

## Section 6.1

## Entrepreneurs in a Free Enterprise System

**Essential  
Question**

What are common elements of success in new businesses?

**Objectives**

After completing this section, you will be able to:

- **Describe** common skills and traits of successful entrepreneurs.
- **Explain** the criteria to qualify as a small business.
- **Identify** sources of professional advice for entrepreneurs.
- **List** common reasons that new businesses fail.

**Section 6.1 Review****Check Your Understanding**

1. How does the US Small Business Administration define *entrepreneur*?

**Answer:** According to the US Small Business Administration, an entrepreneur is “a person who organizes and manages a business undertaking, assuming the risk for the sake of profit.”

2. What are the five Ps of entrepreneurship?

**Answer:** The five Ps of entrepreneurship are five qualities of successful entrepreneurial ventures, which include purpose, passion, persistence, people, and profit.

3. How does the US Small Business Administration define small business in most industries?

**Answer:** For most industries, a small business is defined either in terms of the average number of employees over the past 12 months or average annual receipts over the past three years.

4. Identify three resources an entrepreneur can use for business advice.

**Answer:** Entrepreneurs can turn to mentors, the US Small Business Administration, and the Service Corps of Retired Executives for advice.

5. List some reasons that many new businesses fail.

**Answer:** Some common reasons for the failure of new businesses include (any five) lack of money, lack of business experience, poor management skills, inefficient inventory control, poor credit management, bad location, improper budgeting, and lack of advertising.

## Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

trait

**Answer:** Distinguishing characteristic or quality that makes each person unique.

leadership

**Answer:** Ability to influence others to reach a goal.

job-specific skills

**Answer:** Critical skills necessary to perform the required work-related tasks of a position.

transferable skills

**Answer:** Skills gained through life experience or working on a job that help an individual perform in the workplace or gain success in a career. Also known as *foundation skills*.

planning

**Answer:** Process of setting goals and deciding how to accomplish them.

mentor

**Answer:** Someone with experience who can provide advice, suggestions, and ideas.

## Section 6.2

# Business Planning



Why is planning important for any business venture?

### Objectives

After completing this section, you will be able to:

- **Discuss** the process of developing an idea for a business.
- **Describe** the components of a business plan.
- **Explain** the types of financing available for new businesses.

## Section 6.2 Review

### Check Your Understanding

1. Why is it important for entrepreneurs to know their market?

**Answer:** Knowing the market allows an entrepreneur to focus on the most effective way to develop, advertise, and deliver a product.

2. What is an advantage of buying a franchise?

Answer: The franchisee gets a proven business system and a business name that is already known in the market.

3. Identify the sections of a business plan.

Answer: In general, a business plan includes an executive summary, company description, market analysis, organization and management, service or product line, marketing and sales, funding request, financial projections, and an appendix.

4. List the three financial statements that should be included in the financial plans section of a business plan.

Answer: The three financial statements that should be included are a pro forma balance sheet, a pro forma income statement, and a pro forma cash flow statement.

5. Name two sources of equity financing.

Answer: Two sources of equity financing are venture capitalists and angel investors.

## Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

market research

Answer: Gathering and analyzing information about a business.

market

Answer: All the people and organizations that might purchase a product.

cash flow

Answer: Movement of money into and out of a business.

business plan

Answer: Written statement of goals and objectives for a business with a strategy to achieve them.

mission statement

Answer: Sentence in a business plan that describes the purpose of the business.

start-up capital

Answer: Money necessary to start and open a business; also called *seed capital*.

pro forma financial statements

Answer: Financial statements based on estimates of future business performance, sales, and expenses.

pro forma balance sheet

Answer: Financial statement that reports the assets, liabilities, and net worth of the business.

pro forma income statement

Answer: Financial statement that projects revenues and expenses to show whether or not a business is profitable.

pro forma cash flow statement

Answer: Financial statement that reports anticipated sources and uses of cash from operations, investing, and financing activities.

capital structure

Answer: Refers to the way a business is financed.

debt financing

Answer: Borrowing money that must be repaid for use in the business.

collateral

Answer: Asset pledged that will be claimed by the lender if the loan is not repaid.

assets

Answer: Property or items of value a business owns.

equity financing

Answer: Capital brought into a business in exchange for a percent of ownership in the business.

venture capital

Answer: Money invested in a business by investors who form partnerships or groups to pool investments

angel investors

Answer: Private investors who fund start-up businesses.

