



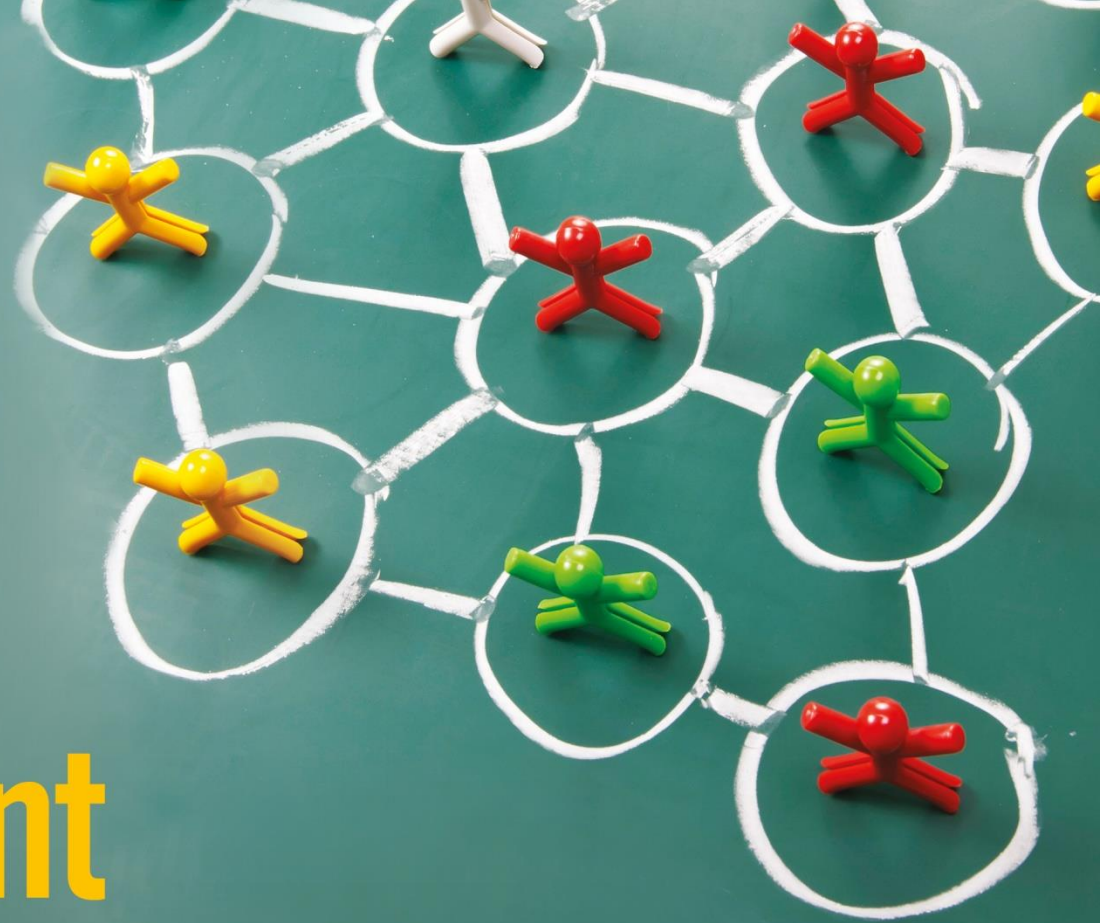
# Definitions p18

1. Define: Command economy (Communism)
2. Define: Competition
3. Provide term for: Recognises corporations as legal persons with certain rights and responsibilities in the same way that individual citizens have rights and responsibilities as members of the community. As a legal entity, a corporation has certain rights and is bound by responsibilities.
4. Define: Corporate entrepreneurship / Intrapreneurship
5. Provide term for: A company's commitment to invest pre-tax profits in community-based projects, it does not refer to a company's contribution to society through its core business activities or local business development.

Introduction to  
**Business  
Management**

9<sup>TH</sup> EDITION

CHAPTER 3  
ESTABLISHING A BUSINESS





# Chapter content

- Introduction
- The legal form of ownership
- Developing a business plan for the new business
- The location of the business
- Summary



# Introduction

- Different forms of enterprise available to the entrepreneur outlined
- Factors in selecting appropriate form of enterprise
- Characteristics of enterprises discussed, as well as advantages and disadvantages
- Entrepreneurs who are aware of options can make informed decisions
- Basic content of business plans
- Location factors of a business



# The legal form of ownership

- Considerations in choosing a form of enterprise:
  - Legal (or juristic) personality
  - Limited Liability
  - Degree of control or management authority
  - Potential for capital acquisition
  - Compliance with legal formalities and regulations
  - Taxation
  - Transferability of interests.



