IT SUPPORT SERVICE

NTQF Level I

Learning Guide #43

UNIT OF COMPETENCE:	**DEVELOP UNDERSTANDING OF ENTREPRENEURSHIP**
MODE TITLE:	**DEVELOPING UNDERSTANDING OF ENTREPRENEURSHIP**
LG Code:	**ICT ITS1 M11 LO4**
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LO 4: **Discuss How to Operate an Enterprise**

INTRODUCTION	Learning Guide # 38

This learning guide is developed to provide you the necessary information regarding the following content coverage and topics –

- Definition of enterprising
- Definition of entrepreneurs
- Role of entrepreneurs
- Use of enterprising

Upon completion of this Learning Guide, you will be able to –

- Analyze and discuss the principles, concept and terminology of entrepreneurship
- Identify the different / various forms of enterprises in the community and their roles
- Categorize and classify the identified enterprises
- Identify and interpret the terms and elements involved in the concept of enterprising
- Explain functions of entrepreneurship in business and how the entrepreneurs improved business and economic environment

Learning Activities

1. Read the specific objectives of this Learning Guide.
2. Read the information written in the "Information Sheets 1" in pages 3-6.
3. Accomplish the "Self-check" in page 7.
4. If you earned a satisfactory evaluation proceed to "Operation Sheet 1" in pages 8-9. However, if your rating is unsatisfactory, see your teacher for further instructions or go back to Learning Activity # 1.
5. Read the "Operation Sheet 1" and try to understand the procedures discussed.
6. If you satisfactorily performed Operation Sheet 1, proceed to "Operation Sheet 2" in pages 10-12. However, if your rating is unsatisfactory, see your teacher for further instructions or go back to

- Your teacher will evaluate your output either satisfactory or unsatisfactory. If unsatisfactory, your teacher shall advice you on additional work. But if satisfactory you can proceed to the next topic.

Information Sheet 1	Startup Capital

Money Needed to Start an Enterprise

Objective of the Lesson

At the end of this lesson trainees will be able to:

1. Make the distinction between pre-operation and initial operation payments.
2. Estimate the amount of money needed to start an enterprise.

Rationale of the Lesson:

- Setting up a business requires a certain amount of money that has to be spent before the business activities can start to generate income through sales. Often, potential entrepreneurs underestimate the amount needed because they only take into account the expenditures for investment items such as premises, machinery, equipment, vehicles, inventory and so on.
- The amount needed as start-up capital is generally much higher than the money available to the entrepreneur. As the difference has to be found from other resources.
- Business starters are generally aware that they need money for machines, tools and equipment, etc... They may not realize that other payments have to be made before they can really start their business.
- The need for working capital is also often underestimated. People think they will be paid immediately. This is often the case in trading activities; however, the shop owner has to have a stock of goods because she/he cannot replace every article sold immediately.
- In manufacturing activities working capital has to cover a longer period and that can last several months.

Estimating the Start-up Capital

If someone wants to start a business he/she must be aware that a certain amount of money is needed during the start-up process of a business for making payments <u>before the business begins to generate enough sales income</u>.

- This money is called start-up capital. It serves two purposes.
- Pre-operation payments or investment capital
- This is money that a person starting a business will have to pay before the business starts operating.
- The money needed for these payments is invested in the business as long as the business is operating.
- This time span depends on the nature of the business.
- This money is also invested permanently in the business and is working capital. When the business expands the working capital needs to be increased
- However, young people very often do not realize that a number of other payments have to be made before they can really start their business. For example:
    - the cost for installation of machines and
    - the expenses for training of workers to use machines
    - fees for licenses and insurance
    - costs related to renovation of facilities

2. Initial operation payments or working capital

It will occur when a new business starts to operate, to cover immediate expenses until revenues from sales flow back into the business.

Estimating the Start-up Capital

- This time span depends on the nature of the business.
- This money is also invested permanently in the business and is working capital. When the business expands the working capital needs to be increased

- If the working capital is underestimated, an entrepreneur may have a flourishing business, but may run out of money to pay salaries, buy additional merchandise for sale, etc.
- It is recommended that a certain percentage is included in the investment capital for unforeseen items.
- Working capital should also include additional funds for unforeseen expenses.
- The start-up capital for a new business is the sum of the expenditures for the investment items and the working capital.
- The future entrepreneur needs to have this amount of money available through using his/her own savings, finding partners and negotiating loans with banks.
- As a general rule, 30% of the start-up capital should be from the entrepreneur's own resources.

Obtaining Money to Start an Enterprise

Objective of the Lesson

At the end of this lesson Trainees will be able to:

- Identify sources of finance to start an enterprise.
- Identify the advantages and disadvantages of using various sources of capital to start an enterprise.

