Evaluating New Venture Opportunities

New-Venture Creation Process

Screening New Venture Opportunities

Evaluation Thresholds and Critical Mass

Reflections: What Can Prospective Entrepreneurs Learn from the Original Wave of Dot-coms?

It's Time to Apply Various Screens for Evaluating the Opportunities

Entrepreneurial Analysis

Attractiveness of the Opportunity

Timing and Opportunity: The Dynamic Duo

Opportunity/Strategy Analysis

What Does the Overall Market Look Like?

What Is the Nature and Duration of the Window?

First Mover Advantage: The Jury Is Still Out - But There Are Risks

Fast Second Mover Benefits

What Is the Nature of the Target Market?

What Is the Competitive Situation?

How Distinct Will Your New Venture's Market Offering Be?

Financial Dimensions

Identifying Each Opportunity’s Resource Requirements

What Happens If None of the Opportunities Exceeds the Three Thresholds?

Ranking the Opportunities

It’s Time to Determine If the Market Truly Values Your Product/Service Concept

Market Research Round Two

Learning from the Market Research

It’s Time to Test Market Your Product/Service

Estimating Demand

How to Use Market Research to Look Before You Leap

Technical and Logistics Test

Vulnerability Analysis

Summary and Conclusions

Introduction

Perceptive people can identify markets and opportunities.
Inventive people can develop products and services.
But it takes an entrepreneurial type of person
to create a venture that can do both for a profit.

-Stephen C. Harper, professor and author

Up to now we have attempted to identify a large number of new venture opportunities, to generate as many ideas as possible without paying attention to evaluate them.

It is assumed that that using brainstorming and open-mindedness will lead to the identification of opportunities that would not have surfaced if screening parameters were established from the beginning.

Introduction, cont.

We will provide **a systematic approach for determining the relative merits of the venture opportunities** identified.

We will profile the process and set the **criteria for evaluating and ranking new venture opportunities**.

A series of screens/filters inside the funnel. Opportunities that meet certain criteria will pass through the screen, these that fail – are dropped from further consideration.

We direct our efforts at identifying opportunities that have the potential to be exceptional companies, **finding the best opportunities**

Attention will also be directed to reducing the risk associated with starting a venture (reducing, not eliminating risk, rather to take calculated risk; the only way to eliminate risk is to not start your business).

Look at opportunities objectively, be diligent in analysing their relative merit, find a mentor who will ask the tough questions, establish an advisory board.

You success will be contingent on whether

- there is a **true market opportunity**,
- you can develop **a strategy that attracts customers and** you **have competitive advantage**
- you can **execute your strategy well**,
- the venture can be **profitable**, and
- **success can be sustained**.

You all together have to **identify potential mines and avoid them as you prepare to enter the entrepreneurial minefield**.

Screening New Venture Opportunities

After identifying new venture opportunities prospective entrepreneurs need to call an emotional time out so they can be objective in their analysis of the relative merit of each opportunity.

Unsuccessful entrepreneurs have one thing in common: they view **every great idea they have as an opportunity**.

Successful entrepreneurs also tend to have one thing in common: **ability to separate the opportunities from the chaotic sea of ideas**.

"If the business is based on a solution without a problem, the business will soon have a problem with no solution"

T.W.Zimmerer & M.S.Scarborough, Entrepreneurship and New Venture Formation, 1996.

The process of evaluating opportunities similar to the process used in selecting candidates for a position in an organisation

(before a position can be filled, the job needs to analysed to **identify the most important dimensions**; then a job description is drafted that identifies required skills and capabilities and the description serves as a basis for evaluating each applicant. **Applicants who do not meet all the criteria are dropped from consideration**. The Pareto 80/20 Principle tends to apply to the initial screening, and **most of the applicants are quickly screened out because they fail to meet at least one of the criteria**. This gives recruiters the time needed for a more in-depth analysis of the remaining candidates).

Entrepreneurs must have a clear understanding of what they want from their new venture. If you do not define expectations, then you will lack the criteria needed for evaluating the opportunities selected, and you will waste time considering ideas without merit.

Particular attention should be paid to the 1) acceptable degree of risk, 2) the demands of your time, 3) the profit potential, 4) resource requirements, 5) any other factor that may affect venture attractiveness.

A **threshold** must be established for each criterion. Opportunities that fail to meet any threshold are **dropped from consideration**.

Screening New Venture Opportunities - Opportunity screening process funnel using a set of criteria

Opportunity 1…Opportunity 5…Opportunity 8…Opportunity 15…Opportunity 25
Initial screening for entrepreneurial skills, opportunity attractiveness and resource requirements

Opportunity 1…Opportunity 8…Opportunity 15…Opportunity 25
In-depth screening for relative merit and goodness of fit

Opportunity 8 & Opportunity 15
Feasibility study and test market

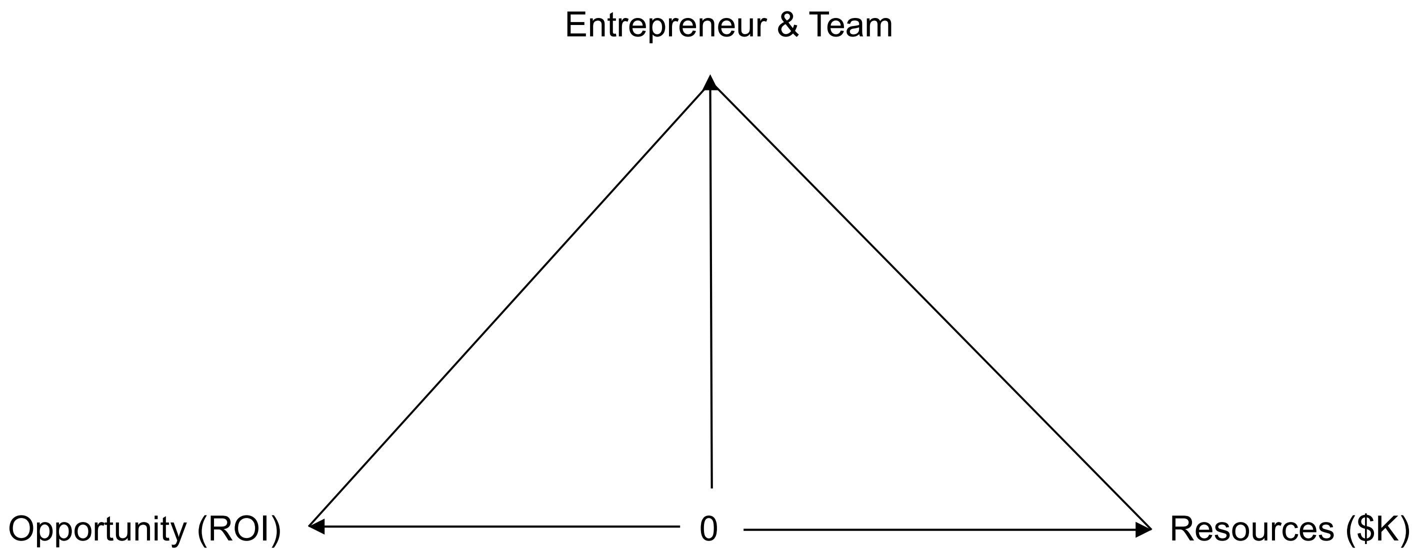
Opportunity 15
Business plan

Pre-launch
Initial funding, hiring, preparation, etc.