# The sole proprietorship

## Advantages

- Simple to create
- Least expensive way to start a business
- Owner has total decision-making authority
- No special legal restrictions
- Easy to discontinue

## Disadvantages

- Owner is personally liable
- Limited diversity in skills and capabilities is available
- Owner has limited access to capital
- Lack of continuity



# The partnership

## Advantages

- Ease of formation
- Diversification of skills and abilities of partners
- Legal and natural persons may be partners
- Increased opportunity for accumulation of capital
- Minimal legal formalities and regulation

## Disadvantages

- Personal liability of partners
- Relative difficulty in disposing an interest in the partnership
- Potential for conflict between partners
- Lack of continuity



# The partnership

- How partnerships are affected in terms of the Companies Act (No. 71 of 2008)
  - Previously only 20 members allowed
  - Companies Act changed this number to unlimited number of members
  - Greater number of partners could hold greater risk of personal liability





# The close corporation

## Advantages

- Separate legal personality
- Limited liability of the members
- Increased capital-acquisition potential
- Management is relatively simple
- Continuity

## Disadvantages

- Membership is limited to ten
- Juristic persons may not be members
- No new close corporations may be registered
- Could be subject to stricter accountability under Companies Regulations, 2011



# The close corporation

- How CCs are affected in terms of the Companies Act (No. 71 of 2008)
  - No longer possible to register new close corporations
  - Companies may no longer convert to close corporations
  - Certain close corporations must comply with stricter legal requirements
  - Identical regulation requirements apply to close corporations and private companies
  - Close corporations must now adhere to Close Corporations Act and Companies Act



# The company

## Advantages

- Legal/natural persons shareholders/members
- No restrictions on number of shareholders
- Limited liability
- Ability to raise large amounts of capital
- Separate ownership and control
- Continuity and transferability of shares

## Disadvantages

- High degree of legal regulation
- High operational costs



# Differences between public company and private company

- Differences in the number of members required and allowed
- Differences in director number requirements
- Differences in transferability of shares
- General public can not subscribe to the shares of a private company
- (Pty) Ltd versus Ltd
- Private company not as strictly controlled as public company in terms of legal regulations



# The company

- How companies are affected in terms of the Companies Act (No. 71 of 2008)
  - Simplified registration procedure
  - Classification of companies will change to 2 types: profit and non-profit companies
  - Stricter requirements for public companies
  - Corporate governance
  - Board of Directors to have more decision making power



# The business trust

- Becoming increasingly popular
- Established out of an ordinary trust
- Has objective of conducting business for profit
- Is not a juristic person
- Regarded as a separate tax payer
- Income tax on income according to the conduit principle
- Transfer of the interest of a beneficiary done by a variation of the trust deed



# The business trust

## Advantages

- Ease of formation
- Natural and legal persons are parties to a trust
- Limited liability
- Extreme flexibility
- Absence of legal regulation
- Continuity

## Disadvantages

- Limited access to capital
- Potential for conflict between parties



# The business trust


- How trusts are affected in terms of the Companies Act (No. 71 of 2008)
  - Define business trust under juristic persons
  - Unclear why this decision was made





# The objectives of a business plan

1. Most important objective is to identify and describe the nature of the new business opportunity or venture
2. Second objective is to present a written plan of how the entrepreneur plans to exploit the opportunity
3. A third objective of the business plan is to attract investors, or to persuade a bank or other institution or person who provides financial resources, to lend the entrepreneur the money he/she needs to establish the new business



# Importance and necessity of the business plan

- To sell the business to yourself – you need to convince yourself that starting the business is right
- To obtain bank financing
- To obtain investment funds
- To arrange strategic alliances
- To obtain large contracts
- To attract key employees
- To complete mergers and acquisitions
- To motivate and focus the management team



