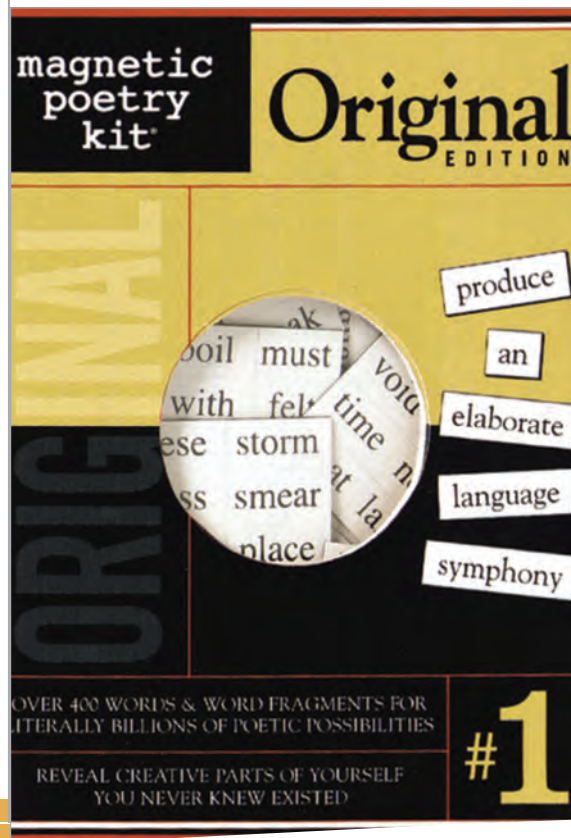


## LEARNING OBJECTIVES

### This chapter will help you:

- L01** Learn the sources of opportunity entrepreneurs draw on to get business ideas.
- L02** Track the traditional ways opportunities are screened for business potential.
- L03** Understand how creativity methods can help business owners recognize new opportunities.
- L04** Understand the five pitfalls that hinder innovation.
- L05** Identify strategies for innovation in your business.
- L06** Learn how to conduct a comprehensive feasibility study for your business ideas.
- L07** Understand the value of building a creative culture in your business.

■ Dave Kapell's company, Magnetic Poetry, was formed through several intriguing circumstances which were marked by creativity, opportunity, and feasibility. How did Dave's later business practices continue to promote creative, feasible opportunities? What kind of entrepreneurial company is Magnetic Poetry?



# Small Business Ideas: Creativity, Opportunity, and Feasibility

## **Focus on Small Business: Dave Kapell: Poetry in Motion<sup>1</sup>**

Dave Kapell was a guitarist and songwriter who played in funk and heavy metal bands in Minneapolis. His bands were popular locally, but he still worked at other jobs doing clerical work for nonprofits and driving a cab. Problem was, he often suffered from writer's block (an especially bad ailment for a lyricist!) and was constantly looking for things to inspire him so that he could write more songs. He happened to see a documentary on the life of David Bowie and learned that Bowie used a technique that Kapell found very intriguing. Following Bowie's suggestion, he began to cut up magazine stories, entries from journals, and even letters from family members and rearrange these small bits of paper to try to spark inspiration for songs. He would often have all these pieces laid out in a room, or across the front seat of his cab. There was just one problem.

Dave suffered from allergy attacks that caused him to sneeze, and when he sneezed, he would send the pieces of paper scattering all over the room or the seat of his car. He thought about gluing them to cardboard backing, but then he would have to put them away and take them out again whenever he wanted to use them. This is when opportunity met need.



One of Dave's roommates was an employee at a pizza restaurant, and the restaurant had a batch of refrigerator magnets it had intended to give to customers as advertising. But the magnets were misprinted and could not be used. Dave's friend brought these magnets home, and Dave came up with the idea of gluing the words to them. He then put the word magnets on a cookie sheet and kept them there so that he wouldn't have to put them away every day. It could have ended there. After all, Dave had solved the problem of the disrupted word collection. But one day someone in the house wanted to actually use the cookie sheets for what they were intended for—bake cookies! Now Dave had the problem of what to do with the magnets, so he casually put them on the refrigerator.

As Dave's roommates and friends came through the kitchen, Dave noticed that they all stopped by the fridge and played with the magnets—rearranging the words the magnets were holding to the fridge into phrases that were funny and bizarre. Dave would say that, while he never intended to start a business, this was a lightbulb experience. His friends started asking for sets of these words, and Dave saw an opportunity. He recalled, "I told everyone that I could make a kit for seven bucks, and I was earning seven dollars an hour in my job at the time and my student loans were coming due, so I made up a bunch of kits. I took 100 kits to my first craft show, and I figured that would be enough for the whole weekend. They sold out in three hours. I knew I was on to something."<sup>2</sup>

That was 1993, the year Dave's company, Magnetic Poetry, was born. As the idea took off, Dave realized he could no longer make the kits himself. He saved \$5,000 from craft fairs and began visiting local screen-printing and die shops in Minneapolis. He paid for 1,000 prototype sets. But the road was not smooth yet. Dave knew next to nothing about distribution. He also learned that retailers are not interested in amateur packaging, and Dave's kit looked like a cardboard jewelry box. Pam Jones, a manager of a local art museum gift shop, gave Dave lots of tips on product presentation. In three weeks, he developed a clear plastic package that Jones thought would fit on her gift shop's shelves. By the end of that first day, she sold the 12 kits Dave gave her. The new packaging was attractive to retailers such as Borders Bookstores, gift shops in the Guggenheim and Whitney museums in New York City, and Signals catalogs. By 1994, Dave's kits were selling in the Museum Company in the eastern part of the United States, and at the San Francisco Museum of Modern Art on the West Coast.

As time went on, Dave decided to do his own manufacturing, since he felt he wasn't getting quick enough turnaround from his manufacturer. He went back to Murray Condon, who had helped him with his prototypes, and the two formed a separate company called Screen D'or Graphics, Inc. Kapell funded the company with the goal of a three-day order-to-delivery turnaround. He now had a number of employees in production, sales, administration, inventory control, and shipping and was looking for other opportunities for his kits, such as introducing them in foreign languages. Today, the Magnetic Poetry product line features over 100 products. Its word kits include everything from the Shakespearean, Artist, and Genius kits to the Dog Lover, Romance, and College kits. (The Original kit remains wildly popular, too.) Magnetic Poetry also has new products that go beyond the magnetic word tile genre, including Sidewalk Poet, the Magnetic Poetry 2002 Calendar, and Magnetic Poetry: The Game, a new board game packaged in a refrigerator shaped storage tin.

Polished versions of the hand-glued magnets that once decorated Dave's refrigerator door in his Minneapolis home now can be found on millions of such doors and metal surfaces across the country. Since Dave Kapell invented Magnetic Poetry in 1993, more than 3 million kits have been sold. Magnetic Poetry, a cultural phenomenon, has appeared in the movies *Conspiracy Theory*, *City of Angels*, and *Notting Hill*, as well as on Jerry Seinfeld's refrigerator on the TV show *Seinfeld*.<sup>3</sup>

DISCUSSION QUESTIONS

1. How did Dave Kapell discover that his idea would be a good business opportunity?
2. How did Dave evaluate whether or not his idea for Magnetic Poetry was successful?
3. What other opportunities might there be for Magnetic Poetry in the future?

## The Source of Business Ideas

Do you recall seeing a new product or service in a store, or maybe hearing about an idea on radio or television, and thinking, “Now, why didn’t I think of that?” In fact, most of the ideas that are turned into new businesses, or result in “new and improved” products and services, come from information and observations that we are surrounded by every day. Does it seem to you that successful business owners must possess unusual powers of observation or use top-secret strategies unknown to anybody else when seeking ideas for new businesses or **innovations** to their existing businesses? It’s far more likely that these people have learned to pay attention to the cues that are around them and to ask many questions of things that most people take for granted, such as the way Dave Kapell did when making Magnetic Poetry. This search and capture of new ideas that lead to business opportunities is called **opportunity recognition**. Researchers in the field of entrepreneurship and small business believe that opportunity recognition behavior is the most basic and important entrepreneurial behavior.<sup>4</sup>

The exact reasons why entrepreneurs seem to be better able to find ideas that work are unclear. The notion of **entrepreneurial alertness** is one that has captured the attention of scholars in the field. This phrase means that entrepreneurs have a special set of observational and thinking skills that help them identify good opportunities. Some scholars have suggested that entrepreneurs are able to notice things that have been overlooked, without actually launching a formal search for opportunities.<sup>5</sup> Others suggest that we also consider the motivations of entrepreneurs to search for new ideas.<sup>6</sup> For example, if an owner of a fast-food restaurant notices that customers are asking for substitutions of healthier ingredients to the food items, she may be motivated to contact her suppliers to ask about obtaining new ingredients and to change the menu and increase the healthy offerings on the menu to keep customers satisfied, possibly bringing in more customers.

Ideas for new businesses come from a great variety of sources. A person who desires to start a business may begin searching for opportunities that exist in the marketplace, perhaps as a way to use skills and knowledge that he or she has acquired in college or in work experience. In the nationwide Panel Study of Entrepreneurial Dynamics,<sup>7</sup> a sample of 480 entrepreneurs were asked whether the business idea or the decision to start some kind of business came first:

TABLE 4.1		What Came First for New Businesses	
Business idea		37%	
Decision to start a business		42%	
Idea and decision were simultaneous		21%	

Source: Adapted from: G. E. Hills and R. P. Singh, “Opportunity Recognition.” In *Handbook of Entrepreneurial Dynamics: The Process of Business Creation*, ed. W. B. Gartner, K. G. Shaver, N. M. Carter, and P. D. Reynolds. Thousand Oaks, CA: Sage, 2004. Table 24.1, page 266.

**L01**

Learn the sources of opportunity entrepreneurs draw on to get business ideas.

**innovation**

Implementation of a creative idea or opportunity leading to profitable and effective outcomes.

**opportunity recognition**

Searching and capturing new ideas that lead to business opportunities. This process often involves creative thinking that leads to discovery of new and useful ideas.

**entrepreneurial alertness**

A special set of observational and thinking skills that help entrepreneurs identify good opportunities; the ability to notice things that have been overlooked, without actually launching a formal search for opportunities, and the motivation to look for opportunities.



But regardless of whether the idea came first or the decision to start a business came first, we now examine the factors that lead small business owners to their business idea.

### Work Experience

Many successful business owners spent years working for a company and gained valuable experience about how things might be done differently. Sometimes the idea grows out of listening to customer complaints.

You can use your own work and personal experiences to think of ideas for doing things differently. Sometimes the best business ideas come from your own frustration or from not finding exactly what you are looking for as a consumer. Anita Roddick, founder of the The Body Shop International PLC, whose 1,900 skin and body care retail stores are in 50 countries spanning 25 languages and 12 time zones,<sup>8</sup> got the idea for her business because she was very frustrated at having to spend a lot of money on moisturizer in fancy bottles from the big name cosmetics companies. Her idea was to give customers an inexpensive, good quality product made from natural ingredients in a recyclable bottle.

### A Similar Business

Even if you don't have years of work experience in an industry or market, you might see a business in an area that intrigues you because you like certain products, or you



#### SMALL BUSINESS INSIGHT

#### Cleaning Up through Innovation

Russell Kendzior of Bedford, Texas, worked as a floor-covering salesman in the late 1980s. He heard customers complain that their floors were slippery right after they were purchased. He did some digging around and even commissioned chemists to develop a soap-free floor-cleaning product. He spent \$5,000 of his own money, quit his job, and finally developed his own product. He gave away some product to friends who owned McDonald's locations, and before long it was the top-selling floor cleaner at McDonald's restaurants in the Dallas area. He ended up licensing his product, Traction Plus, which permitted him to think about other opportunities. Now, companies that bought his license manufacture and distribute wet-floor signs and floor-safety shoes. Traction Plus is a \$20 million company, and its products include chemicals and footwear. Kendzior also developed and now runs the National Floor Safety Institute. He protects his ideas carefully. His soap-free formula is manufactured in several places, so no one knows exactly what is in it. Even Johnson Wax could not match Traction Plus because of Kendzior's vast experience. He describes himself as a resistant virus: "We're very resistant, very strong, but a very small company. I don't want to be Johnson Wax. I think they want to be me."<sup>9</sup>

Russ Kendzior's success sends an important message about looking for business opportunities that emerge through experience, including the frustrations of customers, which in this case was floor safety. Finding a new way to solve people's problems can be an excellent source of ideas for business.



learn that there is a growing market for this business and you think of a way to expand on the opportunity. The mini-case at the end of this chapter introduces Amy Nye Wolf, who founded AltiTUNES, a chain of 26 music stores located in airports around the country. She got the idea for the business while traveling through Heathrow Airport in London while a college student.

