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***4th Edition***

**by Colin Barrow**

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## Starting a Business For Dummies®, 4th Edition

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# Introduction

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If you pulled this book down from the shelf or had it passed to you by a friend or loved one as a gift, you don't have to be psychic to know something about your current business situation. You may be in need of this book for any number of reasons:

- ✔ A relative, hopefully a distant and elderly one, has died and left you, rather than the government or a dogs' home, a pile of dosh and you don't fancy leaving it to your stockbroker to lose on your behalf.
- ✔ Your employer is in the middle of a major downsizing operation as well as proposing to close its final salary pension scheme and relocate to somewhere with lousy schools and no healthcare facilities.
- ✔ You've a great idea for a world-beating product, bigger than Google and Facebook combined, that no one has ever thought of but every one of the world's billion-plus Internet users desperately needs – when they hear the good news, they're going to click a path to your website.
- ✔ Your brother, sister, father, mother or best friend – or worse still, all of them – has started his or her own business and retired to a chateau in France to breed horses, tend the vines and sail on a luxury yacht.
- ✔ You've heard that the Entrepreneurship Barometer, by accountancy firm Ernst & Young, has revealed that Britain is the best place in Europe to start, grow and run a business. Fired up with enthusiasm, you've decided it's now or never to get your business off the ground.

If your present situation is founded largely on luck and serendipity, that isn't enough to get you through the business start-up process unaided. Good ideas, hard work, relevant skills and knowledge about your product and its market, though essential, on their own aren't enough. The 400,000 small firms that close their doors every year in the UK, a figure that rose sharply in the recent recession, are evidence enough that the process is a tough one.

This book is aimed at you if you want to start up a business or to review your prospects in the small-business world. It brings together, from a wide variety of sources, the essential elements of knowledge that are a prerequisite to understanding the world of small business and to achieving financial and personal success, whatever the economic weather.

## About This Book

Most business failures occur within the first 18 months of operation. That fact alone has made it increasingly clear that small businesses need special help, particularly in their formative period. The most crucial needs for owners and managers include the following:

- ✔ Help in acquiring business skills in such areas as basic bookkeeping and accounting. Most failing businesses don't know their financial position. Even if the order book is full, the cash can still run out.
- ✔ Knowledge of what sorts of finance are available and how to put themselves in the best possible position to raise money. Surprisingly, funds aren't in short supply. Rather, problems lie in the business proposition itself or, more often, in the way in which the owner makes the proposition to the financier.
- ✔ Information with which to make realistic market assessments of the size and possibilities of their chosen market. Over-optimism about the size and ease with which a market can be reached is a common mistake.
- ✔ Skills and tools to grow their businesses into valuable assets to pass on to family members or to sell and then sail off into the sunset.

This book gives you help in all these areas.

In addition, every business needs a *business plan*, a statement of business purpose, with the consequences of each element of that purpose spelled out in financial terms. You must describe what you want your business to do – who its potential customers are, how much they're likely to spend, who can supply you and how much their supplies cost. Then you must translate those plans and projections into cash – how much your business needs, how much you already have and how much you expect 'outsiders' to put in. This plan also helps you to avoid catching the 'common cold' of small businesses – underestimating the amount of start-up capital you need. Going back to a bank and asking for 30 per cent more funding six months after opening your doors and retaining any credibility at all is difficult, if not impossible. Yet, new businesses consistently underestimate how much money they need to finance their growth. Many people have never prepared a business plan, don't know how to start and need information. That's where this book comes in. It gives you the information you need to formulate and follow a business plan.

The book is also invaluable to innovators, who have special problems of communication and security when they try to translate their ideas into businesses. All too often, their inventions are left for other countries to exploit, or they feel unhappy about discussing ideas, believing that a patent is their

only protection. However, more often than not, these business owners simply don't know who to talk to, little realising that sophisticated help is often close at hand. Thus this book illuminates a path from the laboratory to the market place so that small firms and inventors can see a clear route.