# Stakeholders in a business plan

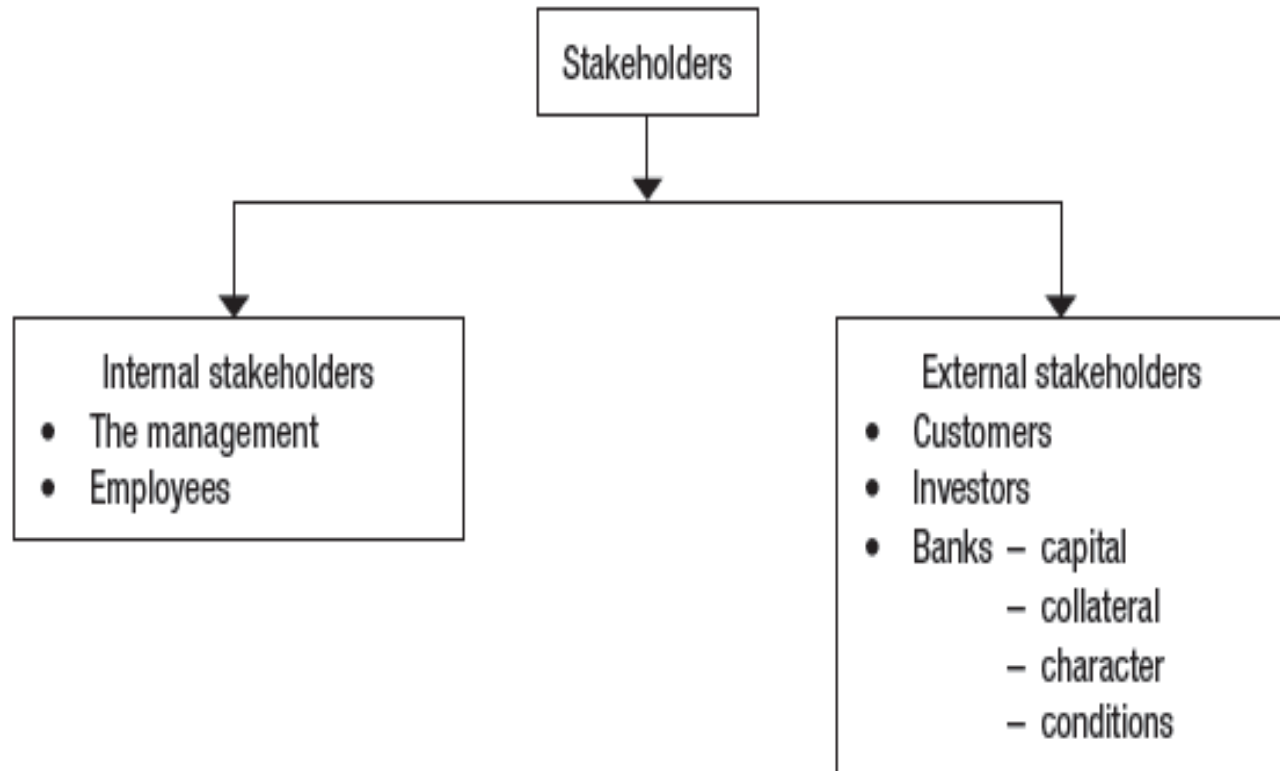
## Internal stakeholders

- Management team
- Employees

## External stakeholders

- Customers
- Investors
- Banks (four Cs of loan application evaluation)

# Stakeholders in a business plan



**Figure 3.1:** Stakeholders in a business plan

# Matrix for evaluation of business plans

<p>High</p> <p style="text-align: center;">↑</p> <p style="text-align: center;">RETURN ON INVESTMENT</p> <p style="text-align: center;">↓</p>	<ul style="list-style-type: none"> <li>• Product or service fully developed</li> <li>• Some markets established</li> <li>• Acceptance by users</li> <li>• Acceptable level of own equity</li> <li>• Patent protection</li> <li>• Experienced management team</li> </ul>	<ul style="list-style-type: none"> <li>• Product or service fully developed</li> <li>• High sales in some markets</li> <li>• Acceptance by users</li> <li>• High level of borrowed funds</li> <li>• Financial projections out of line with industry</li> <li>• Management team without track record</li> </ul>
<p>Low</p>	<ul style="list-style-type: none"> <li>• Product or service idea only</li> <li>• Acceptance not tested</li> <li>• Markets assumed</li> <li>• Patent protection</li> <li>• Acceptable track record of entrepreneur and team</li> </ul>	<ul style="list-style-type: none"> <li>• Product or service idea only</li> <li>• Acceptance not tested</li> <li>• Markets assumed</li> <li>• Market projections out of touch with reality</li> <li>• Single entrepreneur without track record</li> </ul>