Launch

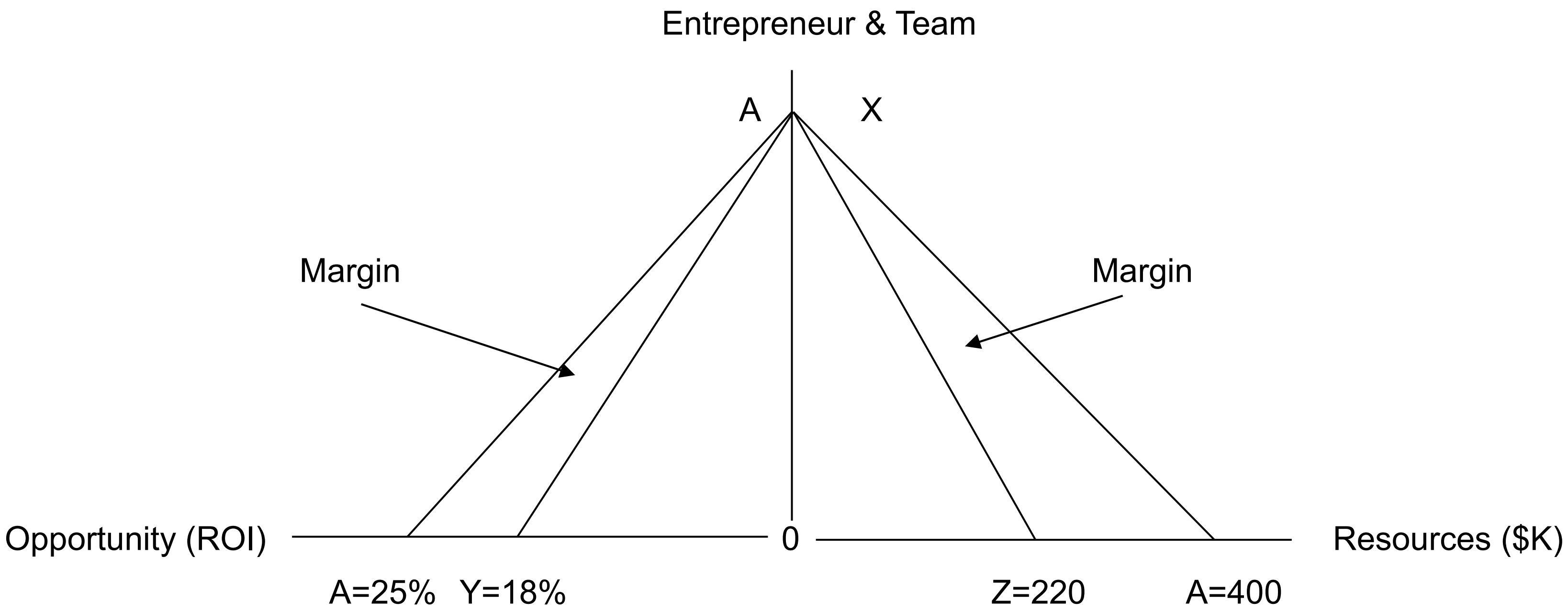
Evaluation Thresholds and Critical Mass

Three key dimensions of the entrepreneurial triangle must exist for a new venture to be successful. There must be a sufficient level of strength in all levels. Each dimension must exceed some minimum initial threshold for that dimension – critical mass.



It is rare that one dimension can make up for the lack of critical mass in any other dimension.

Evaluation Thresholds and Critical Mass, cont.



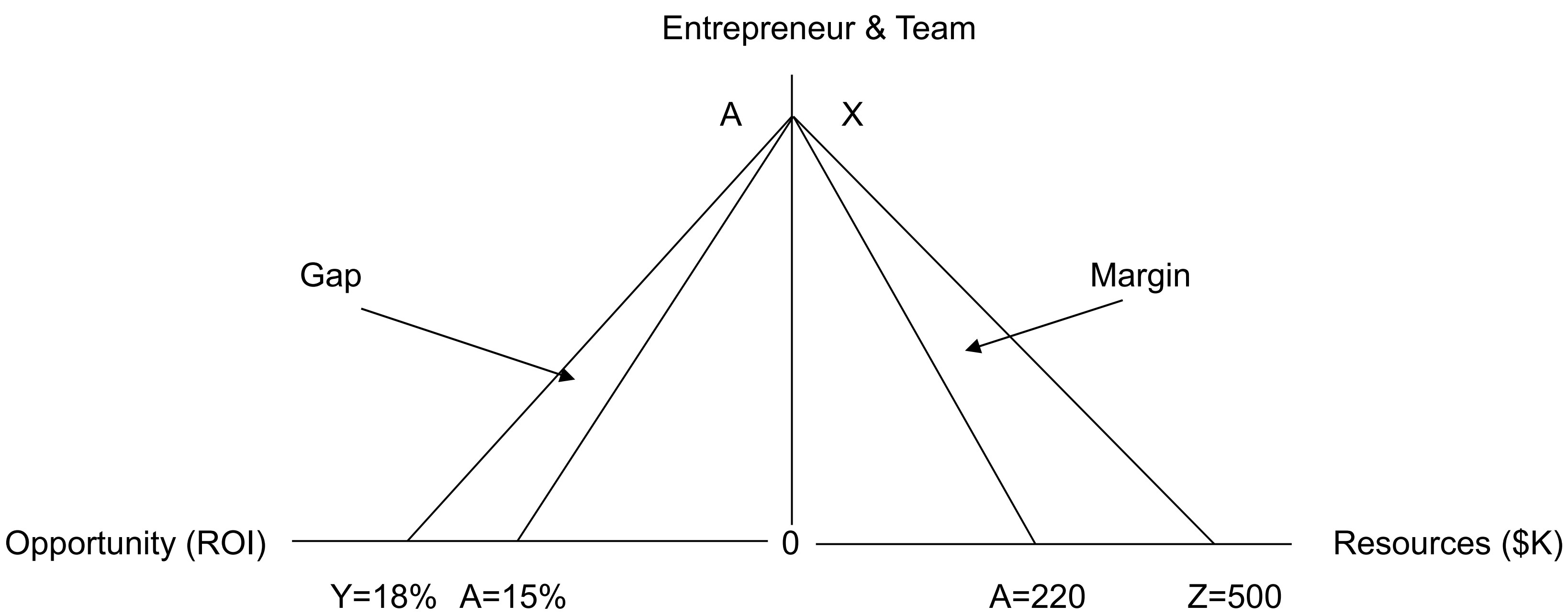
A – **actual level** of skills and experience for entrepreneur/team, projected ROI for the opportunity, and resources available for the venture

X – Skills and capacity **threshold** (what the entrepreneur and team will need)

Y – Opportunity **threshold** (minimum ROI required by the entrepreneur/investors)

Z – Resources **threshold** (amount of money required for that opportunity)

Evaluation Thresholds and Critical Mass, cont.



