Entrepreneurship

Entrepreneurship

Context, vision and planning

John M. Legge

Kevin G. Hindle

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*To the memory of Sir John Monash GCMG;
entrepreneur, soldier and public servant*

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Preface

This book is primarily intended for use on final year undergraduate business programmes and later year postgraduate business programmes as the text for a capstone subject, success in which will force students to call on most or all of their previous business studies. The book should also prove useful to professionals who need to prepare a business plan to exploit an innovative concept that they or their colleagues have developed.

Those who complete such a subject (or read and understand the book without undertaking a structured study programme) will be able to:

- screen proposals for a new enterprise or initiative to be undertaken within an established enterprise rapidly and effectively
- estimate the resources that will be needed to establish and grow an enterprise, and estimate their cost and the dates at which they must be made available
- prepare a convincing and compelling business plan in support of any proposed innovation, including the most sophisticated and complex ones
- understand in general terms the process by which a new venture raises the money it needs to commence and grow its operations

Readers will, along the journey, gain an insight into why innovation and entrepreneurship are important in a modern economy and get a chance to practise two desperately undervalued skills: concept and opportunity-screening; and revenue-forecasting, given a marketing budget, or setting a marketing budget, given a revenue forecast.

Our approach

The past 15 years have seen a veritable explosion in the number of tertiary institutions offering entrepreneurship subjects, sub-majors and programmes; as well as an equally explosive increase in the amount of research conducted into all aspects of entrepreneurship and the economic significance of entrepreneurial activity. Many textbooks on entrepreneurship were published over this period; but in our view, too many of these have taken too little account of contemporary research in entrepreneurship, economics, management and marketing.

This book, to the best of its authors' ability, does reflect such contemporary research. We expect our readers to learn about the 'why', 'when' and 'where' as well as the 'how' of entrepreneurship. We also expect at least some of our readers to plan and lead the most complex and demanding of innovative projects. For this reason we have not attempted to write a book about 'entrepreneurship' but rather we have focused on the development and production of business plans that will command the

attention of potential investors seeking to take a stake in high-growth markets. To make room for such a focus, we have provided no more than a brief overview of the topic of entrepreneurial finance and have assumed our readers' knowledge of the marketing, finance and management subjects normally taught in the first two years of an undergraduate business programme or the first year of an MBA.

This is not an introductory text and neither is it the last word on the subject of entrepreneurship. At the very least a complete programme of study for entrepreneurs should include a full semester subject on entrepreneurial finance and a further full semester subject on the particular problems of managing rapidly growing businesses.

The focus of this book is both narrower and wider than that of many similarly named texts. It is narrower because of its focus on a limited number of entrepreneurial skills: opportunity-screening; revenue-forecasting; and the preparation of a logical, convincing business plan. It is narrower because we pay little explicit attention to new small business formation. It is wider because we embrace all forms of innovation, whether undertaken in new commercial ventures, as projects within established enterprises or pro bono. The common factor is innovation, an irreversible change in social and economic structures and relationships, and the men and women who assemble and direct the resources needed to carry them out.

There are limits to the applicability of military analogy to entrepreneurship, but if one wishes to learn from the military one should start with the best. To English readers the archetypical successful general is probably still Arthur Wellesley, first Duke of Wellington; and anyone involved in any aspect of management and entrepreneurship could learn a lot from reading a biography of the Iron Duke. Our particular hero is General Sir John Monash, who certainly didn't win the First World War on his own, as some overblown Australian patriots and anti-British Americans have suggested; but he had the honour of planning and commanding the offensive that convinced Ludendorff, the chief of the German general staff, that Germany had lost it.

Wellington and Monash were remarkably successful in their military activities. One of the key factors in that success was their ability to define precise objectives and the resources needed to achieve them. Neither general commenced offensive operations before those required resources were under their command. Once one objective was achieved, they developed a new plan before moving towards the next one. When Wellington and Monash encountered difficulties, they were less the result of bad planning than the consequence of subordinates failing to obey their orders. Lord Uxbridge's failure to halt the heavy cavalry's charge after completing the task that Wellington had ordered at the Battle of Waterloo put the entire British position at risk. The heroism of the Guards saved the day for Wellington and the Allies, but the price was heavy and paid in blood. Uxbridge's subsequent sangfroid has distracted attention from his incompetence. Monash was embarrassed on two occasions when he had American troops temporarily under his command and their officers failed, like Uxbridge, to observe Monash's stop lines and so lost the protection of his preplanned artillery strikes. No one has any right to challenge Uxbridge's bravery or that of the American officers and men who fought alongside Monash; but bravery can easily topple into folly.