### Hobby or Personal Interest

Many people find a way to turn their hobbies into successful businesses. David and Tom Gardner, the founders of Motley Fool, didn't start out wanting to write an online investment advice newsletter and Web site. They were avid players of a dice baseball game in high school called Strat-O-Matic, and they had a league in their town outside Washington, DC, where they grew up. Tom recalled, "It was a numbers game, and we kept lots of stats. There were so many different variables, just like the stock market and just like businesses have. And it was also a people thing, which is a big part of running a business, because all the fun of it was making trades with your competitors."<sup>10</sup>

### Chance Happening, or Serendipity

If it is true that successful business owners are alert to what goes on around them and pay attention to things most people miss, then it is no surprise to learn that another popular source for business ideas comes from the chance happening. Whether you think of it as being in the right place at the right time, as luck, or as being observant to the cues around you, many businesses have been formed as a result of the unexpected. In the early 1980s, Rangaswamy Srinivasan worked for IBM, where he worked with lasers and organic plastics. He happened to come upon his "great idea" while at the Thanksgiving table, where he wondered how effective a laser might be in slicing a turkey leg. His experiments contributed to the development of laser eye surgery, an idea that came to him by observing the environment around him. In 2002 he was inducted into the Inventors Hall of Fame.<sup>11</sup>

### Family and Friends

Ideas can come to you through your conversations with your family and friends. If you are open to their suggestions, a great business idea can result. Joan Ecker, founder of The Fat Hat Factory, a \$1.7 million clothing company, got the idea for making a shapeable "fat" hat when a friend told her he would visit her at her new home in Vermont only if she provided him with a warm hat.<sup>12</sup>

### Education and Expertise

As we saw earlier in the chapter, some small business owners decide first that they want to own a business and then go about searching for a viable idea for that business. Often, would-be entrepreneurs look to their own skills and talents for business ideas. Consulting companies are a very popular example of this approach to business ideas. Many owners of consulting companies took their own skills and launched businesses by selling those skills to other companies or individuals who needed them. Some of these consultants were laid off or voluntarily left large employers to consult with clients because they felt their talents would be more significantly recognized and rewarded in their own businesses.

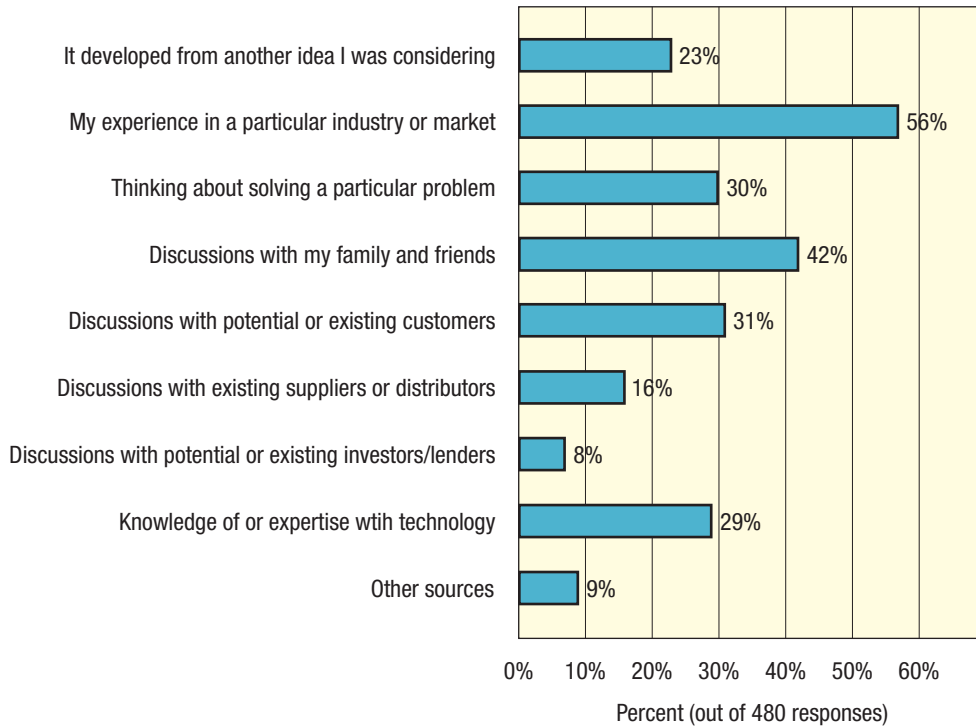
In the Panel Study of Entrepreneurial Dynamics, 480 entrepreneurs were asked, "What led to your business idea?" Figure 4.1 presents the results of this question. Work experience in a particular industry or market was the most frequently mentioned source of ideas, followed by discussion with family and friends.



**FIGURE 4.1**

**What Led to Your Business Idea? <sup>13</sup>**

Source: Adapted from: G. E. Hills and R. P. Singh, "Opportunity Recognition." In *Handbook of Entrepreneurial Dynamics: The Process of Business Creation*, ed. W. B. Gartner, K. G. Shaver, N. M. Carter, and P. D. Reynolds. Thousand Oaks, CA: Sage, 2004. Table 24.4, page 268.



**Technology Transfer**

One powerful but rarely used source of ideas are universities and government agencies. Both develop a tremendous range of new technologies or refinements of existing technologies, *but never do anything with them!* Major universities and government agencies, like NASA and the Departments of Agriculture and Defense, all offer technological inventions for free to small businesses to develop. There are even government programs to help fund such efforts. A good place to start are government technology commercialization sites such as NASA's ([www.ipp.nasa.gov](http://www.ipp.nasa.gov)), the Department of Defense's site at (<http://www.dtic.mil/matris/t2/orgt2.html>), or the Byrd National Technology Transfer Center Web site at (<http://iridium.nttc.edu>). If you have a university nearby which has government funded research, you can contact their technology transfer office and find out about inventions available for commercialization in your own backyard, or check out the Web site of the Association of University Technology Managers [www.autm.net](http://www.autm.net).

[www.ipp.nasa.gov](http://www.ipp.nasa.gov)

[www.dtic.mil/matris/t2/orgt2.html](http://www.dtic.mil/matris/t2/orgt2.html)

<http://iridium.nttc.edu>

[www.autm.net](http://www.autm.net)



**SMALL BUSINESS INSIGHT**

**Royal Touch Salon Plus: A Cut Above the Rest<sup>14</sup>**

Chiquita Miller-Nolan already was in business when she entered Kingwood College in the fall of 2002. She had won first place in the regional Global Student Entrepreneur Awards as a freshman for her business, Royal Touch Salon Plus. Started in 1997, it was the first African-American-owned salon in Atascocita, a suburb of Humble, just northeast of Houston. She grew the salon from 950 square feet to 1,600 square feet, consistently donated 30 percent of profits to nonprofit organizations, and donated food, clothing, and toys to help needy families. For

all these reasons, Chiquita was the winner of the Global Student Entrepreneur Award for her region in 2003. How did Chiquita get the idea for her business? She recalls, “At the time I opened my business I had been a stylist for 10 years. I worked in the Houston/Humble, Texas, area for about two years before I opened my own salon. You’ve heard it said, ‘Necessity is the mother of invention’? Well, honestly there were needs that I endeavored to meet. I needed more options such as flexibility and control concerning my career since I am a mother. At the time I was a stylist for JC Penney. I loved the security that the company gave me, yet for the first time it wasn’t enough. I needed a different type of security and Penney’s couldn’t give me what I needed.”

“I was a skilled hairstylist in *all* hair types, and that was and is something that’s rare for this area. My goal then became to open a full-service salon that could treat *all* hair types, black, white, Asian, Hispanic, Indian, etc., men, women, and children. The next thing I planned was to have a play area so that mothers like myself could bring their children with them. On Mother’s Day, Valentine’s Day, Easter, and special days we set out breakfast croissants, doughnuts, and juice to show our appreciation.”

What does Chiquita advise other business owners who are looking for an opportunity?

“*Seek to fulfill a need*, not just be another of the same thing that already exists. Get feedback from those you survey, don’t just count on a paper survey. Not all the time do things work out that look good on paper. Talk to people and get the heartbeat of the area.”



■ The Global Student Entrepreneur Award, sponsored by Saint Louis University, draws student contestants from eight global regions. Visit [www.gsea.org](http://www.gsea.org) for more details on this year’s application process, information on past winners, and access to entrepreneurial resources.

## Assessing Viability

In the previous section we examine various ways you can search for your business idea or for ideas that improve existing products, services, or business processes. Is every good idea a viable business opportunity? Definitely not. The marketplace is replete with examples of bad business ideas that seemed great in concept but were poor in execution—witness the dot.com bubble that burst recently. The business world learned—in some cases very harshly—that not every idea is evaluated properly or deserves to evolve into a business. So although you may feel strongly that an idea is the *right* idea for you to invest some time and effort in, there are many more steps you need to take before opening your door. Here we use the word *idea* to broadly mean a new or improved product, service, or process. We begin with some fundamental questions. Later in this chapter you will learn how to conduct a comprehensive feasibility analysis for your idea, a formal approach to assessing whether your idea is sound and could lead to a viable business. For now we offer a simple approach to help you start quickly assessing the **viability** of opportunities.

Here are four main questions to ask yourself. They reflect each of four primary areas you should consider when evaluating an idea or opportunity: revenue-generating ability, people, resources, and information.

- 1. How viable is the idea?** Will what you are planning to sell generate actual revenues? One of the mistakes would-be entrepreneurs make is to assume that everyone will love the idea and that people will be standing in line to buy it once the business opens.
- 2. Who are the people behind the idea?** If a great idea with high market potential also has a person or team behind it that is a good fit, the idea is much more likely to be successful than it would be without that person or team. While your skills and talents might have led you to discover the idea, do you have what it takes to turn this idea into a business?
- 3. What resources are needed to take the idea and sell it to the customer?** Beyond the start-up dollars that will be needed to buy any raw materials to make the product or develop the service, what information, relationships, and degree of effort will be needed to turn it into reality?

### L02

Track the traditional ways opportunities are screened for business potential.

### viability

The preliminary assessment of the potential for a business to be created or, once created, to survive.



## SMALL BUSINESS INSIGHT

### Falling in Love with the Idea

Have you ever thought of an idea that was good—great, actually—and then found yourself amazed that nobody else had ever thought of it? Did you think, “Hey, maybe I could do this since no one else has come up with a way to do it?” Then you find yourself getting more and more excited about the prospect of starting this really great business with your amazing idea? If so, you are in good company. Many people who went on to start successful businesses found that during the early stages of preparing to go into or grow their businesses, their so-called “great idea” really wasn’t so great after all. Tim Knox owns a software company, Digital Graphiti, and he recounts such an experience: “We came up with what we thought was an amazing piece of software—a piece of software so amazing, in fact, that we just knew that all of humankind would sit up and take notice, then line up to write us checks. After hundreds of hours and thousands of dollars spent developing the product and finally bringing it to market, we were amazed to find that the only people who thought the software was amazing was us. We made humankind yawn . . . quite an amazing accomplishment.”<sup>15</sup>



The pitfall of idea infatuation happened to Lisa Thomas and Gary Erickson, who now own a successful energy bar company called Clifbar. Before they introduced the energy bars, they had an idea to sell a dessert they really liked called Choclava. They were selling more traditional baked goods and thought they knew what tasted good. After all, as Lisa described, “We made what we liked.” The Choclava was a chocolate version of baklava that Erickson had created. Thomas said, “We thought we had it made. We were going to be on the cover of *Gourmet* magazine.” They put their efforts into Choclava, which required layering phyllo dough, a dough that is very challenging to work with, and chopping walnuts and blending premium chocolate into the mixture. It wasn’t easy to produce, but they were inspired. In the end they couldn’t sell it. “People are either hot or cold on baklava,” acknowledges Erickson. In retrospect, he adds, “We’re probably lucky. Phyllo is incredibly hard to work with.”<sup>16</sup>

4. What do you need to know about the industry and market for the idea? Even if you have done some preliminary research on industry and market trends and forecasts, you should consider what you don’t yet know (about competition or about customers’ preferences) that could affect the way your idea is turned into a business.