*Starting a Business For Dummies* can help you succeed no matter what kind of business expertise you're looking for. If you have a great and proven business idea, you may want to plug straight into finding out how to raise finance. If you need more than just yourself to get your great business idea off the ground, you may want to discover how to find great employees or perhaps a business partner to take some of the financial and emotional strain. This book is set up so that you can dip in and out of it in a number of ways depending on your situation.

- ✔ If you haven't started a business before, or been profit accountable for part of an enterprise, you may want to start at the beginning and work your way through.
- ✔ If you're more experienced, you may start by selecting the areas you're less knowledgeable about to fill in the gaps, and then work outwards from there.
- ✔ If you're quite confident in the business world, you can use this book as a guide and mentor to review a particular topic. You can even use it to plan to sell your business after it's established and move on to a different challenge.
- ✔ If you learn by example, you may want to flip through the book, using the True Story icon as your guide. The text next to this icon highlights 'straight from the horse's mouth' examples of how entrepreneurs have tackled specific situations successfully, be it finding a partner, raising finance or getting a free grant from the government.

## *Foolish Assumptions*

This book gathers together the essential, need-to-know information about getting a business up and running. It assumes that you've not yet been in business but that you're giving some serious thought to starting one. It also assumes that you can produce and deliver products or services that people will be willing to pay you for. These products and services can be anything – you're limited only by your imagination. Finally, this book assumes that you don't already know everything there is to know about starting your own business but that you're eager to get cracking.

## Icons Used in This Book



To help you pinpoint vital information, I've placed icons throughout the text that highlight nuggets of knowledge.

This icon calls your attention to particularly important points and offers useful advice on practical topics.



The Remember icon serves as a friendly reminder that the topic at hand is important enough for you to make a note of.



Business, like any specialist subject, is awash with specialised terms and expressions, some of which may not be familiar to you. This icon draws your attention to these.



When you see this icon, I'm alerting you to the fact that I'm using a practical example showing how another business starter has tackled a particular topic. These examples are usually businesses facing today's difficult environment, and often you can apply the example to your own business.



Proceed with caution; look left and right before crossing. In fact, think carefully about crossing at all when you see this icon, which alerts you to potential dangers.



This icon refers to specialised business facts and data that are interesting as background data but not essential for you to know. You can skip paragraphs marked by this icon without missing the point – but reading them may help you build credibility with outside investors and partners.

## Beyond the Book

As you travel on your journey of discovery through starting up a business, you can augment what you read here by checking out some of the access-anywhere extra information that is hosted online. You can find the book's e-cheat sheet at [www.dummies.com/cheatsheet/startingabusinessuk](http://www.dummies.com/cheatsheet/startingabusinessuk), and by going to [www.dummies.com/extras/startingabusinessuk](http://www.dummies.com/extras/startingabusinessuk) you can access three bonus articles and an extra Part of Tens chapter.

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## *Where to Go From Here*

Take a minute to thumb through the table of contents and get comfortable with the topics the book covers. Pick a chapter that strikes a particular chord with the aspect of starting a business that's uppermost in your mind, such as finding the money or doing business online. Read that and see where it leads you.

You can also use Chapter 6, 'Preparing a Business Plan', as a framework for gathering knowledge and dive into the other chapters as you go.

If all else fails, start at the beginning. That technique has a pretty good track record.



## Part I

# Getting Started with Your New Business



*For Dummies* can help get you started with lots of subjects. Visit [www.dummies.com](http://www.dummies.com) to learn more and do more with *For Dummies*.

## *In this part . . .*

- ✔ Use your knowledge of business cycles to get your business off to the best possible start, and appreciate the effect that the state of the wider economy will have on your business.
- ✔ Lay the groundwork for opening your doors for business either at home or in dedicated premises.
- ✔ Check out your skills and aptitudes and see how they compare to the business idea you have in mind.
- ✔ Investigate your idea and its market in detail.