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Evaluation Thresholds and Critical Mass, cont.

All detailed questions we pose in the process of evaluation of the new venture lead to the **6 principal entrepreneurial questions**:

1. Do the entrepreneur and team have the **ability to create and manage the venture**?
2. Is there an identifiable **gap in the marketplace**?
3. Does the gap represent **a viable business opportunity**?
4. Will the venture be able to **attract the necessary resource**s?
5. Will the venture be able to **bridge the gap and have a competitive advantage**?
6. Will the venture **generate a sufficient financial return** to justify the risk?

Reflections: What Can Prospective Entrepreneurs Learn from the Wave of Dot-coms?

It may be worthwhile to take a look at why numerous dot-coms failed?

Failure is a great teacher.

We can learn from our failures but it is better to learn from other people's failure.

For every Amaozn.com, eBay.com, Yahoo! There were dozens of Boo.com, Eve.com, ...

Boo.com spent 188 $M in 6 months (some say 135 $M in 18 months of operation, closed 18 May 2000).

Time of “Irrational exuberance” - Allan Greenspan, when

– entrepreneurs and investors failed to **differentiate solid business models from hare ideas**
– good faith **demand from wishful thinking**,
– a **well-thought-out business plan from notes scribbled on a cocktail napkin**,
– failed to **differentiate ability to execute from improvising on the fly**,
– people forgot all business sense,
– tons of money chased after a lot of bad ideas.

This is a demonstration what can happen when new venture opportunities and new ventures are not subjected to reasonable evaluation and scrutiny (when true value cannot be separated from ill-conceived concepts, and lucrative and lasting opportunities from aberrations, mirages and hallucinations.

Reflections: What Can Prospective Entrepreneurs Learn from the Wave of Dot-coms?

Entrepreneurial efforts of that time could be summed up as “much to do about nothing”

The dreams **“If we build they will come”, turned into nightmares** for all involved.

Other comments:

The **victors identified and capitalised on real market opportunities**.

The vanquished **failed to differentiate website hits from revenue, revenue from profitability**, had too little money from the beginning or were spending as if they could print it at will.

Either it was not a good enough business model, its formula for success was flawed, its management was unable to manage it, or its capital structure was too massive to enable profitability. May be some were hitting the market too soon.

“There is only one way to make money – you have to earn it”.

Today Internet-based businesses may be even more challenging, both for new ventures and already operating, as **consumers are more sophisticated and technology is changing rapidly.**

Screens (Criteria) for Evaluating Business Opportunities

Numerous **screens/filters** need to be used when evaluating venture opportunities.
They focus on

- **entrepreneurial prowess**/courage,
- the **strength of the opportunity**,
- the extend the new venture can **generate a competitive advantage**,
- **financial worthiness**,
- **projected risk,**
- **personal preferences**,
- **feasibility** issues,
- other, depending on the venture.

Entrepreneurial Analysis

By now, **you already know if you have what it takes** in general terms **to be an entrepreneur**.

You need to recognise that the **skill, capability, and experience** requirements of the entrepreneur and management team will **vary with each venture opportunity** (some require more technical knowledge and experience, other some other sectoral knowledge and experience).

Higher skill and experience level create a greater barrier of entry for potential competitors.

Extensive knowledge and experience create the relative strength which may be reflected in a high attractiveness of the opportunity (as this provides a potential competitive advantage).

The strength of the entrepreneur and team may also enhance the resource availability rating, as the company has critical **human resources**, what is always a critical issue in business.

Attractiveness of the Opportunity

Many prospective entrepreneurs think and say, that if they have a great idea, success is guaranteed.

We have already said that **there is a big difference between a good idea and a viable business**.
And successful entrepreneurs know that.

The attractiveness of of the opportunity reflects a combination of two principal factors:

- the evaluation looks at the **size and nature of the market gap**, and the new venture's ability to **serve the gap** through its products, services, and processes,
- the evaluation looks at **financial attractiveness of the opportunity**.

Timing and Opportunity: The Dynamic Duo

Entrepreneurial success depends on **identifying the right opportunity and seizing it at the right time**.

The window of opportunity concept captures the relationship between timing and opportunities.

From timing perspective, if you get to the window well **before it opens, then you have to wait.**

Successful entrepreneurs have the ability to hold onto their ideas over time, they **wait** until the timing will be more favourable.

If you get to the window after it has been open for some time, then you may find yourself competing with numerous other firms. You also run the risk of entering as the window is closing.

From an opportunity perspective, you **do not want to pursue and opportunity with limited potential** or that only be open for a brief period of time.

Your analysis must be directed to identifying windows of opportunities where you can have a decided timing advantage and that the potential to pen wide enough and long enough for your venture to create and maintain customers for a profit.

Opportunity/Strategy Analysis

Steve Jobs: Entrepreneurs should look for big opportunities because it takes almost as much time to start a small business as it does to start a business that has considerable growth potential.

Rob Ryan, author of *Smartups*: **Don't rob delicatessens – rob banks, that's where the money is**.

Venture capitalists frequently judge prospective investments according to whether they can generate **at least $100 million in sales**.

For this to be possible, we assume the venture can capture 10% of the market, the business can make 10% profit on sales, and the overall market would have to have the potential of $1 billion in sales.

If the VC firm has 30% ownership (given a $3 million investment), then the firm would get:

$1 billion x 0,1 = $100 million x 0,1 = $10 million x 0,3 = $3 million

i.e. a 100% ROI per year. Few opportunities have the potential to provide this kind of return.

Amar Bhidé: Rather than seeing an opportunity as a single entry, he suggests looking at it to see if it can be seen as a number or **series of opportunities**, looking for opportunities that may be the **lead domino in a series of opportunities** where one leads to the next or as a path that has many off ramps – a concept of **adaptive opportunism**, where firms get themselves into the market and then **adapt themselves to opportunities** that appear in front of them.

Dell, eBay, Amazon.com – illustrate the merit in being first into a market and then **exploring growth opportunities** (broadening the scope of business they had at start, i.e. **Amazon.com found it had very effective vehicle for selling not only books but also music and films; e-readers - kindle**).