In facile discussions of entrepreneurship, entrepreneurs are too often described as 'risk-takers', displaying the same reckless indifference to circumstances as Lord

Uxbridge, or his even more notorious successor, Lord Cardigan of the Charge of the Light Brigade. We prefer Monash's approach:

I had formed the theory that the true role of the infantry was not to expend itself upon heroic physical effort, nor to wither away under merciless machine-gun fire, nor to impale itself on hostile bayonets, nor to tear itself to pieces in hostile entanglements ... but, on the contrary to advance under the maximum possible array of mechanical resources, in the form of guns, machine-guns, tanks, mortars and aeroplanes; to advance with as little impediment as possible; to be relieved as far as possible of the obligation to fight their way forward; to march, resolutely, regardless of the din and tumult of battle, to the appointed goal; and there to hold and defend the territory gained; and to gather in the form of prisoners, guns and stores, the fruits of victory. (Serle 1982)

Planning does not eliminate risk but it minimises it, and a well-planned venture, like a well-planned battle, often succeeds so completely that the effort that went into prior planning gets ignored: in the glare of 20:20 hindsight, it just looks easy – or the result of incredible luck.

This book is about how to be a lucky entrepreneur; not necessarily a glamorous or a famous one but certainly a successful one.

Structure

- Chapters 1 to 3 set the context: who becomes an entrepreneur; why they are important, socially and economically; how they should behave; and why entrepreneurial opportunities are unlimited. We devote some attention to the economics of entrepreneurship and the basis of entrepreneurial ethics. We emphasise that entrepreneurship is a social as well as an economic activity and certain institutions must be present and functional before significant entrepreneurial activity is possible.
- Chapter 4 summarises the process of opportunity screening and introduces a sophisticated revenue-forecasting model; an appendix to this chapter summarises the mathematical basis of the forecasting model and the hurdle rate table. The body of the chapter contains tables and methodologies that can be used by people not willing or able to tangle with the mathematics to arrive at soundly based conclusions under most circumstances.
- Chapter 5 discusses the strategic context envisaged for a new enterprise and discusses the issues surrounding the personnel structure and the creation of an asset register. While the work described in Chapter 4 will have established staff budgets, this chapter discusses the completion of the organisational design and the creation of a business model.
- Chapter 6 is our alternative to the list of lists found in books for the less ambitious: rather than providing a business plan and letting you fill in the blanks, we explain what a business plan is and what its crucial attributes are. We draw on recent research that establishes the critically important features of successful business plans.
- Chapter 7 provides a high level view of the law as it affects entrepreneurs, focused on issues that should be dealt with in a business plan. It is necessarily superficial,

and business law is worth at least a full semester subject on its own; but students should learn enough from this chapter to be able to complete a business plan that is not actually dependant on breaches of the law.

- Chapter 8 discusses the impact of government policy on entrepreneurs, in both the neoclassical economic view and the more relevant view arising from system and complexity theories. Government policy is simply too fickle and varies too much from country to country for this to be a useful list of schemes, with tips for making a successful application; rather, we explain why governments might, on occasion, offer help to entrepreneurs. We hope that entrepreneurs who understand the reasoning of those who develop such schemes will be able to focus their applications on the issues that the schemes' authors will consider important.
- Chapter 9 discusses the opportunities and difficulties facing innovative employees of corporations and makes some practical suggestions for corporate entrepreneurs seeking to enlist the resources of a corporation in support of their proposed innovation. While we nowhere exclude corporate innovation as a legitimate entrepreneurial activity, there are sufficient differences in the decision-making process to justify a chapter explaining them. Leading corporations are already replacing their traditional capital budgeting documents with a requirement for a properly prepared business plan and this trend will become general.
- Chapters 10 and 11 deal with the entrepreneurial business plan. Chapter 10 discusses the financial model and explains the construction of a complete set of financial and management accounts for a new venture; this chapter will be critically important for students whose instructor elects not to use 'ExampleCo' or a similar model and useful in explaining the 'ExampleCo' model to those students who will be using it.
- Chapter 11 makes some suggestions for laying out a convincing and compelling plan. We can't claim any great novelty in this chapter; the proposed table of contents and plan structure won't be very different from that recommended in other texts but we provide this chapter for the sake of completeness.
- Chapters 12 and 13 look beyond the completion of the plan: Chapter 12 discusses the sources of finance for entrepreneurial ventures, necessarily limited to an overview of a topic that can easily justify at least a full semester subject.
- Chapter 13 provides a broad overview of entrepreneurial research and the problems and opportunities of encouraging entrepreneurship in societies and cultures where capitalism has barely taken hold.