## Chapter Summary

### Section 6.1 Entrepreneurs in a Free Enterprise System

- Entrepreneurship is willingly risking resources to start and run a business in pursuit of profit. Successful entrepreneurs share many common skills and traits such as basic skills, problem-solving skills, decision-making skills, and planning skills.
- The US Small Business Administration sets business size standards based on industry groups. These standards help to identify and categorize small businesses.
- Most new entrepreneurs are not experienced in all aspects of running a business. There are many sources of assistance available to entrepreneurs, including mentors, the US Small Business Administration, and the Service Corps of Retired Executives.
- Many new businesses fail. The reasons can range from poor management skills to a bad business location.

### Section 6.2 Business Planning

- Most successful entrepreneurs start with a great idea. Then, they do extensive research to test the idea and get to know their market before starting a business. An entrepreneur may choose to start a new business, purchase an existing business, or buy a franchise business.
- A business plan is a written statement of goals and objectives for a business with a strategy to achieve them. The business plan includes several sections, including summaries of the company, its organization and management structures, product lines, marketing and sales plan, and financial projections.
- Most businesses get needed capital through financing at some point. The ability to secure funding is an important factor in the success of any business venture. Two common sources of financing are debt financing and equity financing.

# Review Your Knowledge

1. Describe common skills and traits of successful entrepreneurs.

**Answer:** Entrepreneurs are usually recognized as leaders. In addition to leadership skills, an entrepreneur needs job-specific skills, transferable skills, basic skills, problem-solving skills, decision-making skills, and planning skills. Common traits of successful entrepreneurs include purpose, passion, persistence, people, profit, enthusiasm, creativity, confidence, drive, discipline, empathy, motivation, resourcefulness, and versatility, among others.

2. List five SBA requirements of a small business not related to business size.

**Answer:** The SBA requires that a small business is organized for profit; has a place of business in the United States; operates primarily within the United States or makes a significant contribution to the US economy through payment of taxes or use of American products, materials, or labor; is independently owned and operated; and is not dominated in its field on a national scale.

3. Explain how the Service Corps of Retired Executives can be a resource in operating a small business.

**Answer:** The Service Corps of Retired Executives can provide meetings with local mentors, free local and online workshops, and access to free business templates and tools.

4. How can inefficient inventory control contribute to the failure of a business?

**Answer:** Too much inventory on hand means money is tied up that could be used for other vital activities. Too little inventory results in lost sales and frustrated customers. Inventory should be ordered in the proper amounts at the best prices available.

5. Discuss the process of developing an idea for a business.

**Answer:** Most successful entrepreneurs start with a great idea. The business must be something that appeals to a large number of people, therefore extensive market research must be conducted to test the idea. To appeal to the greatest number of consumers, entrepreneurs must know their market. Knowing the market allows an entrepreneur to focus on the most effective way to develop, advertise, and deliver a product. The next step is to consider start-up strategies.

6. Identify the start-up strategies discussed and explain the benefits of each.

**Answer:** Entrepreneurs who start new businesses have the unique opportunity to build a reputation and establish a customer base on their own terms; buying an existing business has the advantages of an established location and customer base, cash flow, profitable operations, proven products, services, and sales, experienced employees, secure financing, and guidance and advice from the previous owner; and buying a franchise provides the entrepreneur with a proven business system and name.

7. Describe the components of a business plan.

**Answer:** In general, a business plan includes the following sections: executive summary, which describes the purpose of the business; company description, which gives details about the business activities, describes the market it serves, and explains why the business will be successful; market analysis, which provides an overview of the industry and market that the business will serve; organization and management section, which details how the company is organized and run; products section, which details what the business will sell, the products' life cycles, and a plan for pricing; marketing and sales, which describes how the business will reach its market; financial plans, which contains pro forma financial statements; and an appendix, which includes material that may not be relevant to all readers, but can be referenced as needed.

