Understanding the value of the business would save one possible financial losses.*
- *The cost of rectifying the situation later on could be astronomical.*

(3) *Competition, future community development, legal commitments and employee contracts are the qualitative factors that should be considered (see Nieman and Nieuwenhuizen 2014:282).*
(4) *See Nieman and Nieuwenhuizen (2014:283).*
(5) *See section 12.3.2 in Nieman and Nieuwenhuizen (2014:274).*
(6) *See sections 12.5.1 and 12.5.2 in Nieman and Nieuwenhuizen (2014). The asset-based method is easier to apply and more appropriate (given that the adjusted balance sheet values are used) because it gives a more accurate description of the business value. In particular, it is of more use to the buyer of the business, because he or she will know that the transaction is realistic in terms of the value of the assets.*
(7) *See section 12.5.3 in Nieman and Nieuwenhuizen (2014).*

Answers to the case study

(8) *The advantages and disadvantages are as follows:*

Advantages

- *It is a going concern. This will save the new owner time, money and a great deal of energy.*
- *An existing business may have the advantage of already having the best location.*
- *Inventory is in place and the previous owner's experience of maintaining the right balance between too little and too much inventory will be invaluable to the new owner.*
- *The equipment is already in place and the production capacity known. The entrepreneur may buy these facilities and equipment at prices below replacement costs.*
- *It is possible to buy an existing business at a bargain price.*

Disadvantages

- *The business may have a poor reputation or image.*
- *It is possible that the business was never profitable, but the owner disguised this by employing a creative accounting technique. Bear in mind that it is possible for the owner of a business to have more than one income statement.*
- *The business location may be unsuitable.*

- *The equipment, facilities and inventory may be obsolete.*
- *The business may be overpriced.*
- *It is also necessary to consider the disadvantage of operating in the shadow of the previous owner of the business.*

(9) After finding an existing business to buy and evaluating it, the buyer and seller embark on the negotiation process. See section 12.6 in Nieman and Nieuwenhuizen (2014).

(10) The excess earnings method remains the most useful and possibly most realistic method because various factors are taken into account to determine the value of the business.

SUMMARY

The process of buying a business should be approached with caution and enough time should be spent on evaluating the business and negotiating the right price.

This study unit explained how to evaluate a business opportunity and where to find businesses to buy. It is imperative for a potential buyer to conduct research before simply buying a business, because the relevant information will place the buyer in a strong bargaining position in the negotiation process. The study unit also identified traps to avoid when buying an existing business.

Do the revision questions at the end of this chapter in Nieman and Nieuwenhuizen (2014:285).

TOPIC SUMMARY

The aim of this topic was to introduce you to the alternative routes to entrepreneurship. Firstly, entering a family business was discussed. You were introduced to the systems in a family business as well as potential problems an entrepreneur could face when joining a family business. The importance of succession planning was emphasised and the roles of an advisory board and family council discussed.

Secondly, the franchise concept was discussed. You need to understand the difference between a franchisee and a franchisor. The different types of franchising were discussed, as were the reasons why an entrepreneur would buy a franchise. Because franchisors need to comply with certain legal and ethical requirements, the format of the franchise contract was explained.

Thirdly, buying an existing business is the last alternative route to entrepreneurship. There are various reasons why an entrepreneur would rather buy an existing business than start a business from scratch. Before investing money in an existing business, the entrepreneur needs to evaluate the business opportunity by considering certain factors. The business has to be evaluated in order to calculate its real value. Because certain traps should be avoided when buying a business we then discussed the factors involved in such pitfalls.

EVALUATION AND FEEDBACK FORM

We need your help to continuously improve the quality of our learning materials, and therefore require your input and suggestions regarding this study guide and the prescribed book.

NOTE: Your response will be treated in strict confidence, and your name will not be associated in any way with the results of this survey.

STUDY GUIDE FOR MNE2601

(1) How would you rate your level of satisfaction with the study guide?
Please make a cross (x) in the appropriate column.
1 extremely dissatisfied, 2 dissatisfied, 3 neutral, 4 satisfied, 5 extremely satisfied

1	2	3	4	5

(2) What specific concepts or guidelines did you find most helpful?

.....

.....

(3) What specific concepts or guidelines did you find least helpful?

.....

.....

(4) If you could change anything in this specific module, what would it be?

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.....

(5) What additional topics or areas would you like to see addressed in this module in the future?

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PRESCRIBED BOOK

Nieman, G & Nieuwenhuizen, C. 2014. *Entrepreneurship: a South African perspective.* 3rd edition. Pretoria: Van Schaik.

(1) How would you rate the support the study guide gives you in understanding the contents of the prescribed book?

1 extremely dissatisfied, 2 dissatisfied, 3 neutral, 4 satisfied, 5 extremely satisfied

1	2	3	4	5

(2) How would you rate your level of satisfaction with the prescribed book? (1) extremely dissatisfied, (2) dissatisfied, (3) neutral, (4) satisfied, (5) extremely satisfied

1	2	3	4	5

Please fax or post your response to:

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Notes