Using this book

Students

Students will find that we have assumed that they have acquired a basic knowledge of marketing, accounting and other subjects from a standard business curriculum. They will find that this book is very readable, which we hope will compensate them to some extent for the difficulty of some of the concepts and, if their instructor follows our suggestions, an extremely arduous assignment.

There are subjects where students at every level are aware that there is still more to learn and even those at the top of their discipline know that there are still unsolved problems to work on. Entrepreneurial business planning, as described in

this book, is not such a subject, and while there will always be more to learn about business planning and entrepreneurs generally, the successful use of entrepreneurial business planning depends on your skills at collecting information, processing it using all the skills that you will have learned during your business studies, and a few more besides, and presenting it as a coherent, convincing plan and argument for undertaking a particular set of actions with a particular set of objectives. Planning requires the integration of many skills and is meaningless in their absence.

You will not learn how to 'get rich', although entrepreneurial business planning skills can certainly be applied to the gaining of personal wealth. By and large you will learn, from experience if not from this book, that most of those entrepreneurs who do get rich do so as a result of achieving a personal objective that has little to do with money as anything more than an essential resource for those who wish to create new enterprises and as a scorecard at the end of the process. John Kay, writing before Al 'Chainsaw' Dunlap's full contribution to the accounting scandals that marked the start of the twenty-first century became public knowledge, wrote:

I do not recommend that you read Bill Gates's recent book any more than I recommend Al Dunlap's. But if you do read them both, you should notice the contrast: Gates's is entitled *The Road Ahead*; Dunlap's is called *Mean Business*. Gates is enthused by what businesses he might set up; Dunlap by those he might close down. Above all, you learn that while Dunlap's primary concern is money, Gates is primarily interested in computers. Yet Gates, not Dunlap, is America's richest man. (Kay 1998)

Gates has already given away far more in charitable donations and endowments than Dunlap has earned in his life.

Some readers may care even less for money than Gates appears to and seek to create pro bono enterprises or take an active role in one of them, perhaps as a country programme manager for Oxfam or an equivalent role in some other philanthropic organisation. All the skills needed to construct an entrepreneurial business plan for a profit-seeking enterprise are still needed when planning to create a pro bono one: objectives must be determined, the required resources must still be identified and assembled, finance raised and the enterprise staffed and equipped. An entrepreneur's extreme desire for personal wealth won't make a misconceived or ill-planned project profitable; but neither will an aid worker's sincerest desire to deliver benefits to those in need compensate for a failure to define the objectives of a mission properly or assemble the resources it needs.

You will also find that, while we provide numerous examples and anecdotes, there are no extended case studies or narratives. Our reason is that a successful entrepreneurial endeavour must, in some essential respect, be original and so must a sound entrepreneurial business plan. You won't succeed as an entrepreneur by merely copying what someone else has already done, and a plan that merely fills a few blanks in a predefined template is hardly a platform from which to launch a genuinely innovative enterprise.

Instructors

Obviously we are pleased that you have adopted our text. We will not be offended if you ignore our suggestions for teaching entrepreneurial business planning or a similarly named subject, but we are happy to offer them.

We have structured the book to support a course of 12 lectures over a single semester, assuming a two-hour lecture and a one-hour tutorial in each week. The text should be useful for courses taught in other formats or other sequences: having emphasised that students should not treat anyone else's ideas as scripture, we certainly don't claim to have produced a work of scripture ourselves.

We suggest that the lectures should not follow the text strictly. Conceptually, Chapters 10 and 11 should follow Chapter 6, and a lecture series should cover the financial model (Chapter 10) and writing the plan (Chapter 11) immediately after dealing with the theory of the plan in Chapter 6. Students whose assignment consists of a complete business plan will, however, be a long way short of either building their financial model or writing the plan body in week 6, and until they have completed at least a first draft of their plan, Chapters 10 and 11 will lack the immediacy that the practical problems of completing a plan present. Students should therefore be expected to read Chapters 10 and 11, notionally for the second time, as they prepare their assignments for submission and assessment.