Opportunity/Strategy Analysis, cont.

Dell, eBay, Amazon.com – illustrate how **difficult it can be to estimate the size, nature longevity, and profitability of an emerging market**. Dell, Omidayar, Bezos – **none of them perceived how big markets would be or how large the firms would become**.

These examples also illustrate that: Sensing an opportunity is of no value unless you can capitalise on it.

Rob Ryan: To capture the market through major innovation is not enough. Great companies come in with a bang and they try to **keep competitors out by leaving little room for them, so called “Sucking the air out of the room” strategy.**

When you are leading the market competitors will come, and you can't prevent copycats.

Your choice is to operate as you always have, or to enter the *suck mode*.

In suck mode you make it difficult for established companies to compete as well as very expensive for start-ups to enter your area.

Bill Gates – he sucks the air out of the room, and nobody can breathe when they are standing next to Microsoft. And eventually they just quit trying.

What Does the Overall Market Look Like? - general overview

Entrepreneurs should take a close look at the current and projected status of the window of the opportunity being reviewed/evaluated.

Evaluation of processes	Evaluation of your product/service idea
• Is there truly a market? • Is the market definable? • Can demand be measured? • Can customers be identified? • Are customers reachable? • Are channels of distribution in place? • Is the market new and amorphous? • How long will the market opportunity last? • Is the market mature? • Is the market likely to change dramatically? • In what ways is the market likely to change? • Are there clearly identifiable market segments? • Is the market composed of naïve or sophisticated consumers? • Is the market at the interested stage, or the declining stage? • Are firms successful that are already serving the market? • What are the qualities that characterize the most successful firms in the marketplace? • Are existing firms trying to serve the whole market, or are they targeting specific niches?	• Do we have a proprietary position? • Will people buy it? • Will enough people buy it for the venture to make its financial targets? • Can we provide and deliver it? • Can we do it efficiently? • Can we maintain a competitive edge? • Will we be a pioneer or a tweaker? • Are we going after a large market or a niche? • Can we readily access and serve the customers? • Does our product/service lend itself to trialability? • Will the market need to be educated? • Will there be switching costs for prospective customers? • What is the degree of loyalty? • How forgiving will the market be of our mistakes or glitches? • What is the slope of the learning curve to create a competitive advantage?

Nature and Duration of the Window of Opportunity

Entrepreneurs need to recognise that the window is unique. The size of the window and the speed at which it opens and closes will vary with each opportunity; how wide, for what period of time.

If you get to the window **before** it opens, then you will have committed resources and show your competitors what you plan to offer the market. Many businesses died because they had too little capital to hold them until the windows opened and provided them with a revenue stream to cover they costs. *Ernest and Julio Gallo:* ***"We will serve no wine before its time."***

Being **too late** also has it consequences: more perceptive firms have already established their competitive positions and market share, then you will have to fight and your revenue stream will be contingent on the ability to take customers from the other firms.

Being the first in the marketplace is important, as it means you have the whole marketplace for yourself. In a sense you have a **temporary legal monopoly**.

First-to-market firms do not have to be perfect. The market tends to be forgiving at the beginning.

First-to-market firms also have the opportunity to have their brand synonymous with the industry. You gain distinction and publicity.

The **most successful firms get to the window just before it opens**. They **offer** the market what it wants. They **modify** their products, services and processes when it changes. As the market grows, they identify segments that represent niches where they can can gain temporary legal monopolies by being the first to serve them.

They also **sense when the window of opportunity is closing so they can get out before it closes** on them. They can reallocate and redirect their resources to windows that are about to open.

Nature and Duration of the Window of Opportunity, cont.

Questions that can help in the evaluation of the opportunities under review:

- How long will the window of opportunity stay open?
- What is the opportunity's overall potential?
- Is the market susceptible to seasonality?
- Is the market susceptible to business cycles?
- Is the opportunity based on a real need or just a want?
- What is or will be the nature and extent of competition?
- Will the market provide niche opportunities?
- What is the ratio of firms entering the market to the number exiting the market?
- How volatile is the market?
- Is the market susceptible to sudden shifts?
- Are there any forces that could cause the window to be slammed shut?
- Are there major barriers to entry?
- What are the threats?
- Is the market susceptible to changing government regulations?
- Is the market susceptible to technological breakthroughs and obsolescence?
- Is the industry susceptible to litigation?

First Mover Advantage: The Jury is Still Out – But There Are Risks

Being the first-to-market has its benefits but will not automatically guarantee success. And it has **numerous risks**.

- The **window may never open**.
- It may **open but much later** than expected.
- It may be **slow** in opening.
- It may **not open as much as expected**.
- Your offering may **not be in sync with consumer needs**.
- **Competitors may enter sooner than expected**.
- **Competitors** may actually **enter the market with superior offerings**.

And other types of problems

- You will have to bear the burden of **research and development costs**.
- You will have to spend more **money on advertising and educating** the market (JMC).

Firms that plan to be first movers need to proceed with both eyes open.

Don't let **<u>your ego</u>** and eagerness to be first to market to cause you to enter prematurely.

It is dangerous to think you have a first-mover advantage **“I'm first; I'm going to do better”**

Winning is about who crosses the finish line first.

Fast Second Mover Benefits

Firms that try to operate at the leading edge might find themselves at the bleeding edge.

Norm Brodsky, serial entrepreneur who founded numerous ventures:

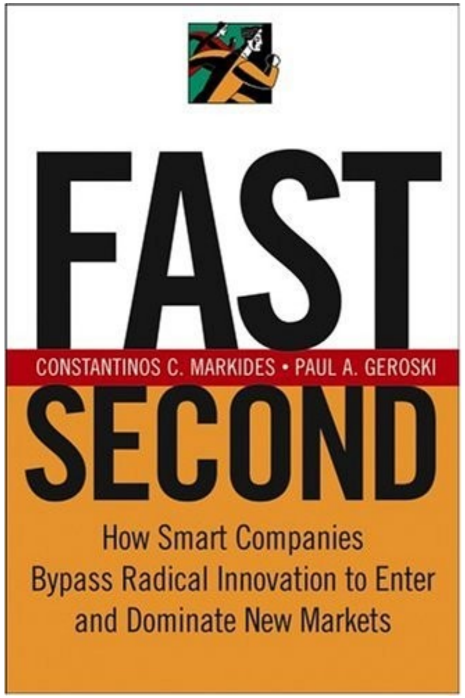
“I never want to be first in a market. There is nothing more expensive than educating a market.”

“I want an industry, ... a business in which most companies are out of step with the customer.”

May be the customer needs have changes and the suppliers have not paid much attention.

May be they are not up to date on the latest technologies.

In any case, there has been a change and the industry has not followed it.”