## From Ideas to Opportunities Through Creativity

You might have a viable business opportunity, but is it the best one to pursue? Are you sure you have the right approach for making the most of the opportunity? Very often the first good idea an entrepreneur has is not necessarily the best one they will have. Before committing yourself to one viable idea, it is a good practice to take some time and see if you can take that viable opportunity and innovate on it to create an even better—more profitable, more distinctive, harder to copy—opportunity.

### L03

Understand how creativity methods can help business owners recognize new opportunities.

Why worry about being innovative in your approach? Consider the ease with which you can get data over the Internet on industries and markets, such as your competition, and how small business research and how-to articles are at your fingertips with many journals and magazines available over the Web. Of course, everybody else who is thinking about starting a business similar to yours has this same information at his or her fingertips also. There are, however, some very creative methods you can use to help you generate ideas and opportunities that take you beyond what everybody else already knows. This is what can give you the innovative edge in business ownership, whether you are looking for ideas that are just a little bit different from the competition, or a world apart from what everybody else is doing or not even doing yet. These strategies are discussed later in the chapter.

Figure 4.2 provides one tool you can use to help you identify new opportunities. It is based on the work of Alex Osborne, a pioneer in the field of **creativity**, who first coined the word, *brainstorming*. The tool is known as **SCAMPER**, and it is an acronym for a set of cues that trigger new ideas for your business.

**Substitute:** Think of what you might substitute for something else to form a new idea. A feature that allows your customers to order directly from a Web site rather than visiting your store or ordering by mail is an example of substitution. Sometimes solutions derived through SCAMPER cues are very “way out” and lead people to some creative ideas for solving annoying problems. One city in the Netherlands, for example, was experiencing a growing litter problem (not unlike your own town or city, no doubt), and the civic leaders tried all the usual ways of fixing the problem: They increased the number of trash bins around the city, they posted signs reminding people not to litter, and they fined people for littering. Nothing seemed to help. Then they got a breakthrough idea: a tiny recording device was installed inside trash bins, and every time someone pushed the lid to deposit litter, a joke would play from the recorder! Not surprisingly, it was not too long before the litter problem declined.

*Idea Trigger: What opportunities can you think of that come as a result of substituting or replacing something that already exists?*

**Combine:** Think of possible combinations you can make that result in something entirely different. Not long ago, if you wanted to buy a book, you went to a store that typically carried only books, and if you wanted to buy a cup of coffee you went to a coffee shop, and if you wanted to hear music you went to a club or theater. Today, you can have all three under one roof at many establishments, including big ones such as Borders and Barnes & Noble, but also some smaller businesses such as Tattered Cover Book Store in Denver, Colorado. Also, when you buy gasoline at the service station, you most likely can pick up some groceries along with basic auto supplies, and maybe even CDs or videotapes.

*Idea Trigger: What separate products, services, or whole businesses can you put together to create another distinct business?*

**Adapt:** Think about what could be adapted from products or services that already exist. Many successful businesses are founded on the concept of adaptation. It’s a popular innovation strategy that can be just as effective, and much more likely in the real world, than business opportunities that are the result of **radical innovations** such as inventions. You may remember the original Book-of-the-Month club that sent members a different book every month. What adaptations can you find? How about beer-of-the-month, pasta-of-the-month, and many other variations? Did you know that one day a manufacturer of toilet tissue received a shipment of paper that was too thick to use? The manufacturer could have thrown it out, but instead it improvised, and paper towels were introduced! Sometimes adaptations occur when entrepreneurs try their best to work with scarce resources.

S – Substitute

C – Combine

A – Adapt

M – Magnify or modify

P – Put to other uses

E – Eliminate

R – Rearrange

#### FIGURE 4.2

#### Using SCAMPER to Recognize Business Opportunities<sup>17</sup>

#### creativity

A process producing an idea or opportunity that is novel and useful, frequently derived from making connections among distinct ideas or opportunities.

#### SCAMPER

A creativity tool that provides cues to trigger breakthrough thinking. The letters stand for substitute, combine, adapt, modify, put to other uses, eliminate, and rearrange.

#### radical innovation strategy

Rejecting existing ideas, and presenting a way to do things differently.

*Idea Trigger: What could you adapt from other industries or fields to your business?*

**Magnify or modify:** Taking an existing product and changing its appearance or adding more features or more hours your store is open or making its advertising more dramatic are some ways you could magnify or modify your idea. Washington Mutual is a financial services company that is currently opening branches all over Chicago, among other cities. All along the expressways are billboards proclaiming this in some very dramatic and humorous ways, poking fun at the traditional fees that banks and other financial service companies charge for checking accounts, for example. It has also launched a series of hilarious TV ads, including the famous “money shrub” which depicts scientists attempting to grow money on plants in the laboratory. Unfortunately, while they do manage to produce a large tree with money growing on its branches, the tree suddenly grabs the scientist and hurls him all around the laboratory. The scene reminds viewers of Audrey II in *Little Shop of Horrors*. The announcer notes that while not everything is ready for the market, did you hear about the new credit card? Clearly, such messages are remembered by potential customers, and the effect is to make the business stick out among its competitors. There is much a small business can do to create memorable images and advertising for itself, and it does not need expensive television ads to do it. It also can cue you to “minimize” something. The microchip industry was born, for example, when someone asked the question, “What if we shrunk them?”

*Idea Trigger: What could I make more noticeable or dramatic, or different in some way from my competitors? It need not be in the product itself, but it could be the way you advertise or treat the customer during the transaction that becomes memorable.*

**Put to other uses:** Think of ways you could generate a high number of opportunities for your product or service beyond what it is traditionally used for. A few years ago, Arm & Hammer Baking Soda was known as a product customers used by the teaspoonful every few weeks when they baked a batch of cookies or a cake. The problem for Arm & Hammer was that it wasn’t selling a lot of boxes of the stuff since it tended to sit in people’s kitchen cupboards for years. At 59 cents a box, that doesn’t bring tremendous sales revenues. One day, the company brought together a group of employees and gave them the challenge to think of all the uses for baking soda (besides baking) that they could. Ideas took off, and today the company produces an entire line of baking soda–related products that bring a handsome return in profits. Can you think of some? (Hint: washing clothes, refrigerators that smell, a product cats use, etc.)

Antoine Fuerchtwanger sold frankfurters at the Chicago Exposition over 100 years ago, and his customers complained that they burnt their fingers when holding them. Fuerchtwanger tried gloves, but customers kept walking off with them. Finally, he took some rolls that a baker had made, cut them in half down the middle, and placed the frankfurters inside them. Hotdogs met buns, and today it’s hard to imagine one without the other.

*Idea Trigger: Suppose you learned that all the traditional uses for your product had disappeared and that you have trailer truckloads out back with tons of product. What other uses might there be? Aim for quantity, and allow outrageous ideas to flow along with more mundane ones. Who knows what new applications you may find.*

**Eliminate:** Search for opportunities that arise when you get rid of something or stop doing something. What products or services emerged when these questions were asked: What if people didn’t have to leave their houses to go grocery shopping? What if you could buy something (or do bank transactions) without leaving your car?

*Idea Trigger: What could I get rid of or reduce that would eliminate something my customer has to do, and as a result give the customer more than he or she expected?*

**Rearrange or reverse:** One of the best examples of this technique is shown in the opening vignette to this chapter. Magnetic Poetry is a product that by definition is about rearranging things to inspire ideas. Other examples include using reverse psychology or paradox to challenge old ways of thinking, for example, using stimulants to calm hyperactive children.

*Idea Trigger: What can you rearrange or reorder in the way your product or service appears, or the way businesses in your industry usually look or are decorated or located?*

SCAMPER is a very effective method for helping business owners and their employees come up with alternative solutions and opportunities. The method works because it helps you to step outside the usual way you look at opportunities or try to solve problems. It offers cues that push you outside your traditional areas of expertise, to consider what interesting new forms might be out there that you could try. We know that highly creative individuals are people who usually ask lots of questions. Creative business owners similarly question and challenge the way things appear, to see if they can find a new way of doing things. When you see a highly innovative business, don't think that there is something especially magical or lucky about the entrepreneur or the situation. It's more likely that the person or team behind the business is simply persistent about asking questions. Following are several recommendations to help you put yourself and your business in an innovative frame of mind.



■ When you're looking for ways to change your business, consider getting out of your comfort zone for innovation. Get together with a group of professionals to discuss trends in your industry and how they are affecting your business. Do you have other recommendations for challenging the way things are being done and coming up with creative new techniques?

## Get into an Innovative Frame of Mind

Regardless of whether you feel your business needs a subtle change or a drastic one, building “change-ability” into a core business is possible if you actually practice change.<sup>18</sup> Here are some techniques you can try as you practice the business of innovation:

- Read magazines or trade journals outside your area.
- Invite someone you never included before to a meeting at which you are solving a problem or searching for a new opportunity. Try a supplier or a friend who works in a different field.
- Have a “scan the environment” day in which you discuss trends and happenings that could impact your business.
- Try a mini-internship. Ask a colleague or friend if you can spend a week at his or her business to see what you can learn that may be applicable to yours.
- Instead of trying to simply sell your product or service to customers, put yourself in their shoes and ask them what frustrates them most or what problems they cannot seem to solve that relate to your business.
- Redesign your work environment. Get a room with a view.<sup>19</sup> This doesn’t have to cost a bundle in remodeling or even redecorating costs. Try to bring in some items from nature and add color and inspirational objects or quotations.

### SKILL MODULE 4.1

#### The Creative Process

The creative process in individuals, teams, and organizations has been studied intensively for over 75 years. It is concerned with the way in which creativity actually happens. Much of what we know about creativity comes from understanding the process that highly creative people go through when they get their ideas. Artists, scientists, composers, poets, and inventors have attempted to describe their creative moments. Graham Wallas<sup>20</sup> developed one of the early descriptions of the creative process, and it is still widely used today to guide the creative process in business. This research suggests that creative thought includes four stages:

1. Preparation—exploring the problem or opportunity in all directions.
2. Incubation—thinking about the problem or opportunity in a “not-conscious” way, putting it on the back burner, so to speak.
3. Illumination—the lightbulb comes on, and ideas begin to flow.
4. Verification—testing of the idea and reducing it to its most exact form.<sup>21</sup>

This process is very useful when you want to explore a business problem, such as why you lost a customer, or when you want to identify further opportunities for your business, such as new markets or features for your product line. If you can pinpoint what stage of the creative process you are in, you can guide yourself through to an innovative solution by looking at things from different perspectives and allowing the issue to simmer in the background for a bit. This technique has worked for many famous creative people—from Leonardo da Vinci to Albert Einstein.

## Avoid Pitfalls

### L04

Understand the five pitfalls that hinder innovation.

In your quest for new business ideas, from time to time you may catch yourself rejecting ideas or jumping on the first good idea you get because you are excited and there is no time to lose.