Rationale of the Lesson:

- Any prospective small business owners have good business ideas and plans. However, they may discover that the capital necessary to initiate their business is not readily available. Learners should be aware of the types of funds available to prospective business owners.
- Entrepreneurs will almost certainly have to invest their personal money in the business. However, some of the capital needed to begin business operations can be obtained through credit.
- This topic will identify potential sources of initial capital, and offer suggestions regarding how to prepare for obtaining debt or credit financing.

Sources of Business Financing

- There are two primary sources of financing to establish a business. These are: (a) owner's equity or (b) borrowing from lending institutions.
  - Equity financing
- It is the money the owner puts into the business.
- It is the owner's investment in the business.
- The main sources of equity financing for most entrepreneurs are:
  - personal savings
  - Family and friends
  - Partners
  - Corporation

- Financial experts say that one-half of the money needed to start a small business should come from the owner. This means future owners must work and save to have enough money to start a business.

2. Borrow from lending institutions

- Borrowing needed capital for the business is called credit or debt financing.
- The lender must sense that the business owner has a personal commitment and involvement in the business.
- This personal commitment includes the time, energy and money the owner is willing to contribute to the business.
- Lenders will usually review a business plan very carefully to lend money.
- This plan should describe how the business will be operated, how much money will be needed and how it will be used, and at what point the business will be profitable.
- Credit or debt financing obtained from: Banks, finance companies, governments agencies (with loan schemes), trade credit and microfinance institutions

- Considerations in applying for a business loan
  - Different lending institutions have different procedures which have to be followed by the loan applicant.
  - It is necessary to understand the following factors that are taken into consideration when a banker is appraising a loan application.

Type of loan
Purpose of the loan
Credit worthiness and integrity of the borrower
Capability
Repayment period
Security or collateral
Guarantors
Business plan
Customers past financial records

- A banker or loan officer will take into consideration the five C's of credit when evaluating a loan applicant:
  - Character
  - Capacity
  - Capital
  - Conditions
  - Collateral

- Criteria for evaluating loan sources

- To determine the best source for raising capital needed in a particular situation, the following five questions should be considered.

- Cost: What are the benefits of a loan in relation to its costs?
- Risk: Which loan source exposes the business to the lowest degree of risk?

3. Flexibility: Will conditions imposed by a loan source reduce flexibility in seeking additional capital, or in using capital generated through operations according to the owner's best judgment? Control:

4. Could the owner's control of the business be adversely affected? Could the loss of control prevent the entrepreneur from making operating decisions that are in the best interests of the business?

5. Availability: Which financial sources are available to the business?
6. Weighing Evaluation Criteria: Every capital source being considered should be evaluated in terms of cost, risk. Flexibility, control and availability. A decision can only be made by the prudent judgment of the owner after assembling and analyzing all relevant facts.

How will the capital be used?

- To help determine your money needs, three groups of costs and expenses are examined: start-up costs, operating expenses and personal expenses.

- Start-up costs: expenses that occur once only when starting the business. Once your business is started, you may never have these expenses again.

2.Operating expenses: until there is enough profit to keep the business running, money will be needed for operating expenses.

3. Personal expenses: these include costs that are necessary for you to live. You need money for personal expenses such as rent payments, food, transportation, insurance, clothing, utilities, medical bills and entertainment.

Equity and Debt Financing

TYPE OF FINANCING	ADVANTAGES	DISADVANTAGES
EQUITY FINANCING		
A. Using personal savings	1. All of the profit kept. 2. Reduces amount of debt. 3. Risk of loss provides motivation to succeed. 4. Shows good faith to any potential lenders.	1. Chance of loss. 2. May force personal sacrifices. 3. Loss of return from use of savings in other investments.
B. Involving friends and family	1. Brings in more cash. 2. May be possible to borrow more. 3. Financial risks shared.	1. Part of profits given up. 2. Part of the ownership given up.
C. Forming a partnership	1. Easy source of cash. 2. Less pressure and restrictions. 3. Informal arrangements.	1. Risk of destroying personal relations 2. May encourage unwanted involvement in business.
D. Forming a limited company	1. Larger amount of cash raised. 2. Financial risks shared. 3. Legal liability reduced. 4. Tax savings.	1. Part of profits given up. 2. Share of control and ownership given up.
E. Forming a cooperative	1. Poor people are able to combine financial resources. 2. Financial risks shared.	1. Profits shared. 2. Financial decision-making shared.
F. Working with financial institutions	1. Set up to help small businesses. 2. Provides loans.	1. Favours expanding businesses.
DEBT FINANCING		
All forms of borrowing	1. Relatively easy to obtain. 2. Control and ownership of the business maintained. 3. Can be repaid at more advantageous time. 4. May save money. 5. Costs may be tax deductible. 6. Inflation allows repayment with cheaper money.	1. High interest costs. 2. Risk that future profits will not cover repayment. 3. Easy to abuse and overuse. 4. Financial and confidential information must be supplied. 5. Lender may impose limitations or restrictions on borrower.