Fast Second: How Smart Companies Bypass Radical Innovation to Enter and Dominate New Markets

According to the authors, a "fast second company" lets other companies innovate and experiment to create new markets. Then the **fast second enters the market just as the dominant design is about to emerge, helps create the dominant design, and uses its size to capture the market**.

The book identifies **Microsoft, Procter & Gamble, Amazon.com, Canon, JVC and Heinz** as successful fast second firms.

What is the Nature of the Target Market?

Although the nature of the whole market is important, the **target market for the firm is what matters most**.

Each segment also represents a window of opportunity. Each has a **different size, degree of profit, and duration**. Some segments can be inviting and lucrative. Other segments can be like minefields where one false step can mean disaster. Entrepreneurs need to identify the segment within the overall market that represents the best opportunity for the new venture.

Questions about overall **nature of the market** combined with the following questions may shed light on the nature of the target market:

- Is this a one-time or repeat type of purchase?
- How lucrative will this segment be?
- What factors are critical to satisfying consumers?
- What is the frequency of purchase?
- What is the extent of brand loyalty for the companies already serving the segment?
- Is there price sensitivity?
- What is the size and strength of suppliers? Do the suppliers have power over their customers?
- What is the size and strength of distribution channels? Do distribution channels have bargaining power?

Norm Brodsky: It is importance to **find a lucrative niche**. Having a niche is critical to every start-up. It has to do with the high gross margins you must have, so your start-up capital lasts long enough for your business to achieve viability.

Amar Bhidé: Entrepreneurs must be willing to seek out **profitable niches** wherever they are. **Dominating a neglected market segment is sometimes more profitable than intellectually stimulating or glamorous market segments.**

What is the Competitive Situation?

No firm operate in a vacuum.

The **stage of the product life cycle** (i.e. the relative maturity or saturation of the market) has a major impact on the **nature of competition**.

If you are first to market and offer credible products, then you will be afforded some latitude in your pricing strategy.

As market matures, consumers can choose from numerous firms. **Firms with limited or no competitive advantage have to lower their prices to attract and keep customers**. This results in **declining profits**, and it is just **a matter of time before they go bankrupt**.

Markets that are growing represent the best opportunities.

- each firm on the market will grow if it merely maintains it **share or slice of the market**,
- **additional segments** or niches **may emerge**, and each of new segments has its own particular needs and expectations; these segments are **like new opportunity waves**.

If the competition is fragmented then no single firm is in a position to determine the rules of the game.

Brand loyalty can affect new venture success. With high brand loyalty it is difficult for a new entrant to attract customers.

How Distinct Will Your New Venture's Market Offering Be?

If your new venture's products and services are not markedly better, more affordable, or more convenient than what is already on the market, then **you should not even consider entering the market**. Success is **not** contingent on **being different but** on **being better**. If the market doesn't value the difference, then you have no competitive advantage. **Uniqueness does not guarantee success**. If your offering is distinctive in the areas that really matter, then it may be able to attract customers.

The degree of distinctiveness can have considerable impact on the firm's pricing strategy. The ability to charge higher prices without reducing demand provides that firm with a better profit margin. Higher margins enable the firm to achieve break-even volume quicker. Quicker profitability reduces new venture risk.

Entrepreneurs need to **show some restraint and humility when** they are **developing** their **products and services**.

As they say, **"The proof of the pudding is in the eating."**

If you believe that you have developed the greatest thing since sliced bread, then you need to step back and do a reality check.

There is a problem that good ideas may be too good. "The idea may be so intuitively obvious that the playing field becomes crowded with opponents, the message gets overhyped, expectations balloon out of control, and a hot idea becomes a flash in the pan." Business writer Scott Kirsner noted, "The first law of business is that every good idea gets taken to excess."

Many entrepreneurs consider their products or services to be killer apps. This can be a mistake. **Entrepreneurs frequently become so ego-involved with their products or services that they cannot see them objectively.** The market, not the entrepreneur, determines whether a product or service is a killer application.

How Distinct Will Your New Venture's Market Offering Be? - cont.

The following questions provide insight into the **factors that might affect the success of the new venture's market offering**:

- Is the market easy to enter?
- What are the barriers to entry?
- How much lead time do we have?
- How long will it take for competitors to enter the market?
- Do competitors have deep pockets to retaliate?
- How long will it take for competitors to match our offering?
- How have existing firms responded to competitive attacks in the past?
- What distinguishes our product from what is already on the market?
- Does our new product, process, or service create value for the purchaser/consumer?
- Does our new product, process, or service make everything on the market obsolete?
- To what extent is the market satisfied with existing products and services?
- Will the product change the way people live and work?
- How sophisticated is our product or service?
- How sophisticated is the target market?
- How different is our new product, process, or service from what people are currently using?
- Is our new product, process, or service going to require people to change their habits?
- Is our new product, process, or service easy to learn how to use?
- Is our new product, process, or service easy to use?
- Will targeted consumers need to be educated on the merit of our new product, process, or service and how to use it?
- Will links in the distribution network have to be educated in the product/service and how to use new product, process, or service?

How Distinct Will Your New Venture's Market Offering Be? - cont.

- Are there significant switching costs involved for potential customers?
- Are there significant switching costs involved for potential distributors?
- How large is the market?
- How much market share can we gain?
- Is the market growing?
- Will everything have to be perfect to attract customers?
- Will we be seeking virgin customers?
- Will we have to steal customers from other firms?
- What is the extent of brand/institutional loyalty for existing firms?
- What are the target market(s) characteristics?
- What is the growth potential for the target market(s) and related segments?
- What is the profit potential for the target market(s) and related segments?
- Is the customer the same person as the consumer?
- What are the differences in potential for domestic and foreign markets?
- Do we have a proprietary position?
- Can we provide a high level of quality and be the low-cost provider?
- Are there substitutes?
- Can the customer do it without us? Are our customers potential competitors?
- Are there any fatal flaws that could kill acceptance of our product or service?
- Can a technological breakthrough make our product or service obsolete overnight?
- Are there other potential segments of users for the product or service?

How Distinct Will Your New Venture’s Market Offering Be? - cont.

- Are there ways to increase the usage rate by consumers?
- Are there other uses for the product or service?
- Are there potential spin-offs for the product or service?
- Can sales of our new product, process, or service be facilitated by the Internet?
- Is it possible to establish alliances with suppliers?
- Is it possible to establish alliances with distributors?
- Is it possible to establish alliances with competitors?
- Who really is the gatekeeper in the purchase decision for the product or service?
- What is the nature and extent of government regulations?
- Do we need government approval before our new product, process, or service can be offered to the public?
- Are there any regulatory changes on the horizon?
- Are channels of distribution established and interested, particularly in foreign markets?
- Will we be vulnerable to litigation, particularly for product liability?
- Can our new product, process, or service be made?
- Can a prototype be made to test production feasibility and for test marketing?
- Will we have to provide service after the sale?
- Will we have to provide a warranty?
- How easy is it to exit the market and/or business?