# Chapter 1

## Preparing for Business

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### *In This Chapter*

- ▶ Getting to grips with the basics of business strategy
  - ▶ Working up to opening up
  - ▶ Measuring your business's viability
  - ▶ Growing for success
- 

**W**hen you're starting a business, particularly your first business, you need to carry out the same level of preparation as you would for crossing the Gobi Desert or exploring the jungles of South America. You're entering hostile territory. A stroll down any high street in the land shows you just how tough it is out there. Since the last edition of this book, Comet, JJB Sports, Clinton Cards, Game, Borders, Barratts, Jane Norman, Habitat, Oddbins, Adams Childrenswear, Principles, Sofa Workshop, Allied Carpets, Viyella, Dewhursts, Woolworths, MFI and Zavvi/Virgin Megastore have hit the rocks. Some 53 retailers have closed 4,000 stores.

Your business idea may be good, it may even be great, but such ideas are two a penny. The patent office is stuffed full of great inventions that have never returned tuppence to the inventors who spent so much time and money filing them. And failure is pretty much a norm for business start-ups. Over the past three years, nearly half a million small firms have shut up shop in the UK alone. As if that wasn't bad enough, the small-business population has actually grown by over a quarter of a million, at a time when the economy has shrunk by around 6 per cent. That means thousands more businesses are chasing a shrinking pot of customer spending power.

How you plan, how you prepare and how you implement your plan makes the difference between success and failure. This chapter sets the scene to make sure that you're well prepared for the journey ahead.

## *Understanding the Enduring Rules of Business Strategy*

When you're engulfed by enthusiasm for an idea for a new business or engaged in the challenge of getting it off the ground, you can easily miss out on the knowledge you can gain by lifting your eyes up and taking the big picture on board too. You won't gain much from taking aim at the wrong target from the outset!

Credit for devising the most succinct and usable way to get a handle on the big picture has to be given to Michael E. Porter, who trained as an economist at Princeton, taking his MBA at Harvard Business School where he's now a professor. Porter's research led him to conclude that two factors above all influence a business's chances of making superior profits – surely an absolute must if you're going to all the pain of working for yourself:

- ✔ **The attractiveness or otherwise of the industry in which it primarily operates.** That's down to your research, a subject I cover in Chapters 2 and 4.
- ✔ **How the business positions itself within the industry in terms of an organisation's sphere of influence.** In that respect, a business can only have a cost advantage if it can make products or deliver services for less than others. Alternatively, the business may be different in a way that matters to consumers, so that its offers are unique, or at least relatively so.

Porter added a further twist to his prescription. Businesses can follow a cost advantage path or a differentiation path industry wide, or they can take a third path – they can concentrate on a narrow specific segment with cost advantage or differentiation. This path he termed *focus strategy*, which I discuss in the following sections.

### *Focusing on focus – and a bit more besides*

Whoa up a minute. Before you can get a handle on focus, you need to understand exactly what the good professor means by *cost leadership* and *differentiation*, because the combination of those provides the most fruitful arena for a new business to compete.

#### ***Cost leadership***

Don't confuse low cost with low price. A business with low costs may or may not pass those savings on to customers. Alternatively, the business can use low costs alongside tight cost controls and low margins to create an effective barrier to others considering entering or extending their penetration of that market.

Businesses are most likely to achieve low-cost strategies in large markets, requiring large-scale capital investment, where production or service volumes are high and businesses can achieve economies of scale from long runs. If you've deep pockets, or can put together a proposition that convinces the money men to stump up the cash, this avenue may be one to pursue. (I cover everything you need to put together a great business plan in Chapter 6.)

Ryanair and easyJet are examples of fairly recent business start-ups where analysing every component of the business made it possible to strip out major elements of cost (meals, free baggage and allocated seating, for example) while leaving the essential proposition – we fly you from A to B – intact. This plan proved enough of a strategy to give bigger, more established rivals such as British Airways a few sleepless nights.