There are five major pitfalls<sup>22</sup> that business owners can become victim to when trying to become more innovative. See if you recognize the ones that apply to you and your business, so that you can sidestep them at every opportunity:

1. **Identifying the wrong problem:** When a problem doesn't stay solved or an opportunity doesn't pan out as expected, it could be that the wrong problem was defined. For example, a synthetic-fiber producer brought a group of employees together to help find ways to reduce the manufacturing costs of a particular product. After spending a few days brainstorming and finding that the problem was not leading them to any interesting or useful solutions, the employees turned the problem around and began developing ways to increase the sales of a highly profitable part of the product line. How were they able to change their focus in this way? They simply examined the problem within the broader context of profitability (instead of costs) and discovered that the real problem was low profits.
2. **Judging ideas too quickly:** At many business meetings when someone suggests a new idea or approach, often the first reaction you hear is, "We've tried that before and it didn't work," "The boss will never go for it," "It's not in the budget," or the frequently heard, "Yes, but . . ." People tend to judge ideas prematurely, before they take the time to ask, "What's right about this idea?" or "How could this idea be made better?"
3. **Stopping with the first good idea:** The first good idea you come up with is rarely the best. That's because it was the easiest to think of, and so there is little doubt that your competitors have already thought of it, too. The very best ideas come a little later, after the ideas that are on the top of your mind come out. Using a tool such as SCAMPER, for example, encourages you to explore things more deeply than just rattling off the first thing you can think of and then doing that.
4. **Failing to get the "bandits on the train" and ask for support:** Imagine you are on a train in the American West in the late 1800s. At the time, bandits often placed dynamite on the tracks to hold up the train. How can you keep that from happening? One way is to get the bandits on your train. In modern business terms, this means figuring out whose support you must have or who could derail your project and then involving them early in the project. If you need an employee's involvement or a supplier's agreement, get them on board early to avoid failure later.
5. **Obeying rules that don't exist:** We sometimes put obstacles in front of ourselves because we think we can't do something, when in fact there is no reason we can't. Are you assuming that as the business owner you need to do all the work, or make all the sales calls, or solve everybody's problems (including your employees' or partners' problems)? Before you assume that you do, challenge the assumption.

## Types of Innovations Small Businesses Develop

Companies may find it easier to mimic the strategies of other firms because of the expense and intense effort required to make decisions based on a radical innovation strategy. In addition customers may view a new company as more legitimate if it imitates established practices in the industry.<sup>23</sup> This is the idea behind several of the methods for product-based legitimacy described in Chapter 2. It is also central to the idea of pursuing an **imitative strategy**, which is covered in detail in Chapter 7.

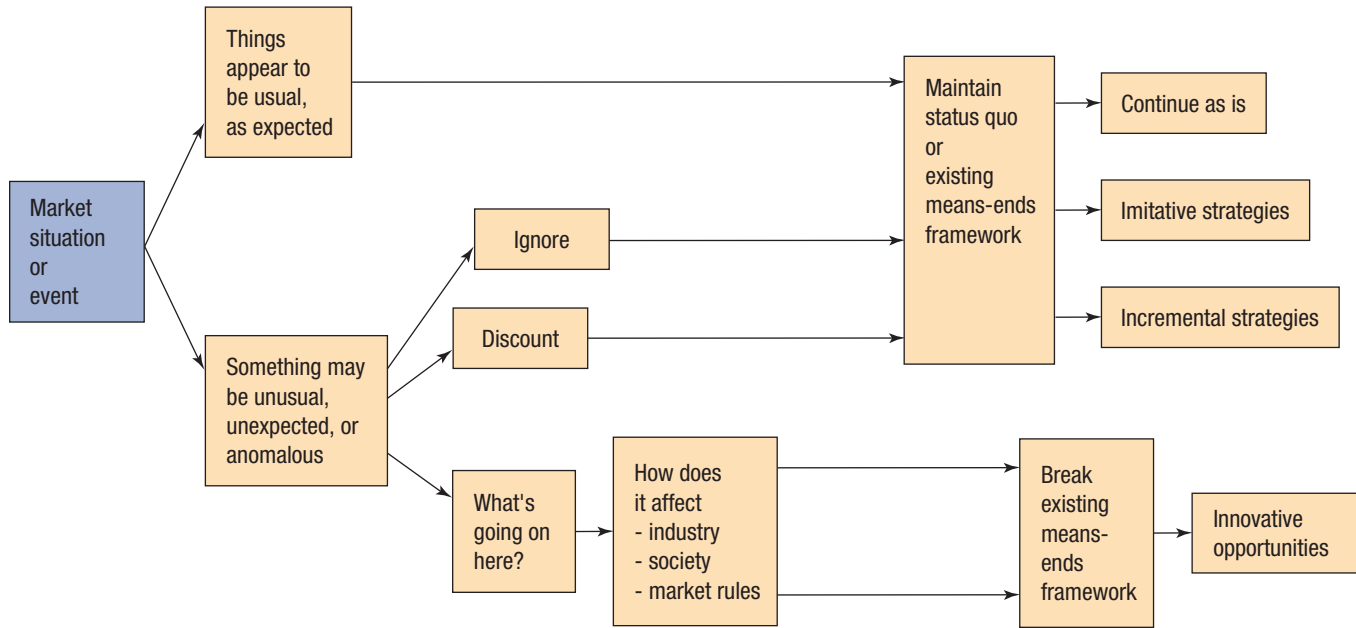
But mimicking others is not the only strategy that an entrepreneur can pursue. Gaglio and Katz<sup>24</sup> offer a model for thinking about the business implications of opportunities. Called the *opportunity identification process* (see Figure 4.3), it has the

### L05

Identify strategies for innovation in your business.

### imitative strategy

An overall strategic approach in which the entrepreneur does more or less what others are already doing.



**FIGURE 4.3**

**Opportunity Identification Process**

Source: Adapted from: C. M. Gaglio and J. A. Katz, "The Psychological Basis of Opportunity Identification: Entrepreneurial Alertness," *Small Business Economics*, 16, no. 2, (March 2001), p. 99.

**incremental strategy**

Taking an idea and offering a way to do something slightly better than it is done presently.

**L06**

Learn how to conduct a comprehensive feasibility study for your business ideas.

**feasibility**

The extent to which an idea is viable and realistic and the extent to which you are aware of internal (to your business) and external (industry, market, and regulatory environment) forces that could affect your business.

entrepreneur assess whether the situation faced is one that is the same as it has been traditionally or if it is changing. Strategies that involve doing the same thing, or mimicking others, or pursuing an **incremental strategy** make a lot of sense when the business is continuing on a fairly steady course. Sometimes during these periods of stability, trying innovative ideas might help win more business from rivals, and “shake up” the industry, perhaps giving the innovator an advantage. During times of great change—whether from technological, political, economic, or cultural change—the potential for steady business declines, and the attractiveness of innovations increases. At times of great change, people become more willing to try extreme new ideas, so it becomes a great time to introduce extremely innovative ideas.

One unusual ability found in the entrepreneurs studied by Gaglio and Katz was that many of them can come up with new ideas given nearly any combination of resources. Sitting at an airport, entrepreneurs begin to look where lines are forming and wonder how to make money off that. Others can be given some everyday items and in a few minutes they are thinking up ways to combine them to make a profit. Their use of the opportunity identification process tells us that being creative can become a way of life.

## Make Sure an Idea Is Feasible

Before you implement a business idea, you should test the idea for its **feasibility**, which means the extent to which the idea is viable and realistic and the extent to which you are aware of internal (to your business) and external (industry, market, and regulatory environment) forces that could affect your business. In this section, we examine the major criteria that will help you determine the feasibility of your business opportunity. Before we examine an outline for conducting a feasibility study, let’s take a look at the results of a study in which entrepreneurs revealed what matters most to their business, with respect to the economic and community context in which their businesses are located.<sup>25</sup> The entrepreneurs were asked, on a scale of 1 (very confident) to 5 (very unconfident) how certain they were that the new business would be able to accomplish the following:

**TABLE 4.2** What Start-Up Entrepreneurs Feel Confident About

Comply with local/state federal regulations	1.64
Keep up with technological advances	1.84
Attract customers	1.85
Obtain raw materials	1.95
Deal with distributors	1.95
Compete with other firms	2.10
Attract employees	2.29
Obtain working capital	2.70
Obtain start-up capital	2.84
Obtain a bank's help	3.15
Obtain venture capitalists' help	3.41

Source: Adapted from C. H. Matthews and S. E. Human, "The economic and community context for entrepreneurship." In *Handbook of Entrepreneurial Dynamics: the process of business creation*, ed. W. B. Gartner, K. G. Shaver, N. M. Carter, and P. D. Reynolds. Thousand Oaks, CA: Sage, 2004. Table 36.1, page 424.



Feasibility studies consist of careful investigation of four primary areas: the product/service, the industry and market, financial projections (profitability), and the plan for future action. Within each of these areas you will examine the strengths and weaknesses (advantages and disadvantages) of your business opportunity. Figure 4.4 is an outline of a feasibility study,<sup>26</sup> and we will look more closely at each of the areas that will help you decide whether your idea or opportunity can be a viable business or not.

**I. Description of Your Business**  
 What business are you *really* in? Describe your product or service in the most concise way you can, and think beyond the characteristics of the product or service to the *experience* that you hope the customer receives from buying the product or service.

**II. The Product/Service**

- **Unique Features: Benefits**  
 What are the unique features of the product or service? How do these features meet your customers' needs or preferences? What are the benefits of this product or service compared to the competition? Describe your product or service very simply, and use photos or drawings to illustrate how it works.
- **Unique Features: Limitations**  
 What are the specific shortcomings of the product or service? Can it become obsolete soon? Is it perishable, difficult to use or install, or are there legal restrictions? An honest assessment of your product or service is extremely important during this analysis. You do yourself no favor by being in denial, or failing to see the disadvantages *before* you go into business. Noting them now will help you prepare solutions or ways to minimize these issues.
- **Stage of Development**  
 Is the product still in the idea stage, or is there a model or working prototype available? Have any samples been manufactured? If it is still in the idea or prototype stage, what is the time frame for getting it ready for production?
- **Legal Restrictions and Rights**  
 List any patents, copyrights, trademarks, or licenses that apply to your product or service. If you are entering into a franchise agreement, partnerships, distributorships, etc., these should be discussed in this section. Seek the assistance of patent attorneys or intellectual copyright specialists for assistance. Also list

**FIGURE 4.4**  
**The Feasibility Study Outline**  
 Guidelines for Completing Your Study

the government regulations you must adhere to, such as FDA, EOA, OSHA, IRS, Secretary of State, etc., and research zoning restrictions carefully. If you will be home-based and your clients will be coming to your house, will this be impacted by your neighborhood's zoning restrictions?

- **Insurance Requirements**

Research the liability of your product or service and consult an insurance specialist to be sure you are protected adequately. This will depend on the nature of your business. A flower shop that sells floral arrangements is in a different liability situation than a pet grooming business, for example. If you have employees, you will need insurance to protect them from harm also, along with any insurance benefits you want to provide your staff.

- **Trends Related to the Product or Service**

How will you keep your finger on the pulse of change in your product or service area? What trends are likely to occur in the way the product is used, or what features it offers, for example?

- **Production or Service Delivery Costs**

Will you be producing or sub-contracting out the manufacturing or delivery of your product or service? List all the costs, including labor, supplies, shipping, repairs, etc.

### III. The Industry and Market

- **Current Industry**

Describe the industry as specifically as you can. There are some excellent sources in your college or public library that can help you determine the size of the industry, location of the industry (local, regional, national or global), and average sales and profitability for the industry. For example, the Risk Management Association provides industry-specific data based on the SIC (Standard Industry Classification Code) that can tell you what the average revenues are for a particular industry, and what profits you might expect to earn.

- **Market Potential for this Industry**

Is the industry in a period of decline, stability, or growth? What is the market demand likely to be for the next 1 to 3 years? Talk to people in the industry as well as potential customers for their ideas about where the industry might be headed. Consider how technology or the global economy might affect the market potential for the business. Research trends in the industry.

- **The Competition**

Who are your primary competitors, and what are their distinct advantages and disadvantages? Consider not only your direct competitors, but also your indirect ones who might be selling a substitute for your product or service or bundling your product with something else they provide.

- **Your Customers**

Who are your customers? Demographic information tells you all about your customers' personal characteristics, such as where they live, how much household income they have, and how many children they have. You can find very specific information in your library or on-line using zip codes for communities. What are your customers' preferences, values, attitudes that relate to your business? How will you find out what your customers think or intend to buy? How can you find out what problems they have, what they need, or what they want that they don't know yet! Use your creativity to learn as much as you can about your potential customers. If you have more than one target market, do this for each market segment. It's important to note the different benefits and limitations for each customer group.