8. What kind of information do pro forma financial statements provide?

**Answer:** A pro forma balance sheet that measures the net worth or value of a business at a particular time. A pro forma income statement lists revenues and expenses to show whether or not a business is profitable. A pro forma cash flow statement details anticipated income and expenses for a business.

9. How does capital structure affect a business?

**Answer:** It determines who has control of the business and decision-making power. If the capital structure consists primarily of loans, the owner retains more control and usually has more decision-making authority. If the capital structure includes money from investors, the business is owned by investors who have a vote in the management of the company.

10. What are two common sources of financing for businesses?

**Answer:** Debt financing is borrowing money that must be repaid for use in the business. Equity financing is capital brought into the business in exchange for a percent of ownership in the business.

## Apply Your Knowledge

1. Could you be an entrepreneur? Why do you think that starting your own business would be a good venture for you? Incorporate the five Ps of entrepreneurship in your explanation.

**Answer:** Student answers will vary. Evaluate each response individually.

2. Make a list of all of the skills you think you would need as an entrepreneur. For each skill, rate yourself on a scale of one to five, with five being very skilled. For each skill that you rate at less than three, brainstorm ideas of how you can improve through training or by partnering with someone else.

**Answer:** Student answers will vary. Evaluate each response individually.

3. Write several paragraphs about a business idea you would consider developing. What is the best way to start your business—start a new business, purchase an existing business, or buy a franchise? Explain your choice.

**Answer:** Student answers will vary. Evaluate each response individually.

4. Franchises are a popular way for entrepreneurs to start a business. Make a list of some of the popular franchises that are in your neighborhood. Would any of these businesses be of interest to you? Why or why not?

**Answer:** Student answers will vary. Evaluate each response individually.

5. If you decided to start a business, which forms of financing would you prefer to use? Explain why. List the pros and cons of each form of financing, as they apply to your business.

**Answer:** Student answers will vary. Evaluate each response individually.



## You Do the Math

### Geometric Reasoning

The area of a two-dimensional shape considers measurements of its perimeter. The area of a rectangle, for example, is calculated by multiplying the length of two sides that meet at a right angle. The area of a circle is calculated by multiplying the constant pi (3.14) by the radius of the circle squared. To calculate the volume of a cylinder, multiply its height by the area of its base.

#### Solve the following problems.

1. Catalina must calculate the area of a parking lot in order to estimate the cost of repaving it. The parking lot measures 75 feet by 125 feet. What is the area of the parking lot?

Answer:  $75 \text{ feet} \times 125 \text{ feet} = 9,375 \text{ ft}^2$

2. Tim must order cleaning fluid for his cleaning service. The cleaning fluid comes in buckets that are 12 inches in diameter and 2 feet in height. What is the volume of cleaning fluid in each bucket?

Answer:  $2 \text{ feet} = 24 \text{ inches}$

Height = 24 inches

Radius = diameter  $\div 2 = 12 \text{ in} \div 2 = 6 \text{ in}$

Area of base =  $3.14 \times \text{radius}^2 = 3.14 \times (6 \text{ in})^2 = 113.04 \text{ in}^2$

Volume = area of base  $\times$  height =  $113.04 \text{ in}^2 \times 24 \text{ in} = 2,712.96 \text{ in}^3$

3. Geoff must buy enough plywood to cover the floor in a room that is 12 feet by 25 feet. One sheet of plywood is 4 feet by 8 feet. How many sheets of plywood must be purchased?

Answer: Area of room:  $12 \text{ ft} \times 25 \text{ ft} = 300 \text{ ft}$

Area of plywood:  $4 \text{ ft} \times 8 \text{ ft} = 32 \text{ ft}$

$300 \div 32 = 9.375$

Plywood needed = 9.375 sheets