The preceding **list of questions can be overwhelming, yet they need to be addressed**. They provide a broad view of the factors that need to be considered while the new venture is determining **which markets to enter and the products and services it needs to offer**. **The extent the firm is able to gain a competitive advantage will have a significant impact on the firm’s profitability.**

Financial Dimensions

New ventures will be successful to the extent they create and maintain customers for a profit.
Profits are the fuel for paying off loans, paying dividends, investing in new product development, improving the firm's processes, rewarding the firm's human resources, and for building the value of the firm.

Each opportunity needs to be evaluated in terms of its profitability, cash flow, and return on investment.
Although a threshold may be established for the overall level of attractiveness, the threshold for the market gap and financial attractiveness may vary with each opportunity.
Opportunities that require a substantial investment may have a higher threshold than opportunities that place fewer resources at risk.

Scalability may be an **important factor when evaluating ventures**. It describes the extent the venture can be started on a small scale and then expanded in manageable increments.

Fred DeLuca, cofounder of Subway Restaurants, captures the nature of scalability in the title of his book, ***Start Small, Finish Big***.

Sweet spot/jewel – lucrative returns with minimal investment, but as investment is low there may be few barriers to entry for competitors and as ROI may be high in % terms the yield in absolute $ may be small; look for opportunities that can generate lucrative returns in relative terms and absolute dollars.

The next big thing – substantial initial capital required and a regular infusion of capital to grow and dominate a substantial market

Lifestyle business – good as an alternative to working for someone else and for those who have low financial expectations.

Hole in the ground – such ventures should be avoided; they require substantial investment but provide minimal return.

The threshold value – usually a few points above what you could get for a safe investment (what is ~10%), so 12-15%.
It is good to run best-case, most-likely, and worst-case sales projections for 5 years. **Opportunities that exceed the threshold with even worst-case scenario are particularly noteworthy.** Opportunities that do not generate a higher level of profit per dollar invested are dropped from consideration.

Financial Dimensions, cont.

The following questions provide valuable insights **when evaluating the financial worthiness** of each opportunity:

- What is the return on investment threshold?
- What is the initial capital requirement?
- What is the projected return on investment?
- How much money do I have available to invest?
- Are there areas where I can reduce costs constructively via the learning curve?
- What is the assets-to-sales ratio? (This indicates how much money will be required to support growth.)
- What is the gross margin to sales ratio?
- What is the net profit margin to sales ratio?
- What is the break-even point?
- What is the burn rate? (daily cash outlay to keep the business running)
- What is the cash flow?
- How soon will the firm achieve positive cash flow?
- Is the financial side of the firm easy for bankers and investors to understand?
- What are the financial risks?
- How forgiving are the financials?
- How easy is it to cash out of the business?

Financial Dimensions, cont.

Each opportunity **should be evaluated for at least its first five years of operation**.
Profitability in the first year is not as critical as cash flow.

Opportunities that can maintain
- a **20+ % annual growth rate**,
- have at least a **10 to 15 % profit on sales after tax**, and
- generate a **20 to 25 % ROI**

will help justify risking your time and money.

Veteran entrepreneurs reflect on what would be the **ideal situation from a financial perspective when starting a new venture**:

- ability to make an **extraordinary return on a minimal investment**,
- the ability to generate **positive cash flow and profitability right away**,
- **minimal loss if things do not work out**,
- **ease of cashing out**, and
- a steady **stream of people who want to buy the venture** that will give you an incredible gain.

According to statistics **it takes 7 years to find out if the venture is truly successful and less than 2 years to find out if it is a loser**.
The longer it takes the venture to generate solid financial returns, the greater the risk.

Identifying Each Opportunity's Resource Requirements

Each opportunity will require a different set of resources.
The resources may include **materials, equipment, skilled labour, intellectual property, and money**.
Some opportunities will be very capital intensive.

Some of the opportunities that require substantial resources may be able to **reduce** their **resource needs through outsourcing, joint ventures, by forming alliances, or by leasing**.

Service organizations tend to require fewer resources, but if knowledge and expertise is important then human resources become a key issue, both to attract and to retain employees who could find a higher-paid job the very next day.

Resources need to be viewed as more than logistical necessities. They can provide the new venture with competitive advantages.

Resources are like time. "With time all is possible, without it nothing is possible."

You need to identify the **resource requirement for each opportunity**.

You then **compare each opportunity with your resource threshold**.

The resource threshold will be influenced by the money you have at your disposal.

Identifying Each Opportunity's Resource Requirements, cont.

- What is the resource threshold?
- What resources will be required to start the venture?
- What is the cost of the resources?
- Will additional resources be required after the start-up stage?
- What resources do I have at this time?
- Is there a resource gap?
- What skills and capabilities do I need to acquire via hiring?
- What is the level of availability for key talent?
- What resources can be acquired by having additional investors?
- What resources can be acquired by loans?
- What resources can be obtained through leasing?
- What resources can be obtained through licensing?
- What resources can be obtained through alliances?
- What resources can be obtained through joint ventures?
- Are there any intellectual property considerations?
- Is the computer hardware and software required readily available?
- Can I secure the needed licenses, permits?
- Can the firm develop intellectual property?
- What will it take to protect the firm’s intellectual property?

What Happens if None of the Opportunities Exceeds the Three Thresholds?

It is possible that none of the opportunities under consideration achieves sufficient critical mass for launching a new venture.

If this is the case, then you have 3 choices.

- Your first alternative is to **start the process all over** and scan the market for opportunities that have recently emerged or that you may have originally missed. The marketplace is changing so quickly that gaps are constantly occurring that represent new venture opportunities. If you are truly committed to the entrepreneurial journey, then you should consider the time invested so far as a learning experience rather than as a waste of your time.

- The second alternative involves **lowering the threshold for one or more of the three dimensions** in the entrepreneurial pyramid. You need to be objective and ask yourself if the thresholds were realistic in the first place. Some entrepreneurs are so risk averse that they set the thresholds too high. These entrepreneurs want to have their cake and eat it too. If the thresholds are lowered because they were unrealistically high, then such an effort may be appropriate. If the thresholds are lowered out of desperation, then the entrepreneurial journey should be stopped at this time. The need to maintain objectivity is one of the reasons you should have an advisory board from the beginning of your entrepreneurial journey.

- The third alternative is to **pack up your tent and end your entrepreneurial journey**. You may be like a number of people who looked and didn’t leap! You may have found that what you were looking for wasn’t available or that you did not have the skills or resources needed to take the plunge. To not venture forward is not to have failed; it may be the smartest thing to do. Some things shouldn’t be forced. Entrepreneurship is one of those things.