### ***Differentiation***

The key to *differentiation* (ensuring that your product or service has a unique element that makes it stand out from the rest) is a deep understanding of what customers really want and need and, more importantly, what they're prepared to pay more for. Apple's opening strategy was based around a 'fun' operating system based on icons, rather than the dull MS-DOS. This belief was based on Apple's understanding that computer users were mostly young and wanted an intuitive command system and the 'graphical user interface' delivered just that. Sony and BMW are also examples of differentiators. Both have distinctive and desirable differences in their products. Neither they nor Apple offer the lowest price in their respective industries; customers are willing to pay extra for the idiosyncratic and prized differences embedded in their products.

Consumers can be a pretty fickle bunch. Dangle something faster, brighter or just plain newer and you can usually grab their attention. Your difference doesn't have to be profound or even high-tech to capture a slice of the market. Book buyers rushed in droves to Waterstones for no more profound a reason than that its doors remained open in the evenings and on Sundays, when most other established bookshops were firmly closed.

### ***Focus***

Your patience is about to be rewarded. Now I can get to the strategy that Porter reckoned was the most fruitful for new business starters to plunge into.

*Focused strategy* involves concentrating on serving a particular market or a defined geographic region. IKEA, for example, targets young, white-collar workers as its prime customer segment, selling through 235 stores in more than 30 countries. Ingvar Kamprad, an entrepreneur from the Småland province in southern Sweden, who founded the business in the late 1940s, offers

home furnishing products of good function and design at prices young people can afford. He achieves this quality and price by using simple cost-cutting solutions that don't affect the quality of products. (You can read more about Kamprad in the sidebar 'Less is more'.)

Warren Buffett, one of the world's richest men, knows a thing or two about focus. His investment company combined with Mars to buy US chewing gum manufacturer Wrigley for \$23 billion (£11.6 billion) in May 2008. Chicago-based Wrigley, which launched its Spearmint and Juicy Fruit gums in the 1890s, has specialised in chewing gum ever since and consistently outperformed its more diversified competitors. Wrigley is the only major consumer products company to grow comfortably faster than the population in its markets and above the rate of inflation. Over the past decade or so, for example, other consumer products companies have diversified. Gillette moved into batteries used to drive many of its products by acquiring Duracell. Nestlé bought Ralston Purina, Dreyer's, Ice Cream Partners and Chef America. Both have trailed Wrigley's performance.

Businesses often lose their focus over time and periodically have to rediscover their core strategic purpose. Procter & Gamble is an example of a business that had to refocus to cure weak growth. In 2000 the company was losing share in seven of its top nine categories, and had lowered earnings expectations four times in two quarters. This situation prompted the company to restructure and refocus on its core business: big brands, big customers and big countries. Procter & Gamble sold off non-core businesses, establishing five global business units with a closely focused product portfolio.



## Less is more

Furniture company IKEA was founded by Ingvar Kamprad when he was just 17, having cut his teeth on selling matches to his nearby neighbours at the age of 5, followed by spells selling flower seeds, greeting cards, Christmas decorations and eventually furniture. Worth £16 billion, Kamprad still lives frugally, in keeping with the functional nature of the IKEA brand. He lives in a bungalow, flies easyJet and drives

an 18-year-old Volvo. When he arrived at a gala dinner recently to collect a business award, the security guard turned him away because he saw Kamprad getting off a bus. He and his wife Margaretha are often seen dining in cheap restaurants. He does his food shopping in the afternoon when prices are lower and even then haggles prices down.