- **Market Penetration**

How will you reach your target customers? What forms of distribution or selling will you use? How will your potential customers become aware of your business? How will you advertise?

### IV. Financial Projections

- **Pricing**

How much will you charge for your product or service? Do a break-even analysis, and list all the assumptions behind your pricing.

- **Sales Revenue Forecast**

How much of your product or service will you expect to sell? What will your gross revenues be? What percentage of market share do you think you will reach in one year? Three years?

- **Cost Forecast**

What does it cost to produce, distribute, deliver, etc., your product or service? If you plan to manufacture goods, consider the cost of raw materials, labor, and delivery of goods. If you plan to retail

or wholesale goods and services, consider mark-up, inventory costs, and freight. Refer to the RMA (Risk Management Association) studies for more information to help you compute these costs. See [www.rmahq.org](http://www.rmahq.org).

- **Gross Profit**

What are your sales minus cost of goods sold? Do this for each product or service and compare to industry averages.

- **Operating Expenses**

What marketing expenses (advertising, etc.), administrative (clerical and management), and general expenses do you expect to incur? Be sure to state your assumptions about these figures.

- **Profitability**

What is your expected net profit? After you have derived your gross profit above, subtract other expenses you expect to incur, such as rent, insurance, and salaries. This will help you determine your net profit.

## V. Future Action Plan

- **Start-up Capital**

How much money do you need to start the business? In addition to the cost of goods sold that you calculated and your marketing and administrative expenses, what additional costs do you have, such as renting space, utility expenses, and salaries?

- **Sources of Start-up Capital**

Where can you obtain the money you need to start the business? Consider all the sources available to you, such as personal savings, family and friends, bank loans, investors, etc.

- **Further Information Needed**

What are you uncertain about? Whom could you ask? Where can you find this information? Your analysis is incomplete if you haven't considered what it is you don't yet know.

- **Writing a Business Plan**

The feasibility analysis will help you get started writing your business plan. You will have the information you need to address the competitive advantages and disadvantages of your business and the strategies you will use to meet your goals.

- **Support Needed**

List the individuals or groups you could consult for advice. Consider developing an advisory board consisting of people with experience in your industry and professionals from other industries who might be expert marketers, for example. Do you have an attorney, accountant, Web site designer, etc., who could help you when needed? Make a list of all the supporting actors your business may need in the future.

## Ways to Keep On Being Creative

Once you have generated your business idea and evaluated it and determined whether or not it is feasible, you have completed the opportunity identification and evaluation process. But this process never really ends. Even after you are well on your way into business and even after your business is successful and you have met your initial goals, the nature of entrepreneurs and small business is that you will always be on the lookout for new opportunities. Successful business owners never rest on their laurels and assume that, since they have achieved success, it will always be there. One of the pitfalls small business owners can fall into is to fail to build a company culture—a way of thinking and behaving—that encourages new ideas and embraces change. This is especially important if you employ or plan to employ other people. There is nothing as discouraging as working for someone who feels there is nothing new you can possibly contribute to the business. And you would be surprised to learn how many business owners have this mentality. Here are some ways you can avoid this and build a company that is “idea prone.” You will find that you can attract more creative employees and get more useful ideas out of them that affect your business’s bottom line by following the recommendations given in Skill Module 4.2.

Innovation is at the heart of entrepreneurship, because every time people start a business or become the owner of one, it is a new start and often a new experience for them. Some businesses are themselves built on new ideas or new twists on existing ideas. For

### L07

Understand the value of building a creative culture in your business.

## Great Ideas for Making Idea-Prone Companies

1. Give yourself and your employees time to think of ideas. While it can seem that there is never enough time to get everything done and deadlines are always looming, you can't afford not to take the time to come up with new ideas. Allow even just a few minutes every day to discover what your customers or employees are thinking and what problems or frustrations they may be experiencing. Ask your employees what they are working on, where there may be problems, and what ideas they have for solving them.
2. Positively reinforce ideas<sup>27</sup>—avoid the automatic no. As discussed earlier, don't rush to judge ideas. It's the process of coming up with ideas that needs to be reinforced, not whether the idea is good or not. Evaluation can come later.
3. Look to unlikely sources of opportunities. You never know where creativity and innovation will emerge. Think beyond your age group, socioeconomic status, and education.
4. Get a room with a view. Give your employees—and yourself—varied experiences. Get away from the office, go visit customers, allow employees to learn one another's jobs, and so on. It enables people to get a different perspective, and it is when we can change our routine that breakthrough ideas often can be discovered.

An innovative company does not automatically develop out of an innovative business idea. You have to deliberately set your expectations and communicate them to your employees. Remember that recognition is fuel—it fans the fires of creativity and helps your business reach potentials that you may never have anticipated. Einstein said, "Creativity is contagious . . . pass it on." As the business owner, you are in a unique position to make sure that people's brains don't stop at your company's door.

these kinds of situations, taking some time before committing your money to think about which ideas make the most sense as a profit-maker can save a lot of grief later on. That is where the opportunity identification process and the assessment of viability and feasibility come in to play. It is also true that one of the greatest challenges facing a business is getting control over the process of change—knowing when and how to change and try something new. Sometimes even thinking in new ways can be difficult, and that is when techniques like SCAMPER can make all the difference. The point is that while many people think innovation is a bolt from the blue, unpredictable and uncontrollable, in reality it is anything but that. That is good news, because it means that one of the most powerful techniques for building your business is under your control.

## CHAPTER SUMMARY

### **L01** Learn the sources of opportunity entrepreneurs draw on to get business ideas.

- Opportunity recognition is one of the most basic entrepreneurial behaviors.
- Entrepreneurial alertness means that entrepreneurs have a special set of observational and thinking skills that help them identify good opportunities.
- A plurality of entrepreneurs studied knew they wanted to start a business and were very motivated to find business ideas.
- Ideas for new businesses come from a great variety of sources. These include work experience, seeing a similar business, hobbies or personal interests, a chance happening, discussions with family and friends, and education and experience.

**L02 Track the traditional ways opportunities are screened for business potential.**

- In assessing the potential value of your business idea, there are four major areas to consider:
  - What is the viability or the ability of your idea to actually generate revenues?
  - Who are the people behind your idea?
  - What resources do you need?
  - What information do you need to know about industries and markets for your idea?
- Avoid the pitfall of idea infatuation. If no one else has ever tried the idea, is there a reason why?

**L03 Understand how creativity methods can help business owners recognize new opportunities.**

- Creative methods help you identify opportunities beyond what everybody else already knows.
- SCAMPER is a tool you can use to trigger new opportunities for your business.
- Use techniques to help you get into an innovative frame of mind. Read outside your area, invite a “wild card” to a business meeting, have a “scan the environment” day, arrange a mini-internship, solve your customer’s problem rather than selling a product, redesign your work environment to stimulate your innovative skills.
- The creative process has four stages: preparation, incubation, illumination, and verification.

**L04 Understand the five pitfalls that hinder innovation.**

- Identifying the wrong problem.
- Judging ideas and opportunities too soon.
- Stopping with the first good idea.
- Failing to get support.
- Obeying rules that don’t exist.

**L05 Identify strategies for innovation in your business.**

- There are three innovative strategies small business owners can select:
  - Imitative strategies take an idea that somebody else has already discovered and build a business around that idea.
  - Incremental strategies take an idea and offer a way to do something better than it is done now.
  - Radical innovation strategies reject existing ideas and present a way to do things differently.

**L06 Learn how to conduct a comprehensive feasibility study for your business ideas.**

- Conduct an analysis to determine whether or not your business idea is feasible.
- Describe your business idea concisely, including the experience you wish to sell to potential customers, as well as details about your product or service.
- List the unique benefits and limitations of your product or service, at what stage of development it is now (idea or prototype), any proprietary restrictions and obligations, insurance needs, product or service trends, and any production costs.

- Describe your industry, including its size and trends. Provide the market potential for your product or service, the strengths and weaknesses of your competition, who your customers are, what their needs and preferences are, and how they will find you.
- Compute financial projections. Provide sales revenues, cost forecasts, gross profits, operating expenses, and net profit.
- Write a future action plan. Determine the start-up capital you need and where you can raise it. Consider any further information you need, and begin writing a business plan. Decide where you can find additional support, such as from attorneys, accountants, and other business advisers.

### **L07 Understand the value of building a creative culture in your business.**

- Build a company culture that values new ideas and embraces change.
- Create slack time to enable employees to think of new ideas.
- Positively reinforce ideas others bring to you.
- Look to unlikely sources of opportunities.
- Get a room with a view and establish an environment that stimulates innovation.

## DISCUSSION QUESTIONS

1. How do entrepreneurs recognize new ideas for their business?
2. What are some common ways you can search for new business opportunities?
3. How can entrepreneurs evaluate the merit of a new idea?
4. How are creative methods for opportunity recognition different from traditional ways of searching for ideas?
5. What should you watch out for as you are searching for new opportunities?
6. What are the differences between imitation, incremental, and radical innovation strategies? How can you assess which one is right for your business?
7. What should a good feasibility study contain? What questions can it help you answer to determine if your business idea is a sound one?
8. How can entrepreneurs ensure that their business stays innovative and fresh? Why do you think some small businesses lose their creative edge as the business grows?

## EXPERIENTIAL EXERCISES

1. As you go on errands or walk around your campus, notice all the things that you could improve. Make a list of things that frustrate you or things that could be made even better. Does your list surprise you in terms of how much you noticed?
2. List 15 new uses for a popular product or service. Try paper clips, or coffee mugs, or home delivery. Use SCAMPER to generate new uses and make connections to other uses.

3. Interview a local business owner and ask how he or she thought of the idea behind the business. How does the business develop new ideas now?
4. Do some research on innovative companies in your area. What sets them apart? How are they designed to take advantage of the innovativeness of their staffs?
5. Next time you are working on a problem or looking for new ideas (your major in college? Where to move on campus? What do to this weekend? ), go to a museum, a park, or anywhere outside the ordinary places you frequent. Were any new ideas suggested to you?
6. Keep a journal in which you can record your ideas as they come. Sometimes we get breakthrough ideas while our brain is incubating as we sleep. By the time we wake up in the morning we have lost them, so keep your journal near your bed.
7. Pick a business idea and research its industry and market. What did you learn? What are some creative questions you might ask about contemporary trends in this business? How could you find out the answers?

## Mini-Case

### AltiTUNES: FROM IMITATION TO CONTINUOUS INNOVATION<sup>28</sup>

Amy Nye Wolf had completed a backpacking tour across Europe in the mid-1980s when she saw a store selling music at London's Heathrow Airport. Wolf recalled that she was tired of the music she had and was very happy to see it. She purchased some music, and returned to the States excited to have found the store. At that time retail outlets in American airports consisted of food service restaurants and newsstands.

It wasn't until five years later, after Wolf had completed college and worked as an investment banker for Merrill Lynch, that she decided to go into business for herself. She never forgot the music store at Heathrow, and Wolf founded AltiTunes Partners LP, now a chain of music stores with 28 locations. All but one are in airports (one is called Train Tunes, and it is located inside Grand Central Station in New York). AltiTUNES' five year mission is to become the leading brand for small format, extraordinary-location, music and electronics retailing with an expanding network of domestic and international locations.

Plans include at least 10 more airport locations. Over the next five years, AltiTUNES will expand to other extraordinary locations such as hospitals, hotels, and travel plazas. Its latest innovation is that shoppers can carry a PDA-sized device that lets them scan any CD they pick off the shelf and hear selections of music. The EARport™ is another innovation at AltiTUNES that features a series of interactive listening stations that are programmed to preview music and help customers decide on their music selections. The EARport features individual stations (which are each sponsored by a record label or distributor), as well as a top 100 station. All are equipped with headphones so as not to disturb other customers. Members of AltiTUNES's retail staff match the music they play to the audience, which varies at each specific location and at different times of the day. Amy Nye Wolf's success sprang from an idea she saw while traveling, and she found a way to take what somebody else had done and move it to the next level.