Information Sheet 2	Startup Capital

Managing Sales

Characteristics of Successful Salespersons

1. **Results Oriented**
2. **Highly Motivated**
3. **Self-Confident**
4. **Professional Appearance**
5. **Honest**
6. **Dependable**
7. **Knowledge of Products**
8. **Good Listener**
9. **Enthusiastic (Passionate, excited)**
10. **Pleasing Personality**
11. **Communicator**
12. **Sociable**
13. **Courteous (Polite, well-mannered)**

Qualities of Potential Customers

- **Potential customer is the most important “Very Important Person” to a business.**
- **A potential customer is not dependent on any business.**
- **Potential customers do not interrupt business activity they are the purpose of business.**
- **Potential customers are not statistics: they are human beings who have feelings and emotions like everyone else.**
- **Businesses never win an argument with a potential customer.**
- **The job of business is to cater/furnish to the potential customers’ wants and needs.**

Selling Requires Communication

- **When selling, you communicate to prospective clients something about yourself and the product or service you are selling.**
- **This process can be viewed as a series of steps, and each step involves a higher level of communication.**
  - **Step 1: approach the prospective customer and introduce yourself and your company**
  - **Step 2: specify your reason for approaching the prospective customer**

- **Step 3: show or describe the product/service you are selling**

- **Step 4: demonstrate how the product/service will benefit the prospective customer**
- **Step 5: negotiate terms and conditions of the sale**
- **Step 6: ask the prospective customer to make a decision regarding the purchase of the product.**
- **Step 7: once customers do start to buy your product or service, develop strategies to help you to keep your customers.**

✓ **Research study has indicated that it costs 10 times as much to attract a new customer than it does to keep an old customer.**

- **Selling is a two-way communication process.**
- **Selling requires active listening to understand customer needs and interests.**
- **You have to adapt your message and communication style to the personality and buying motives of the prospective customer.**
- **Effective communication help to build a relationship with the customer based on trust and confidence; this forms the foundation for the present sale transaction and for future sales as well.**

➢ **Successful selling depends on the entrepreneur's ability to:**

- **Attract the buyer's attention.**
- **Determine customers' needs, wants, problems and goals.**
- **Show how the product or service will satisfy those needs.**
- **Work out the problems that prevent customers from buying.**
- **Ask for the customers' business.**

  - **The success of a business depends on the art of selling, the entrepreneur must focus not only on producing the product or service, but on selling the product or service as well.**
  - **Entrepreneurs to create satisfied customers have to take advantage of the opportunity to *serve people, to satisfy their needs and to solve their problems,*.**
  - **Satisfied customers continue doing business with an entrepreneur and recommend the products and services to others.**

- **Entrepreneurs are salespersons in the sense that they are always selling their products/services to the public.**
- **Entrepreneurs must maintain their sales image wherever they go and whatever they do in the community.**

The Product Life Cycle

- **The concept of the product life cycle describes the stages (or courses) a new product goes through in the market place.**
- **In other terms, product life is the course of product's sales and profits over its lifetime.**
- **A new product progresses through five distinct stages: *introduction, growth, maturity, decline and recycling.***
- **The product life cycle has an impact on the marketing strategy and the marketing mix.**

Introduction stage

- **In this stage, the entrepreneur seeks to build product awareness and develops a market for the product.**
- **The impact on the marketing mix is as follows:**
  - **Product branding is established**
  - **Pricing may be low to build up market share rapidly**
  - **Distribution (Place) is selective until consumers show acceptance of the product**
  - **Promotion is aimed at product awareness and to inform potential consumers about the product.**

Growth stage

- **In this stage, the firm seeks to build brand preference and increase market share.**
  - **Product quality is maintained and additional features may be added.**
  - **Pricing is maintained or increased when the demand is high**
  - **Distribution is diversified**
  - **Promotion is aimed at a broader audience**
  - **Promotion is extended to broader public**

Maturity stage

- **At maturity, the strong growth in sales diminishes. There may be competition with similar products. The primary objective is to defend the market share and to maximize profit**
  - **Product features may be enhanced to make the difference with competitors**
  - **Pricing may be decreased due to competitors**
  - **Distribution needs to be extended and incentives offered**
  - **Promotion will emphasize product features**

Decline stage

- **As sales decline the entrepreneur has different options**

— **Maintain demand for the product by adding new features**

— **Reduce costs and prices and continue to offer the product**

— **Stop producing the product.**

Recycling

➢ **At the end of the lifetime of any product the product or part of it can be *recycled*.**

— **At any time in the life cycle once the product reaches the end of its lifetime the product might be collected back by the producer.**

— **The entire product or part of it can be reused in the production process as recycled raw material**

— **Recycling can reduce costs and prices and helps to continue to offer the product**

Product Life Cycle