Chapter 5  Small Business, Entrepreneurship, and Franchises

① Define what a small business is and recognize the fields in which small businesses are concentrated.
② Identify the people who start small businesses and the reasons why some succeed and many fail.
③ Assess the contributions of small businesses to our economy.
④ Describe the advantages and disadvantages of operating a small business.
⑤ Explain how the Small Business Administration helps small businesses.
⑥ Explain the concept and types of franchising.
⑦ Analyze the growth of franchising and franchising’s advantages and disadvantages.
Small Business: A Profile

• A business that is independently owned and operated for profit and is not dominant in its field

• SBA developed specific “smallness” guidelines for various industries
Small Business: A Profile (cont’d)

- **Small-business sector**
  - There are about 26.9 million businesses in the U.S.
  - Just over 17,000 employ more than 500 workers
  - In the last decade, the number of small businesses increased 49 percent
  - Part-time entrepreneurs have increase fivefold and account for one-third of all small businesses
  - Seventy percent of new businesses survive at least two years, about 50 percent survive at least five years, and 31 percent survive at least seven years
  - The primary reason for these failures is due to poor management stemming from a lack of business know-how
  - Small businesses provide over 50% of the jobs in the U.S.
Industries That Attract Small Businesses

• **Attractive small-business industry characteristics**
  • Low initial capital investment
  • Some special skill requirements
  • High growth and profit potential

• **Industries that attract small businesses**
  • Distribution—retailing, wholesaling, transportation, and communications (about 33 percent of all small businesses)
  • Service—medical and dental care; watch, shoe, and TV repairs; haircutting and styling; restaurant meals; dry cleaning; financial services (over 48 percent of all small businesses)
  • Production—construction, mining, and manufacturing (about 19 percent of all small businesses)
The People in Small Businesses: The Entrepreneurs

- **Characteristics and other personal factors**
  - The “entrepreneurial spirit”
  - The desire for independence
  - The desire to determine one’s own destiny
  - The willingness to find and accept a challenge
  - Personal background
  - Age

- **Motivation**
  - “Had enough” of working for someone else
  - High-tech opportunities, especially for teens
  - Losing a job and deciding to start a business
  - An idea for a new product
  - An opportunity presents itself
The People in Small Businesses: The Entrepreneurs (cont’d)

• **Women**
  - Owned at least 51 percent of small businesses in 2008
  - Own 66 percent of home-based businesses
  - 7.8 million women-owned businesses in the U.S. provide almost 7.6 million jobs and generate $1.2 trillion in sales

• **Teenagers**
  - High-tech entrepreneurship is exploding
  - Face unique pressures juggling schoolwork, social life, business workload
  - Need skills for planning, persistence, patience, people management, generate profit
Why Some Entrepreneurs and Small Businesses Fail

• Lack of capital and cash-flow problems
• Lack of management skills
• Overexpansion
The Importance of Small Businesses in Our Economy

• **Providing technological innovation**
  
  • Innovation among small-business workers is higher than among workers in large businesses
  
  • Small firms produce 2.5 times as many innovations as large firms relative to the number of persons employed
  
  • More than half of the major technological advances of the 20th century originated with individual inventors and small businesses
  
  • Inventions may spark new industries or contribute to established industries
The Importance of Small Businesses in Our Economy (cont’d)

- **Providing employment**
  - Small firms hire a larger proportion of younger and older workers, women, and part-time workers
  - Small businesses provide 67 percent of workers with their first job and initial job skills
  - Small businesses represent 99.7 percent of all employers and employ over 50 percent of the private work force
  - Small businesses provide 2/3 of the net new jobs added to the economy
The Importance of Small Businesses in Our Economy (cont’d)

- **Providing competition**
  - Small firms can compete with large firms, forcing the larger firm to become more efficient and responsive to customer needs

- **Filling needs of society and other businesses**
  - Small firms can meet the special needs of smaller groups of customers
  - Small firms can act as specialized suppliers of goods and services to larger businesses
The Pro and Cons of Smallness

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<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
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<tr>
<td>• Personal relationships with customers and employees</td>
<td>• Risk of failure</td>
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<td>• Ability to adapt to change</td>
<td>• Limited potential</td>
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<td>• Simplified recordkeeping</td>
<td>• Limited ability to raise capital</td>
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<tr>
<td>• Independence</td>
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<tr>
<td>• Advantages of sole proprietorships</td>
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<tr>
<td>• Keeping all profits</td>
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<td>• Ease and low cost of going into business</td>
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<td>• Keeping business information secret</td>
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Developing a Business Plan

• Business plan—A carefully constructed guide for the person starting a business

• Three basic purposes
  • Communication
  • Management
  • Planning

• Banking officials’ and investors’ questions
  • What is the nature and mission of new venture?
  • Why is it a good idea?
  • What are the goals?
  • How much will it cost?
# Components of a Business Plan

**Table 5.4 Components of a Business Plan**

1. **Introduction.** Basic information such as the name, address, and phone number of the business; the date the plan was issued; and a statement of confidentiality to keep important information away from potential competitors.