#### CASE DISCUSSION QUESTIONS

1. How did Amy Nye Wolf discover her business opportunity?
2. How did she evaluate whether it was a good opportunity or not?
3. What did she copy from the store in Heathrow?
4. What innovations did Wolf add to AltiTUNES to make her idea unique?
5. How do you think Wolf and her staff continue to identify new opportunities for AltiTUNES?

# A Sample Feasibility Study<sup>1</sup>

## PET ÉLAN

### I. DESCRIPTION OF YOUR BUSINESS

In recent years, there has been an increase in the number of households that have pets, especially dogs and cats. Further, there is emerging a steadily growing group of pet owners that is willing to purchase upscale, unique products for these important members of their family. Pet Élan is an upscale boutique for these discriminating pet owners. Pet Élan will offer high-quality pet products to discerning individuals who wish their pets to enjoy a healthy, fun, and elegant lifestyle while being pampered. By carefully selecting luxurious accessories made with superior materials, Pet Élan will provide an elite product line that celebrates the uniqueness of each animal's personality.

### II. THE PRODUCT/SERVICE

#### Unique Features: Benefits

Pet Élan will offer products that promote a healthy, fun, and elegant lifestyle for dogs and cats. Our products are grouped into three primary categories: dietary products, playtime products, and accessories.

#### Dietary Products

Pet Élan will offer all-natural pet food and treats, full of essential vitamins and nutrients to promote a healthy diet. We will carry two to three top-selling brands of organic pet food from the industry leaders such as Newman's Own Organics,<sup>2</sup> Natura Pet Products,<sup>3</sup> and Organix.<sup>4</sup> We will also feature snacks and treats from Old Mother Hubbard,<sup>5</sup> Three Dog Bakery,<sup>6</sup> Flint River Ranch,<sup>7</sup> and Howling Hound Bakery.<sup>8</sup>

#### Playtime Products

Playing with one's pet is also a key ingredient for a pet's healthy lifestyle. Pet Élan will offer products that enable owners and their pets to play in style. For dogs, we will offer toys for chewing, retrieving, tugging, and chasing. For cats, we will offer toys stuffed with premium grade catnip and other toys to chase and fetch. We will offer exclusive toy brands such as Happy Dog Toys,<sup>9</sup> KONG Toys,<sup>10</sup> and Fat Cat, Inc.<sup>11</sup>

#### Accessories

Pet Élan will make walking or traveling with a dog or cat an extension of the owner's unique style with leashes, collars, and travel bags that make a statement. We will also offer pet home accessories including food and water bowls, pet furniture and pillows, and pet clothing made from fine fabrics such as silk, suede, and faux fur.

Unlike other pet stores, Pet Élan will target clientele who demand top quality in pet couture. To fulfill this demand, Pet Élan will order pet clothing and accessories from the trendiest brands such as Woof: The Small Dog Company,<sup>12</sup> Dogz Togz,<sup>13</sup> and Ruff Ruff and Meow.<sup>14</sup>

#### Unique Features: Limitations

One of the largest threats to the luxury pet accessory industry is the presence of online stores. Pet Élan will compete with these online retailers, as well as other local pet stores. Consumers have the opportunity to comparison shop on the Internet, so Pet Élan will need to carefully determine the pricing strategy for each line of accessories to remain competitive. However, it is likely that pet owners will want to sample and view unique products we carry and will be willing to come to our store for its one-of-a-kind shopping experience—and bring their pets with them.

The rise of larger chain pet stores, like PETCO and PETsMART, has made it much easier for pet owners to satisfy all their pet needs in one place. These stores are now offering pet apparel, pet furniture, and natural pet food. Pet Élan will offer a higher quality, but more expensive, product mix that may overlap with these stores in some areas. To counter this, Pet Élan will showcase the products we carry that cannot be obtained at the larger retailers.

#### Competitive Advantage

Pet Élan's competitive advantage is quality and the ability to provide customers with the feeling that pampering their pets is an integral part of a healthy, fun, and contemporary lifestyle. Pet Élan must establish this reputation through *high quality products* and *selective advertising* and through *exceptional customer service*.

### Stage of Development

Pet Élan is currently in the idea stage. This feasibility study is the first step in exploring the market potential for a luxury pet store. The current time frame for introducing Pet Élan is one year. Pet Élan has set the following milestones to accomplish prior to launch:

- Complete feasibility study: month 1.
- Begin and complete business plan: months 2–4.
- Pursue start-up capital: months 5–6.
- Receive start-up capital: month 7.
- Identify store location and secure appropriate permits: months 7–8.
- Plan and order inventory: month 9.
- Receive inventory and set up store: months 10–11.
- Store launch: month 12.

### Legal Restrictions and Rights

Pet Élan will operate as a Sub-Chapter S Corporation to ensure limited personal liability and for tax advantages. Pet Élan will have one owner, who will have day-to-day responsibility for running the business. The corporation will receive all income generated by the business and pay the owner a salary and/or reinvest in the store. A board of directors will be appointed by the owner.

### Insurance Requirements

Although business insurance may not be *required*, Pet Élan will purchase insurance to protect the corporation's assets and to benefit employees:

- Property insurance will cover the business in the event of damage or loss to the business property. The insurance will need to cover the store location's fixtures, cash registers/computers and any other equipment, any store furniture such as display tables and shelving, as well as inventory and supplies.
- Liability insurance will protect the business against the unfortunate situation of a customer or employee being injured on the property and suing.<sup>15</sup>

As an employer, Pet Élan will also need to secure additional insurance for:

- **Workers' compensation insurance:** The Workers' Compensation and Workers' Occupational Diseases Acts require

employers to provide insurance for accidental deaths, injuries, and occupational diseases of employees arising in the course of employment. Temporary workers who normally do not receive company benefits are still provided workers' compensation. The Illinois Workers' Compensation Act requires all employers to post a notice in the workplace that explains workers' rights and lists the name and address of the workers' compensation carrier.

- **Unemployment insurance:** Since Pet Élan will most likely employ one or more workers in each of 20 or more calendar weeks, the business will be required to make unemployment insurance contributions to the Illinois Department of Employment Security.<sup>16</sup>

### Trends Related to the Product or Service

Several studies show that pet ownership is at an all-time high and that people are taking better care of their pets and spending more money on them than previously. Surveys conducted every two years by the American Pet Products Manufacturers Association, Inc. (APPMA) show that 63.4 million households have a pet, compared to 52.6 million households a decade ago.<sup>17</sup> Pet Élan will cater to the increasing number of customers that consider their pets a full-fledged member of the family.

#### **Trends in Customer Demographics**

The demographics of the typical customers of the pet industry have been shifting over recent years from married with children, to younger, cohabitating couples who are waiting longer for marriage, as well as married baby boomers looking to fill their empty nests, and single households composed of divorcees and seniors looking for companionship. In fact, only one-third of all pet owners today are married with children.<sup>18</sup>

#### **Trends in Pet Products**

The pet products industry is booming. The upscale pet services industry was named as a hot market by *Entrepreneur* magazine in its annual prediction of the hottest business ideas for both 2004 and 2005.<sup>19</sup> The APPMA also cites luxury, natural, and hygiene products as the top three amongst its top ten trends in pet gifts.<sup>20</sup> In fact, the APPMA further notes that high-tech and high-end products such as luxury doghouses are showing the most growth.<sup>21</sup>

Similar to the human food industry, pet food trends are moving toward more organic and natural products. The Organic Trade Association reported that organic pet food sales are up by 63 percent from last year and are growing at almost three times the rate of human organic food sales.<sup>22</sup>

### III. THE INDUSTRY AND MARKET

#### Current Industry

Americans spent a total of \$34.4 billion on pet food, care, and supplies in 2004, and the industry is estimated to increase to \$35.9 billion in 2005. Sixty-five percent of this estimated total was spent on food and supplies alone (*supplies also included medicine*).<sup>23</sup>

This growing industry is made up of a diverse customer base. Although families have been the traditional focal point of pet-related businesses, only one-third of all pet owners today are married with children.<sup>24</sup> Pet Élan plans to not only target this traditional market, but also to reach out to newer niche markets such as seniors, young unmarried, and middle-aged couples who are married but have no children.

Thirty-nine percent of Americans between the ages of 55 and 64 own a pet.<sup>25</sup> One of the largest percentages of pet owners is 18- to 34-year-old married Americans without children (52 percent). Of this group, 36 percent own a dog and 26 percent own a cat. In addition, this group is 33 percent more likely than the average American to own more than one pet.<sup>26</sup> Finally, 52 percent of married 35- and 54-year-olds without children have a pet and 31 percent have two or more.

#### Market Potential for This Industry

One out of three U.S. households owns a dog or cat,<sup>27</sup> and over 80 percent of pet owners purchased at least one accessory for their pet during the past year.<sup>28</sup> In 2003, MarketResearch.com predicted that the pet supplies industry would be an \$8 billion market by 2007.<sup>29</sup> Business Communications Co. projects that the pet services industry as a whole (including pet food, pet services, and pet supplies) will grow to \$36.3 billion by 2008.<sup>30</sup>

Despite this promising growth and if the economy continues to contract, customers may have less disposable income. The percentage they intended to spend on their cat or dog may be diverted for necessity purchases. However,

according to pet industry analyst Julia Dvorko, “Owners tend to pamper their pets even when they have to cut back on [household] spending. After all, even during economic downturns, people give gifts to family members and buy special treats for their children.”<sup>31</sup>

#### The Competition

Pet Élan plans to open in the 60657 zip code area of Chicago, Illinois, locally known as Lakeview. There are 22 pet-related businesses in this zip code: nine are veterinarians, three are pet sitting/walking services, three are pet grooming services, three large chain pet stores (one PETsMart, two PETCO), two combination pet grooming/accessories stores, a combination boarding/training store, a pet adoption/accessories store, and one boutique called “Sam & Willy’s: A Bow Meow Boutique.”

While not competing directly in the 60657 area code market, national companies including Paul Mitchell, Omaha Steaks, Origins, Harley Davidson, and Old Navy are now offering lines of pet products ranging from dog shampoo, pet attire, and name-brand toys to gourmet treats and food.<sup>32</sup> Although these companies have recognizable brand identities, they do not specialize in the pet retail market. They do not carry a full line of pet products as Pet Élan will, and they cater more to impulse buyers rather than discerning pet owners.

The following table compares the strengths and weaknesses of a subset of the competitor pet stores in the 60657 area code, as well as online retailers, and highlights the differentiating features of Pet Élan.

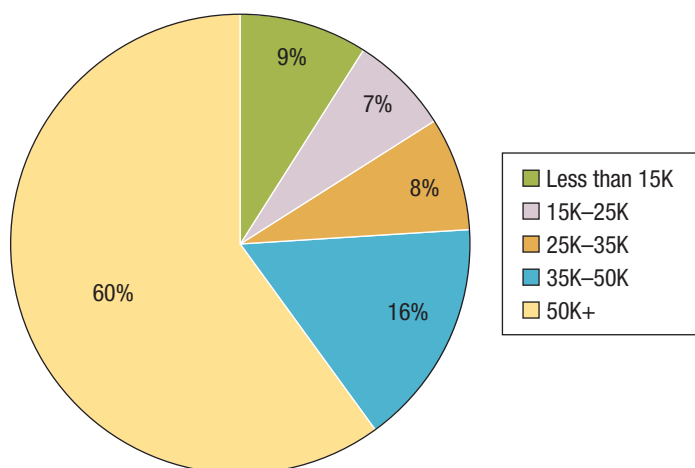
#### Customers

According to the APPMA, 62 percent of households in the United States own a pet, and 46 percent of households own more than one pet. Also, as mentioned earlier, dogs or cats are found in at least one out of three households (in the United States).<sup>33</sup> Data collected on dog owners show that they are likely to be married high school graduates who own their homes. As income increases, the percentage of households with a dog increases as well.<sup>34</sup> In fact, 75 percent of the households with dogs have a combined income of greater than \$35,000. This is consistent with the specific market profile of the clientele Pet Élan plans to target in the 60657 zip code.