Ranking the Opportunities

Let's assume that a few opportunities have made it through the screening process. Now the evaluation process comes down to 1) **financial attractiveness**, 2) **projected risk**, and 3) **personal preference**.

Opportunities can be rated on a **10-point scale for each of these three criteria**. Each type of stakeholder may place a different weight on each of the factors.

Investors look for opportunities that will provide significant **capital gain** with an acceptable risk. Although they may not admit it, most people would rather invest in something that has emotional appeal.

Bankers look at the degree of risk in their evaluation of a loan application. Each loan request is reviewed to determine inherent risk and ability to **pay off** the note. Although bankers do not focus their attention on the opportunity's ability to generate considerable wealth, they do place a premium on business opportunities that will borrow larger amounts of money to finance additional growth.

The **entrepreneur's personal preference** is rarely left out of the evaluation equation and the final decision. Personal preference should be considered at this stage. Personal preference can be weighted to reflect how important it may be to the entrepreneur. Most entrepreneurs place a high weight on personal preference. Because they will be investing their blood, sweat, and tears in the venture as well as their own money, they tend to place a premium on opportunities that fit their personal interests that supplement financial rewards with non-financial rewards.
Passion plays a very important role in creating and running a successful venture.

Ranking the Opportunities, cont.

The entrepreneur assigns a weight to each of the three criteria that reflects its relative importance. The rating for each opportunity on a 10-point scale for each of the three criteria is then multiplied by the weighting factor.

Criteria and Weighting	(%)	Opportunity A	Opportunity B
Financial Worthiness	40% or 0.4	0.4 × 8 rating = 3.2	0.4 × 7 rating = 2.8
Degree of Risk*	40% or 0.4	0.4 × 6 rating = 2.4	0.4 × 8 rating = 3.2
Personal Preference	20% or 0.2	0.2 × 8 rating = 1.6	0.2 × 7 rating = 1.4
Total	100%	7.2	7.4
* Higher ratings indicate lower levels of risk			

Opportunity Rating System

Risk, financial worthiness, and personal preference may vary from industry to industry.

The *all things considered* nature of the overall rating system enables all the opportunities to be ranked that met the threshold requirements.

Attention! You have the exercise to complete using this method and your created business ideas.

It Is Time to Determine if the Market Truly Values Your Product/Service Concept

Most of your analysis **until now** has been at a fairly **superficial level**. **Now** it is time to do a **more in-depth analysis** of whether **consumers** are in search of a business and whether your product/service concept is truly in sync with their needs.

There are various levels of market research. Each level is intended to reveal a particular type of information.
The following steps capture the **multiple iterations of market research** (market research is a multi-iterative learning process).

1. ***Initial market research.*** This is when you listen to the market to see if there are gaps where people's needs are not being met well or at all.
2. ***Identify and articulate a particular need.*** You tighten up the general gap into a more specific need.
3. ***Develop a preliminary concept.*** You develop a preliminary product/service concept to meet the need.
4. ***Market research round two.*** You go back into the marketplace to ask prospective consumers and distributors about their perceptions of your product/service concept.
5. ***Learn from the market research.*** Analyse the comments and suggestions made by potential consumers and distributors.
6. ***Modify your product/service concept to incorporate what you learned.***
7. ***Test market the modified product/service concept again in the market.***
8. ***Take what you have learned from the market and develop a basic prototype.***
9. ***Test market of the prototype to see how potential consumers and distributors like it.***
10. ***Modify the prototype given what you learned from the market.***
11. ***Possibly test market the modified prototype again to see if potential consumers and distributors like it.***
12. ***Take what you have learned from the test market and forecast the corresponding level of the sales.***

The first 3 steps were completed for the ranking process that compared the opportunities. Now we shall discuss the remaining steps.

Market Research Round Two – Ask Prospective Consumers and Distributors

The first round of market research may have revealed that there was a gap in the market.

Two cautions need to be raised before proceeding with the following steps:
- market research is not a science, **market research information is not always accurate**; what people say and what they do can be different,
- **there are no perfect products or services**.

Round two is directed to gaining insights from potential customers and distributors by asking them perceptive questions. You want to know if there is a genuine need and what you will need to offer your target market to give them a compelling reason to buy your product/service offering.

This step attempts to probe problem – solution issues.

Round two may use various market research techniques:
- **sending a product/service specification sheet** to some prospects and asking them for their comment about its merit, and how it could be improved to make it more appealing to them,
- **surveying people** at trade shows, contacting user groups, and/or conducting focus groups to learn what they want and where existing businesses are not meeting their needs,
- **strategies for gaining insights from potential consumers about your concept to see** if potential consumers see your product/service concept **as a solution to their problems**.

Many company founders attribute some of their success to their solicitation of customer (including prospective customer) input and their willingness to modify and, in some cases, tailor their firm’s offerings to their customers’ desires.

Learning from Market Research

Round two market research forces the entrepreneur to **seek real information from real consumers** about their needs and the entrepreneur's concept. Many entrepreneurs fall in love with their product/service concepts. They believe the world has a need for them, and that consumers will be delighted with their product/service offering.

Round two represents **a crucial and timely reality test for the entrepreneur**.
Some entrepreneurs are reluctant to do the market research because they do not want to take the time or spend the money to do it. Some entrepreneurs are reluctant to do it because they are afraid that someone will steal their idea. Some entrepreneurs don't do it because they have already made up their mind and don't want to be confused with the facts.

The best way to reduce risk is to learn as much as you can about the situation before making a decision. This is what venture capitalists call due diligence. Market research attempts to get complete, accurate, and timely information.

You need to recognize, however, that you will never have complete, timely, and accurate information. Prospective entrepreneurs need to recognize **there is a time to think, a time to analyse—and then there is a time to take the entrepreneurial leap**. Prospective entrepreneurs need to recognize that **there is a time to decide and a time to act**.

You should use market research techniques, yet you should also recognize that conventional market research techniques have a number of drawbacks:

- market research techniques **take time and money**,
- the **information you gain** from them may be as **perishable** as today's news; what people say they want and what other firms offer tend to change over time, so if you listen to what consumers say and make the changes, then you run the risk of making changes that accommodate today's concerns rather than directing your attention to what consumers will want when you actually bring the product/service to market,
- there may be a **big difference between what consumers say and what they will actually do**,
- **consumers may not be in a position to articulate their needs or imagine what might be possible**.

It Is Time to Test Market Your Product/Service

The test market represents **a trial run** – usually involves presenting a prototype to a group of potential customers or distributors. It

- **indicates the level of interest** in the product or service the firms plans to offer the target market,
- may provide useful feedback, **insights into distribution preferences, price sensitivity, quality perception, service-after-sale expectation, etc.**

Possible activities: **take a prototype to a trade show, select a sample of potential customers and let them use you product/service for a couple of weeks, run an ad in a magazine to see what type of response it generates.**

You may find opportunities are not there where you initially expected them to find.