**Figure 3.2:** Matrix for the evaluation of business plans



# The scope of the business plan

- How much planning is needed?
- Consider the following:
  - Style and ability of the entrepreneur
  - Preferences of management team
  - Complexity of the product or service being offered
  - The competitive environment
  - The level of uncertainty in business environment



# The format of the business plan

- Determine who should write the plan
- Identify the necessary skills to write the plan
- There are no rigid rules regarding the format of the business plan
- Appearance is important
- Length depends on the type of business and can vary from 5 to 20 pages



# The content of the business plan

- The executive summary
- The general description of the venture
- The products-and-services plan
- The marketing plan
- The management plan
- The operating plan
- The financial plan
- The supporting materials





# Overview of a business plan


**Table 3.2:** Overview of a business plan

Executive summary	A one- to three-page overview of the total business plan. Written after the other sections are completed, it highlights their significant points and, ideally, creates enough excitement to motivate the reader to read on.
General company description	Explains the type of company and gives its history if it already exists. Says whether it is a manufacturing, retail, service or other type of business. Shows the type of legal organisation.
Products-and-services plan	Describes the product and/or service and points out any unique features. Explains why people will buy the product or service.
Marketing plan	Shows who will be the business's customers and what type of competition the business will face. Outlines the marketing strategy and specifies what will give the business a competitive edge.
Management plan	Identifies the 'key players': the active investors, management team and directors. Cites the experience and competence they possess.
Operating plan	Explains the type of manufacturing or operating system the business will use. Describes the facilities, labour, raw materials and processing requirements.
Financial plan	Specifies financial needs and contemplated sources of financing. Presents projections of revenues, costs and profits.

# Outline of a simple business plan

**Table 3.3:** Outline of a simple business plan

General company description	<ul style="list-style-type: none"><li>• Name and location</li><li>• Nature and primary product or service of the business</li><li>• Current status (start-up, buy-out or expansion) and history (if applicable)</li><li>• Legal form of organisation</li></ul>
Products and/or services	<ul style="list-style-type: none"><li>• Description of products and/or services</li><li>• Superior features or advantages relative to competing products or services</li><li>• Any available legal protection, for example, patents, copyrights or trademarks</li><li>• Dangers of technical or style obsolescence</li></ul>
Marketing plan	<ul style="list-style-type: none"><li>• Analysis of target market and profile of target customer</li><li>• How customers will be identified and attracted</li><li>• Selling approach, type of sales force and distribution channels</li><li>• Types of sales promotion and advertising</li><li>• Credit and pricing policies</li></ul>
Management plan	<ul style="list-style-type: none"><li>• Management-team members and their qualifications</li><li>• Other investors and/or directors and their qualifications</li><li>• Outside resource people and their qualifications</li><li>• Plans for recruiting and training employees</li></ul>
Operating plan	<ul style="list-style-type: none"><li>• Operating or manufacturing methods used to produce the product or service</li><li>• Description of operating facilities (location, space and equipment)</li><li>• Quality-control methods to be used</li><li>• Procedures used to control inventory and operations</li><li>• Sources of supply and purchasing procedures</li></ul>
Financial plan	<ul style="list-style-type: none"><li>• Revenue projections for three years</li><li>• Expense projections for three years</li><li>• Necessary financial resources</li><li>• Sources of financing</li></ul>



# A general description of the new venture

- Some important questions to address:
  - What is the mission statement?
  - What type of business is it?
  - What is the primary product or service?
  - What customers are served?
  - In what industry do they operate?
  - What is the current and predicted state of the particular industry?
  - What are its objectives?
  - What are the distinctive competencies?



# Determining the financial needs of the new venture

- Essential that the entrepreneur understands financial statements and how to interpret them
- Entrepreneur must understand how profitability is assessed
- Entrepreneur must have the ability to determine the venture's financial requirements



# Location factors

- Sources of raw materials
- Availability of labour
- Proximity of, and access to, the market
- Availability and cost of transport facilities
- Availability and costs of power and water
- Availability and costs of a site and buildings
- Availability of capital
- Attitude, regulations and tariffs of local authorities
- The existing business environment



# Location factors (continued)

- The social environment
- Climate
- Central government policy
- Personal preference



# Summary

- Legal forms of business
- Characteristics, advantages and disadvantages of different types of entities
- Development of a business plan for new venture
- Location factors



# Activities

1. Create a matrix with the following:
  - Columns with each business form
  - Rows with all elements that distinguish various business forms from each other.
  - Clear explanation of each suitable to use as study material for exams.
2. Review elements of a business plan.
3. Prepare definitions - p 19