## Competitive Analysis of Pet Stores

Competitor Pet Stores in Zip Code	Strengths	Weaknesses	Differentiating Features of Pet Élan
Area pet grooming/ accessories stores	<ul style="list-style-type: none"> <li>Customers whose pets are being groomed can browse while they wait for their pets</li> </ul>	<ul style="list-style-type: none"> <li>Limited selection</li> <li>Pet grooming is core competency, not selling accessories</li> </ul>	<ul style="list-style-type: none"> <li>Core competency and primary focus of store are on selecting and selling luxury pet products and accessories</li> </ul>
PETCO <sup>35</sup>	<ul style="list-style-type: none"> <li>Well-established brand identity</li> <li>All-in-one brick-and-mortar stores</li> <li>Wide selection of basic pet necessities</li> <li>Online shopping</li> </ul>	<ul style="list-style-type: none"> <li>Does not sell pet food because of high shipping costs</li> <li>Limited number of brands in pet clothing and accessories</li> <li>Inexperienced sales associates</li> </ul>	<ul style="list-style-type: none"> <li>Caters to discerning pet and owner tastes by providing high-end pet products and accessories</li> <li>Store owner builds personal relationships with customers based on knowledgeable service that focuses on their individual preferences and pet's personality</li> </ul>
PETsMart <sup>36</sup>	<ul style="list-style-type: none"> <li>Well-established brand identity</li> <li>All-in-one brick-and-mortar stores</li> <li>Wide selection of basic pet necessities</li> <li>Online shopping</li> </ul>	<ul style="list-style-type: none"> <li>Sells pet food online, but consumer faces high shipping costs</li> <li>More pet clothing and accessories brands than PETCO, but not high-end brands</li> <li>Inexperienced sales associates</li> </ul>	<ul style="list-style-type: none"> <li>Caters to discerning pet and owner tastes by providing high-end pet products and accessories</li> <li>Store owner builds personal relationships with customers based on knowledgeable service that focuses on their individual preferences and pet's personality</li> </ul>
Omaha Steaks <sup>37</sup>	<ul style="list-style-type: none"> <li>Customers may add on pet treats as an impulse when shopping for themselves or for gifts</li> </ul>	<ul style="list-style-type: none"> <li>Limited selection—only offers one variety of pet treats</li> </ul>	<ul style="list-style-type: none"> <li>Pet Élan will offer a wider variety of pet treats (all organic)</li> </ul>
Old Navy/Harley Davidson <sup>38</sup>	<ul style="list-style-type: none"> <li>Recognizable brand</li> <li>Can target impulse buyers who are making other purchases</li> </ul>	<ul style="list-style-type: none"> <li>Products are not currently available on Web site</li> <li>Very specific target audiences</li> </ul>	<ul style="list-style-type: none"> <li>Pet Élan will target customers that look for the latest pet couture by focusing on brands made exclusively for pets</li> </ul>
Sam & Willy's: A Bow Meow Boutique <sup>39</sup>	<ul style="list-style-type: none"> <li>Provides accessories and gifts to pets and their owners in a boutique setting</li> <li>Provides variety of organic pet food brands</li> </ul>	<ul style="list-style-type: none"> <li>Static Web site</li> <li>Sponsor local animal shelters but doesn't have social entrepreneurial mission</li> </ul>	<ul style="list-style-type: none"> <li>Web site will provide tips and trends for hip pet owners</li> <li>Five percent of pretax profits will go to a local no-kill animal shelter</li> </ul>

Household Income for Lakeview Residents



Seventy-six percent of Lakeview households have a combined income of \$35,000 or more (see chart).<sup>40</sup>

Additionally, 30 percent of Lakeview residents own their homes, and 94 percent of residents over age 25 are high school graduates. The average family size is 2.56 with 7,523 residents below the age of 16 and 7,706 senior residents (65+). The median household income is \$63,695.<sup>41</sup> Of the approximately 49,534 employed residents 16 years and older in the 60657 zip code area (as of the 2000 census), 64 percent are in “management, professional, and related occupations.”<sup>42</sup>

### Market Penetration

Pet Élan will serve customers in a boutique setting where pets are welcome to browse along with their owners. The store will operate with a social entrepreneurial mission and will donate 5 percent of pretax profits to a local no-kill animal shelter. Consistent with this socially responsible mission, Pet Élan will work with other area pet-related businesses to form a network of highly qualified veterinarians, as well as well-established boarding, grooming, in-home sitting, and training service providers. By connecting Pet Élan customers with reliable service providers, Pet Élan will also benefit from the reciprocal referrals from these service providers.

Pet Élan will also maintain a Web site, but initially only to provide the location and hours of operation. As the business grows, the Web site could include tips and trends information for current and future consumers to keep up with the latest in pet fashion accessories. Pet Élan will

seek assistance from a local college or Small Business Development Center for the Web site and market research assistance.

When the Pet Élan storefront opens, we plan to advertise by hosting a series of pet fashion shows, combined with an adoption event with local pet shelters. The events will raise awareness among clientele and would help a good cause. Until Pet Élan breaks even, the store will rely on the advertising and public relations from partnering with other service providers to draw customers into the store.

## IV. FINANCIAL PROJECTIONS

### Pricing

Pet Élan will price the merchandise it intends to sell using cost-plus pricing. The base cost will be the wholesale cost of the pet product, and the markup component will be the profit Pet Élan will make on each product. For purposes of this feasibility study, Pet Élan will assume a 54 percent margin on goods sold. Because Pet Élan will be selling luxury products and because the target clientele is customers with a large percentage of disposable income, we will work to maximize the profit from each item sold.

The store will also follow a price skimming strategy, meaning it will set relatively high prices on the newest luxury products when they are first released, and then lower the price over time. By maintaining a wide selection of the newest fashions and accessories for cats and dogs, Pet Élan will be able to charge a higher price for newly released items, reducing prices as the trend becomes more mainstream.

The social entrepreneurial mission is to donate 5 percent of pretax profits to a local no-kill animal shelter, and this amount will be donated quarterly based on pretax profits from that quarter. Pet Élan made the following assumptions in putting together the sales revenue forecast for the first three years of operations:

- Pet Élan will sign a three-year rental agreement for a 2,000 square-foot storefront location. The rental property will be priced at \$35 per square foot, with an additional real estate tax of \$9.50 per square foot per annum.
- Pet Élan will be open for business six days a week (Monday through Saturday) from ten o'clock in the morning until seven o'clock in the evening. The store will be closed on Sunday.
- It is estimated that the average Pet Élan customer will spend \$18 per visit and will visit the store, on average, two times per month.
- Pet Élan will contribute 5 percent of pretax profits to a local no-kill animal shelter on a quarterly basis. This contribution has been accounted for in the pretax net profit (loss) forecast.

Based on these assumptions and a break-even analysis, Pet Élan's break-even sales will be \$263,699, or \$21,975 per month. This was calculated by determining the total fixed costs in the first year and by dividing it by a gross margin expressed as a percentage of sales.

### Sales Revenue Forecast

Pet Élan forecasts gross revenues during year one of operations to be \$296,740. The gross revenues for year two and year three are predicted to increase to \$404,448 and \$458,304, respectively.

### Cost Forecast

Pet Élan will maintain an inventory of products in each of the three primary areas of focus mentioned earlier: dietary products, playtime products, and accessories. As products are purchased, Pet Élan will reorder monthly to maintain a sufficient inventory to serve its customers' needs. Pet Élan has estimated that initial inventory will cost \$20,000. The wholesale cost of inventory for the first year is estimated to be \$147,000. As the customer base grows, Pet Élan will need to have a significantly higher amount of inventory

on hand to support increased demand. The future cost of inventory is forecast to be \$186,880 for year two and \$211,730 for year three.

### Gross Margin

The gross margin (sales minus cost of goods sold) for Pet Élan during the first three years of operation is estimated to be \$159,620, \$217,568, and \$246,574 respectively.

### Operating Expenses

There are several operational costs associated with running a pet store like Pet Élan, and these are also accounted for in the budget forecast for the first three years of operation. These operational expenses include items such as rent, utilities, advertising costs, and professional services assistance. These operational costs are summarized in total operating expenses and are forecast to be \$147,907 for year one, \$190,881 for year two, and \$201,744 for year three.

The owner will be the primary employee of Pet Élan for the first three months of operation. Beginning in the fourth month of operation, Pet Élan will hire one full-time sales associate. As the business grows, Pet Élan anticipates hiring a second full-time sales associate during the second year of operation. The full-time sales associates will assist the owner with customer service and other retail functions. Pet Élan will pay the sales associate approximately \$12.25 per hour (or \$25,500 per year) for the work.<sup>43</sup>

### Profitability

The expected net profit of Pet Élan for the first year of operation is \$10,660. This profit is expected to grow significantly in the future two years as some of the initial start-up costs are defrayed and the customer base becomes larger. In year two the net profit is forecast to be \$25,345, and in year three it is estimated to be \$42,589.

## V. FUTURE ACTION PLAN

### Start-up Capital

To start the business, Pet Élan will need to have enough start-up capital to cover leasing costs to secure the storefront location. The start-up capital will also need to cover insurance and operating expenses including appropriate licensing, store utilities, and professional services such as legal and accounting assistance. Initial inventory,

as well as retail equipment needs (such as a cash register) will require a large initial investment. These needs will be funded through the start-up capital that Pet Élan secures prior to opening. The amount needed is estimated to be \$70,000.

### **Sources of Start-up Capital**

The start-up capital of \$70,000 is composed of 45 percent (or \$31,500) of the owner's personal savings, 25 percent (or \$17,500) of a bank loan, in addition to two equity investors (one family member of the owner and one local veterinarian), each with a 15 percent stake (or \$10,500) in the company.

### **Further Information Needed**

To ensure the successful opening of Pet Élan, we must have a deeper understanding of the customer needs in the area. Conducting market research in the 60657 zip code area, using techniques such as surveys and/or focus groups of customers in Pet Élan's target market, could assess these needs. Pet Élan should also begin to approach other pet service providers in the area to explore potential partnership opportunities that could help raise awareness about both Pet Élan and the partnering business. This would also allow the owner of Pet

Élan to form a network within the local pet products and services industry.

### **Writing a Business Plan**

Pet Élan's next step is to create a business plan to further explore the business model of Pet Élan from an objective point of view. By identifying strengths and weaknesses, opportunities and threats for Pet Élan as compared to other market competitors, the company will have a much better chance of reaching the business and financial objectives outlined in this feasibility study. The business plan will also provide vital information about the business to potential investors and allow them to evaluate the viability of Pet Élan's business model.

### **Support Needed**

Pet Élan will seek guidance from a local Small Business Development Center. Pet Élan will review the initial draft of the business plan with a volunteer from the Service Corps of Retired Executives (SCORE), which is associated with the Small Business Association, to learn from his or her experience. Pet Élan will also form an advisory board made up of small business owners and members of the pet retail industry.