Our experience has been that this subject is best taught in parallel with a major business planning assignment, with students expected to produce and present a plan of 30–40 pages for a genuinely innovative project. Most students will propose a plan for a new venture, but we believe plans for an innovation in either the corporate or pro bono sectors should be acceptable. Students can be asked to work as individuals or in teams of up to five members: teams may spread the workload or make it more bearable; a good business plan may take 200 hours or more to research and write.

Some students may find the selection of an appropriate subject for their business plan difficult but most won't. When teaching a class of new engineering graduates undertaking a management diploma full time, we required each team to go into the world and find someone who needed their help. On the first occasion we worried about a backlash, but there wasn't one and the subjects all seemed very grateful for the plan the students prepared for them and other advice they were able to give. Such an approach might not work so well with part-time students. Many part-time (and relatively mature) students will start this subject with a clear idea for a plan and should be encouraged to use it; those without such an idea can be prompted to ask their employer for suggestions; most companies have a backlog of ideas that they would like to see properly investigated.

We have recently allowed students to use a prewritten Excel® model to perform the calculations described in Chapter 4 and Chapter 10, and the 'ExampleCo' model is available in the instructors' section of the Palgrave website (<http://www.palgrave.com/business/legge>) for your use as an educational tool. Note that neither the authors nor Palgrave accept any responsibility for the consequences of the use of this model commercially. If students on a course for which this book is the prescribed text discover errors in the model, they may be referred to John Legge, who will respond as and when time becomes available. The model does not appear to reduce the time spent by students much, if at all, but for the majority of students being relieved from a substantial volume of Excel® programming appears to allow them to concentrate on other planning issues and generally produce better plans, judged overall.

Because of the workload, students should be encouraged to commence work on

their plans from the end of the first lecture, and each tutorial should include time for reviewing progress and resolving issues. To offset the workload inflicted by the assignment, we suggest running a short exam only, possibly using the test bank available in the instructors' section of the Palgrave website, or even deleting the exam and substituting an individual assignment, such as writing and presenting a report on an innovation.

If time, timetables and resources permit, students should present their business plans to the class. When possible the instructor should be assisted in the assessment by someone from the business world; we have used senior accountants, venture capitalists and successful entrepreneurs in this role, generally successfully.

Instructional aids

We have 'topped and tailed' each chapter with an introduction and a summary, and added a number of questions that could be used to stimulate class discussion or private study. We provide, on the instructors' section of the Palgrave website (<http://www.palgrave.com/business/legge>), an instructor's manual, the 'ExampleCo' Excel® model, a substantial test bank in 'ExamView' format, and a set of PowerPoint slides. Palgrave representatives can make the instructor's manual available in hard copy. The website also includes a downloadable student workbook, which aids independent study and enables the students to work at their own pace. In addition, the website highlights the changes which differentiate this text from the previous Australian edition, giving it greater global appeal.

Professionals

Some of the readers of this book will not be current students in a business programme but they will wish to launch an enterprise of some form; possibly a new venture, but more probably an initiative within a corporation. Traditionally, corporations allocated money to internal projects through a capital budgeting process where those proposals that passed divisional scrutiny were referred to the controller's office. The controller's staff ranked them before a senior committee selected those that would be allowed to proceed. The process placed a premium on the ability to fill in forms correctly but has often failed to select good projects or reject bad ones.

The business planning process, if carried out thoroughly as described in this book, stops a lot of bad projects simply by exposing their dependence on unrealistic assumptions; it also means that top executives can make far better decisions when choosing between competing proposals because the information they need to inform such decisions is presented to them in a systematic and readily appreciated manner. Some corporations have already replaced the capital budgeting process with a business planning one; but the executives of those who have not yet done so are likely to respond far more favourably to a capital requisition backed up by a high-quality business plan than they will to a similar document where the same forms are supported by an undocumented and unfocused stream of optimistic verbiage. Most senior executives of major corporations take their duties seriously and really do wish to act in 'the interests of the company'. A well-written business plan is one of the best ways of explaining to them how to do their job properly.

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