Consumers may suggest ways to modify the product/service to fit their needs.

They may identify different uses, applications, distribution channels, etc.

Leave you Power Point at home, just share ideas and let your consumers talk.

The test market should indicate how consumers classify the product/service: “nice to have”, “like to have”, or “must have right now!”, how compelling the product/service is, how sensitive consumers are to the price.

“It's great idea; of course I buy it.” Good intentions don't guarantee sales. Talk is cheap. Ask them if this was available right now at $x **would you buy it, or can I sent an invoice**?

It Is Time to Test Market Your Product/Service, cont.

The test market should address the following questions:

- Do people really want the product or service?
- What is their level of interest?
- Are there enough customers out there who will buy the product?
- Can they tell the difference between the firm's planned offering and products and services already available?
- What price are they prepared to pay for the product or service?
- How do they want to buy the product?
- How frequently would they buy the product or service?
- What brand do they currently buy?
- Are there other users for the product/service?
- Are there other uses for the product/service?

The longer you wait for actual product launch, the greater the chance that another firm will steal your thunder or that consumers may change their preferences.

Market research and test marketing should be handled in a discrete manner.

Before you know it, there are 10-20 companies committed to the market—and your product is still in beta testing.

The sooner you can get the product/service into the market, the greater the head start you have over your competitors.

Estimating Demand

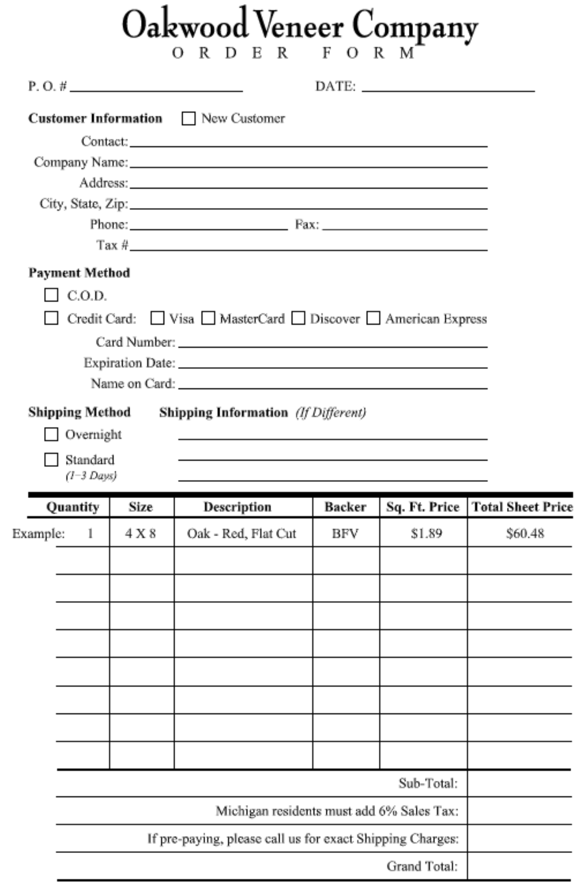
Market research and test marketing provide a foundation for doing an **initial forecast of demand**.

The determination of **market demand is by far the most important criterion of a proposed new product idea**.

Assessment of the market opportunity and size needs to take into account such factors as

- the **size of this potential market in dollars and units**,
- the **nature of the market with respect to its stage in the product life cycle** (growing or declining),
- the **share of the market the product could reasonably capture**,
- current **competing producers, prices, and marketing policies** should also be evaluated, particularly in terms of their impact on market share of the proposed product.

Nothing beats signed purchase orders as a basis for forecasting demand.



Oakwood Veneer Company

ORDER FORM

P. O. # ____ DATE: ____

Customer Information ☐ New Customer

Contact: ____
Company Name: ____
Address: ____
City, State, Zip: ____
Phone: ____ Fax: ____
Tax #: ____

Payment Method

☐ C.O.D.
☐ Credit Card: ☐ Visa ☐ MasterCard ☐ Discover ☐ American Express
Card Number: ____
Expiration Date: ____
Name on Card: ____

Shipping Method **Shipping Information** *(If Different)*

☐ Overnight
☐ Standard *(1–3 Days)*

	Quantity	Size	Description	Backer	Sq. Ft. Price	Total Sheet Price
Example:	1	4 X 8	Oak - Red, Flat Cut	BFV	$1.89	$60.48

Sub-Total:
Michigan residents must add 6% Sales Tax:
If pre-paying, please call us for exact Shipping Charges:
Grand Total:

Technical and Logistic Test

A feasibility study needs to be conducted to **determine whether the product or service** the firm plans to offer **can actually be provided to the target market**.

- Are distributors really willing to carry it?
- Are suppliers really willing to provide the various components?
- Can you get that location?
- Are the key people committed to joining the venture team?
- Do you have any unfair advantages, exclusivity?
- Is there an available supply of labour?
- Will employees have to be trained?
- Will labour conditions affect your ability to attract talent?
- Will your business be the target for unionisation?
- Can a working prototype be made?
- Can the actual product be made?
- Can the actual product be made economically?
- Can the actual service be provided?
- Can the actual service be provided economically?
- Can the processes be designed and tested at this time?
- How long will it take to make the product?
- What are the potential bottlenecks?
- Can the process be tested earlier so there is time to get the bugs out?

Vulnerability Analysis

Vulnerability analysis **helps reduce the likelihood you will be blindsided by events that can derail your new venture**.

You should look at the opportunity from kaleidoscopic perspective. Although the screening process may have looked at the nature of the market opportunity, your competitive advantage, financial worthiness, and other factors, you need to look around to see if there may be any other risks that should be analysed.

Vulnerability analysis encourages you to **scan the environment and run scenarios to identify potential threats**.

Particular attention should be directed to **assumptions or conditions that could become fatal flaws**. These factors could include **changes in the weather, competitive entry, breakthrough innovation, a major change in government regulations, diseases** (e.g. Mad Cow disease), and so forth.

Integrated Medical Resources - a national chain of clinics that specialized in diagnosing and treating impotence. But Viagra became available.

Remember, however, that the only way to eliminate business risk is not to go into business. The key is to keep your eyes open, to anticipate the unexpected, and to be prepared to deal with almost anything. That is what due diligence is all about.

If you get a new idea, don’t expect everybody to say, “Let’s go.” You’re the one who says that.

Summary and Conclusions

Hopefully, the analysis, data and preliminary projections indicate that the venture will have a competitive advantage and that consumers are excited about your product/service.

So the time has arrived for you to begin **preparing the business plan**.

A lot of homework still needs to be done about the industry and all the other factors that may influence whether your venture can beat the odds.

Opportunities multiply as they are seized; they die when neglected.

Life is a long line of opportunities.

– John Wicker, in *Forbes*