**FINANCIALS—SUMMARY**

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
<b>Revenue</b>	\$296,740	\$404,448	\$458,304
<b>Cost of Goods Sold</b>	137,120	186,880	211,730
<b>Gross margin</b>	<u>159,620</u>	<u>217,568</u>	<u>246,574</u>
<b>Operating expenses</b>	<u>\$147,907</u>	<u>\$190,881</u>	<u>\$201,744</u>
<b>Net profit (loss) pretax</b>	\$ 11,713	\$ 26,687	\$ 44,830
<b>Net profit (loss) pretax and post contribution (5%)</b>	<u><u>\$ 10,660</u></u>	<u><u>\$ 25,345</u></u>	<u><u>\$ 42,589</u></u>

## FINANCIALS—YEAR 1

	Month 1 September	Month 2 October	Month 3 November	Month 4 December	Month 5 January	Month 6 February
<b>Sales</b>	<b>\$11,620</b>	<b>\$16,900</b>	<b>\$20,060</b>	<b>\$27,460</b>	<b>\$20,060</b>	<b>\$21,120</b>
Less Cost of Goods Sold	\$ 5,370	\$ 7,810	\$ 9,270	\$12,690	\$ 9,270	\$ 9,760
<b>Gross Margin</b>	<b>\$ 6,250</b>	<b>\$ 9,090</b>	<b>\$10,790</b>	<b>\$14,770</b>	<b>\$10,790</b>	<b>\$11,360</b>
<b>Operating Expenses</b>						
Utilities	185	160	165	180	200	200
Salaries	2,500	2,500	2,500	2,500	2,500	2,500
Labor	—	—	—	2,125	2,125	2,125
Payroll Taxes and Benefits	313	313	313	578	578	578
Advertising	300	300	300	300	300	300
Website	20	20	20	20	20	20
Office Supplies	150	75	50	50	50	50
Insurance	250	250	250	400	400	400
Maintenance and Cleaning	50	50	50	50	50	50
Legal and Accounting	350	350	350	350	350	350
Licenses	300	—	—	—	—	—
Bags, Paper, etc.	150	150	200	250	250	250
Telephone	85	85	85	85	85	85
Miscellaneous	200	200	200	200	200	200
Rent	5,833	5,833	5,833	5,833	5,833	5,833
<b>Total Operating Expenses (Fixed Costs):</b>	<b>10,686</b>	<b>10,286</b>	<b>10,316</b>	<b>12,921</b>	<b>12,941</b>	<b>12,941</b>
<b>Gross Profit (Loss)</b>	<b>(4,436)</b>	<b>(1,196)</b>	<b>475</b>	<b>1,849</b>	<b>(2,151)</b>	<b>(1,581)</b>
<i>Contribution to Charity (5% of net):</i>	—	—	24	92	—	—
<b>Net Profit (Loss) Pre-Tax:</b>	<b>(4,436)</b>	<b>(1,196)</b>	<b>451</b>	<b>1,756</b>	<b>(2,151)</b>	<b>(1,581)</b>
<b>First year fixed costs (FC)</b>			\$ 147,910			
<b>Contribution Margin Ratio (CMR) ((sales - cogs)/sales)</b>			53.8%			
<b>Annual breakeven sales (FC / CMR)</b>			\$ 274,970			
<b>Average monthly breakeven sales</b>			\$ 22,910			

Month 7 March	Month 8 April	Month 9 May	Month 10 June	Month 11 July	Month 12 August	Total
\$ 24,290	\$ 26,400	\$ 28,510	\$ 31,680	\$ 35,900	\$ 32,740	\$ 296,740
\$11,220	\$12,200	\$13,170	\$14,640	\$16,590	\$15,130	\$137,120
\$13,070	\$14,200	\$15,340	\$17,040	\$19,310	\$17,610	\$159,620
180	170	165	185	185	185	2,160
2,500	2,500	2,500	2,500	2,500	2,500	30,000
2,125	2,125	2,125	2,125	2,125	2,125	19,125
578	578	578	578	578	578	6,141
300	300	300	300	300	300	3,600
20	20	20	20	20	20	240
50	50	50	50	50	50	725
400	400	400	400	400	400	4,350
50	50	50	50	50	50	600
350	350	350	350	350	350	4,200
—	—	—	—	—	—	300
300	300	300	300	300	300	3,050
85	85	85	85	85	85	1,020
200	200	200	200	200	200	2,400
5,833	5,833	5,833	5,833	5,833	5,833	69,996
12,971	12,961	12,956	12,976	12,976	12,976	147,907
99	1,239	2,384	4,064	6,334	4,634	11,713
5	62	119	203	317	232	1,054
94	1,177	2,265	3,861	6,017	4,402	\$ 10,660

### FINANCIALS—YEAR 2

	September	October	November	December	January	February
<b>Sales:</b>	<b>\$31,680</b>	<b>\$33,790</b>	<b>\$35,900</b>	<b>\$35,900</b>	<b>\$29,570</b>	<b>\$32,740</b>
Less Cost of Goods Sold	\$14,640	\$15,610	\$16,590	\$16,590	\$13,660	\$15,130
<b>Gross Margin</b>	<b>\$17,040</b>	<b>\$18,180</b>	<b>\$19,310</b>	<b>\$19,310</b>	<b>\$15,910</b>	<b>\$17,610</b>
<b>Operating Expenses</b>						
Utilities	195	170	175	190	210	210
Salaries	2,500	2,500	2,500	2,500	2,500	2,500
Labor	4,250	4,250	4,250	4,250	4,250	4,250
Payroll Taxes and Benefits	844	844	844	844	844	844
Advertising	400	400	400	400	400	400
Website	30	30	30	30	30	30
Office Supplies	100	100	100	100	100	100
Insurance	550	550	550	550	550	550
Maintenance and Cleaning	60	60	60	60	60	60
Legal and Accounting	400	400	400	400	400	400
Licenses	300	—	—	—	—	—
Bags, Paper, etc.	400	400	400	400	400	400
Telephone	100	100	100	100	100	100
Miscellaneous	225	225	225	225	225	225
Rent	5,833	5,833	5,833	5,833	5,833	5,833
<b>Total Operating Expenses:</b>	<b>16,187</b>	<b>15,862</b>	<b>15,867</b>	<b>15,882</b>	<b>15,902</b>	<b>15,902</b>
<b>Gross Profit (Loss)</b>	<b>853</b>	<b>2,318</b>	<b>3,443</b>	<b>3,428</b>	<b>8</b>	<b>1,708</b>
<b>Contribution to Charity (5% of net):</b>	<b>43</b>	<b>116</b>	<b>172</b>	<b>171</b>	<b>0</b>	<b>85</b>
<b>Net Profit (Loss) Pre-Tax:</b>	<b>811</b>	<b>2,202</b>	<b>3,271</b>	<b>3,257</b>	<b>8</b>	<b>1,623</b>

March	April	May	June	July	August	Total
\$31,680	\$32,740	\$34,850	\$35,900	\$33,790	\$35,900	\$404,448
\$14,640	\$15,130	\$16,100	\$16,590	\$15,610	\$16,590	\$186,880
<b>\$17,040</b>	<b>\$17,610</b>	<b>\$18,750</b>	<b>\$19,310</b>	<b>\$18,180</b>	<b>\$19,310</b>	<b>\$217,568</b>
190	180	175	195	195	195	2,280
2,500	2,500	2,500	2,500	2,500	2,500	30,000
4,250	4,250	4,250	4,250	4,250	4,250	51,000
844	844	844	844	844	844	10,125
400	400	400	400	400	400	4,800
30	30	30	30	30	30	360
100	100	100	100	100	100	1,200
550	550	550	550	550	550	6,600
60	60	60	60	60	60	720
400	400	400	400	400	400	4,800
—	—	—	—	—	—	300
400	400	400	400	400	400	4,800
100	100	100	100	100	100	1,200
225	225	225	225	225	225	2,700
5,833	5,833	5,833	5,833	5,833	5,833	69,996
<b>15,882</b>	<b>15,872</b>	<b>15,867</b>	<b>15,887</b>	<b>15,887</b>	<b>15,887</b>	<b>190,881</b>
<b>1,158</b>	<b>1,738</b>	<b>2,883</b>	<b>3,423</b>	<b>2,293</b>	<b>3,423</b>	<b>26,687</b>
58	87	144	171	115	171	1,334
<b>1,100</b>	<b>1,651</b>	<b>2,739</b>	<b>3,252</b>	<b>2,179</b>	<b>3,252</b>	<b>\$ 25,345</b>

## FINANCIALS—YEAR 3

	September	October	November	December	January	February
<b>Total Sales:</b>	<b>\$35,904</b>	<b>\$33,792</b>	<b>\$38,016</b>	<b>\$42,240</b>	<b>\$33,792</b>	<b>\$35,904</b>
Cost of Goods Sold:	\$16,590	\$15,610	\$17,560	\$19,510	\$15,610	\$16,590
<b>Gross Margin</b>	<b>\$19,314</b>	<b>\$18,182</b>	<b>\$20,456</b>	<b>\$22,730</b>	<b>\$18,182</b>	<b>\$19,314</b>
<b>Operating Expenses</b>						
Utilities	205	180	185	200	220	220
Salaries	2,750	2,750	2,750	2,750	2,750	2,750
Variable Labor	4,674	4,674	4,674	4,674	4,674	4,674
Payroll Taxes and Benefits	928	928	928	928	928	928
Advertising	400	400	400	400	400	400
Website	32	32	32	32	32	32
Office Supplies	120	120	120	120	120	120
Insurance	570	570	570	570	570	570
Maintenance and Cleaning	70	70	70	70	70	70
Legal and Accounting	440	440	440	440	440	440
Licenses	300	—	—	—	—	—
Bags, Paper, etc.	420	420	420	420	420	420
Telephone	125	125	125	125	125	125
Miscellaneous	225	225	225	225	225	225
Rent	5,833	5,833	5,833	5,833	5,833	5,833
<b>Total Operating Expenses:</b>	<b>17,092</b>	<b>16,767</b>	<b>16,772</b>	<b>16,787</b>	<b>16,807</b>	<b>16,807</b>
<b>Net Profit (Loss) Pre-Tax:</b>	<b>2,222</b>	<b>1,415</b>	<b>3,684</b>	<b>5,943</b>	<b>1,375</b>	<b>2,507</b>
Contribution (5%)	111	71	184	297	69	125
<b>Final Net Profit (Loss) Pre-Tax:</b>	<b>2,111</b>	<b>1,344</b>	<b>3,500</b>	<b>5,646</b>	<b>1,306</b>	<b>2,382</b>

March	April	May	June	July	August	Total
\$38,016	\$40,128	\$40,128	\$40,128	\$40,128	\$40,128	\$458,304
\$17,560	\$18,540	\$18,540	\$18,540	\$18,540	\$18,540	\$211,730
\$20,456	\$21,588	\$21,588	\$21,588	\$21,588	\$21,588	\$246,574
200	190	185	205	205	205	2,400
2,750	2,750	2,750	2,750	2,750	2,750	33,000
4,674	4,674	4,674	4,674	4,674	4,674	56,088
928	928	928	928	928	928	11,136
400	400	400	400	400	400	4,800
32	32	32	32	32	32	384
120	120	120	120	120	120	1,440
570	570	570	570	570	570	6,840
70	70	70	70	70	70	840
440	440	440	440	440	440	5,280
—	—	—	—	—	—	300
420	420	420	420	420	420	5,040
125	125	125	125	125	125	1,500
225	225	225	225	225	225	2,700
5,833	5,833	5,833	5,833	5,833	5,833	69,996
16,787	16,777	16,772	16,792	16,792	16,792	201,744
3,669	4,811	4,816	4,796	4,796	4,796	44,830
183	241	241	240	240	240	2,242
3,486	4,570	4,575	4,556	4,556	4,556	\$ 42,589

## INITIAL CALCULATIONS

### Cost Assumptions First Year of Operations

Fixed Costs (FC)	Monthly	Annually
Lease payment (\$35 / sq. foot)	\$ 5,833	\$ 70,000
Utilities	200	2,400
Insurance	833	10,000
Salary of Owner	2,500	30,000
Salary of Sales Assistant	2,125	25,500
Advertising	200	2,400
General supplies	300	3,600
Professional Services	667	8,000
Miscellaneous Expenses	417	5,000
Website	20	240
<b>Total</b>	<u>13,095</u>	<u>157,140</u>
Variable Costs (VC)	Monthly	Annually
Cost of Goods Sold	11,427	137,120
<b>Total</b>	<u>28,250</u>	<u>339,000</u>
Break-Even Amount	Monthly	Annually
Contribution margin ratio (CMR)	53.8%	53.8%
Breakeven (FC \ CMR)	\$ 24,340	\$292,082
	<b>Daily</b>	<b>Monthly</b>
Breakeven number of customers	45	1,352
Assumptions:		
Rental location will be 2,000 square feet		
Average customer spends \$18 per visit and comes to the store on average twice per month.		
One Time Startup Costs		
Licensing & permits	\$ 300	
Decorating	\$ 800	
Signage	\$ 5,000	
Beginning Inventory	\$40,000	
Fixtures and Equipment	\$ 6,000	
Professional fees (accountant, attorney)	<u>\$ 5,000</u>	
<b>Total</b>	<u>\$57,100</u>	