2. **Executive Summary.** A one- to two-page overview of the entire business plan, including a justification why the business will succeed.

3. **Benefits to the Community.** Information on how the business will have an impact on economic development, community development, and human development.

4. **Company and Industry.** The background of the company, choice of the legal business form, information on the products or services to be offered, and examination of the potential customers, current competitors, and the business’s future.

5. **Management Team.** Discussion of skills, talents, and job descriptions of management team, managerial compensation, management training needs, and professional assistance requirements.

6. **Manufacturing and Operations Plan.** Discussion of facilities needed, space requirements, capital equipment, labor force, inventory control, and purchasing requirement.

7. **Labor Force.** Discussion of the quality of skilled workers available and the training, compensation, and motivation of workers.

8. **Marketing Plan.** Discussion of markets, market trends, competition, market share, pricing, promotion, distribution, and service policy.

9. **Financial Plan.** Summary of the investment needed, sales and cash flow forecasts, breakeven analysis, and sources of funding.

10. **Exit Strategy.** Discussion of a succession plan or going public. Who will take over the business?

11. **Critical Risks and Assumptions.** Evaluation of the weaknesses of the business and how the company plans to deal with these and other business problems.

12. **Appendix.** Supplementary information crucial to the plan, such as résumés of owners and principal managers, advertising samples, organization chart, and any related information.

The Small Business Administration

- A governmental agency that assists, counsels, and protects the interests of small business in the U.S.

- **SBA management assistance**
  - Management courses and workshops
  - Service Corps of Retired Executives (SCORE)
  - Help for minority-owned small businesses
  - Small-business institutes (SBIs)
  - Small-business development centers (SBDCs)
  - SBA publications
The Small Business Administration (cont’d)

• **SBA financial assistance**
  • Regular business loans
    • Loans are made by private banks but are partially guaranteed by the SBA
  • Small-business investment companies
    • Venture capital: money invested in small firms that have the potential to become very successful
    • Small business investment companies: privately owned firms that provide venture capital to small enterprises that meet their investment standards
The Small Business Administration (cont’d)

• State of small business during the recession
  • Among the segments of society hardest hit
    • Layoffs
    • Closures
  • Government assistance to improve market conditions
    • American Recovery and Reinvestment Act
    • Affordable Care Act
    • New tax cuts and credits
    • SBA loans with favorable terms
Franchising

• Franchise
  • A license to operate an individually owned business as though it were part of a chain of outlets or stores

• Franchising
  • The actual granting of a franchise

• Franchisor
  • An individual or organization granting a franchise

• Franchisee
  • A person or organization purchasing a franchise
Types of Franchises

• A manufacturer authorizes retailers to sell a certain brand-name item

• A producer licenses distributors to sell a product to retailers

• A franchisor supplies brand names, techniques, or services instead of a complete product
The Growth of Franchising

- **The growth of franchising**
  - Franchising has expanded with the growth of the fast-food industry
  - Franchising is attracting more women and minority business owners than ever before
  - Dual-branded franchises, in which two franchisors offer their products together, are a new trend
The Growth of Franchising (cont’d)

- **Are franchises successful?**
  - The success rate for franchises is significantly higher than that for other small businesses
  - The vast majority, 94 percent, of franchise owners report that they are successful
  - Too rapid expansion, inadequate capital or management skills, or other problems can cause franchises to fail
## Advantages of Franchising

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<tr>
<th>TO THE FRANCHISOR</th>
<th>TO THE FRANCHISEE</th>
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<td>• Fast and well controlled distribution of its products</td>
<td>• Opportunity to start a proven business with limited capital</td>
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<td>• No need to construct and operate its own outlets</td>
<td>• Guaranteed customers</td>
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<td>• More working capital available for expanded production and advertising</td>
<td>• Franchisor available for advice and guidance</td>
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<td>• Franchising agreements maintain product and quality standards</td>
<td>• Materials for local promotional campaigns and participation in national campaigns</td>
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<td>• Motivated work force of franchisees</td>
<td>• Cost savings when purchasing in cooperation with other franchisees</td>
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## Disadvantages of Franchising

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<th>TO THE FRANCHISOR</th>
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<tr>
<td>• Failure of the franchisee to operate franchise properly</td>
<td>• Franchisor retains a large amount of control over</td>
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<td>• Disputes with and lawsuits by franchisees over the terms of the franchise</td>
<td>the franchisee’s activities</td>
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<td>• Franchisor opening competing franchises within</td>
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<td>the franchisee’s market</td>
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Global Perspectives in Small Business

• Growing interdependence of national and international economies as trade barriers diminish

• Instant communications shrinks distances and expands business opportunities

• The Internet is the favored strategy for growth for small businesses
  • Technology provides leverage and power to reach markets previously limited to large corporations

• The SBA offers counseling on how and where to market overseas

• Small businesses must adapt to demographic and economic changes in the world marketplace