## *Appreciating the forces at work in your sector*

Aside from articulating the generic approach to business strategy, Porter's other major contribution to the field was what has become known as the Five Forces Theory of Industry Structure. Porter postulated that you have to understand the five forces that drive competition in an industry as part of the process of choosing which of the three generic strategies (cost leadership, differentiation or focus) to pursue. The forces he identified are:

- ✔ **Threat of substitution:** Can customers buy something else instead of your product? For example, Apple – and to a lesser extent Sony – have laptop computers that are distinctive enough to make substitution difficult. Dell, on the other hand, faces intense competition from dozens of other suppliers with near-identical products competing mostly on price alone.
- ✔ **Threat of new entrants:** If it's easy to enter your market, start-up costs are low and no barriers to entry exist, such as intellectual property protection, then the threat is high.
- ✔ **Supplier power:** Usually, the fewer the suppliers, the more powerful they are. Oil is a classic example where less than a dozen countries supply the whole market and consequently can set prices.
- ✔ **Buyer power:** In the food market, for example, just a few, powerful supermarket buyers are supplied by thousands of much smaller businesses, so the buyers are often able to dictate terms.
- ✔ **Industry competition:** The number and capability of competitors is one determinant of a business's power. Few competitors with relatively less attractive products or services lower the intensity of rivalry in a sector. Often these sectors slip into *oligopolistic behaviour*, preferring to collude rather than compete. You can see a video clip of Professor Porter discussing the Five Force model on the Harvard Business School website (<http://hbr.org/2008/01/the-five-competitive-forces-that-shape-strategy/ar/1>).

## *Recognising the first-to-market fallacy*

People use the words 'first mover advantage' like a mantra to justify a head-long rush into starting a business without doing enough basic research. That won't happen to you – after all, you're reading this book and by the end of this section you'll be glad you paused for thought.

The idea that you've the best chance of being successful if you get in first is one of the most enduring in business theory and practice. Entrepreneurs and established giants are always in a race to be first. Research from the 1980s claimed to show that market pioneers have enduring advantages in distribution, product-line breadth, product quality and, especially, market share.

Beguiling though the theory of first mover advantage is, it's probably wrong. Gerard Tellis, of the University of Southern California, and Peter Golder, of New York University's Stern Business School, argue in their research that previous studies on the subject were deeply flawed. In the first instance earlier studies were based on surveys of surviving companies and brands, excluding all the pioneers that failed. This fact helps some companies to look as though they were first to market even when they weren't. Procter & Gamble boasts that it created the USA's disposable-nappy (diaper) business. In fact, a company called Chux launched its product a quarter of a century before Procter & Gamble entered the market in 1961.

Also, the questions used to gather much of the data in earlier research were at best ambiguous and perhaps dangerously so. For example, researchers had used the term 'one of the pioneers in first developing such products or services' as a proxy for 'first to market'. The authors emphasise their point by listing popular misconceptions of who the real pioneers were across the 66 markets they analysed:

- ✔ **Online book sales:** Amazon (wrong); Bookshop.co.uk (right). Amazon opened on 16 July 1995. Bookshop.co.uk opened in 1992 and was bought out by WH Smith in 1998 for £9.4 million.
- ✔ **PCs:** IBM/Apple (both wrong); Micro Instrumentation Telemetry Systems (right) – it introduced its PC, the Altair, a \$400 kit, in 1974 followed by Tandy Corporation (Radio Shack) in 1977.
- ✔ **Search engines:** Google (wrong); Archie (right). The credit for developing the first search engine goes to Alan Emtage, a student at McGill University in Montreal, who in 1990 created Archie, an index for archiving computer files. The following year, Mark McCahill, a student at the University of Minnesota, used hypertext to create Gopher, which was able to search for plain text references in files. Then the search engine race was on, starting with Excite (1993), followed by Yahoo!, WebCrawler, Infoseek and Lycos (1994), AltaVista (1995), Inktomi (1996) and Ask Jeeves, now Ask (1997). Google didn't come on the scene until 1997, making it 11th in the race, but nevertheless the winner.

In fact the most compelling evidence from all the research is that nearly half of all firms pursuing a first-to-market strategy are fated to fail, but those following fairly close behind are three times as likely to succeed. Tellis and Golder claim the best strategy is to enter the market a few years after pioneers, learn from their mistakes, benefit from their product and market development and be more certain about customer preferences.