**CHAPTER 3: BUSINESS FORMATION**  
**3.1 INTRODUCTION**

A business formation deals with the formalization and actual implementation of business ideas in to practice. In today’s economic development/transformation, small businesses are creating new jobs even as large businesses continue eliminating jobs and they are more flexible than large ones in the products and services they offer. This chapter discusses the issues of business development and the different legal forms of business. In addition, the concept of MSEs in the Ethiopian and international context are discussed. The importance/roles of MSEs and a business formation deal with the formalization and actual implementation of business ideas in to practice. The importance/roles and set up of MSEs are discussed very well

**3.2 The Concept of Small Business Development**

Specifying size and standard to define small business is necessarily arbitrary, because people adopt different standards for different purposes. Based on socio- economic conditions, countries define small business differently. But all may use size and economic criteria as a base to define small business. Size criteria include number of employees and the startup capital. Size does not always reflect the true nature of an enterprise; in addition, qualitative characteristics are used to differentiate small business from other business. The economic/control definition covers market share, independence and personalized management. Small and medium enterprises (SMEs) cover a wider spectrum of industries and play an important role in both developed and developing economies. Ethiopia is no exception and SMEs occupy a prominent position in the development of the Ethiopian economy.

**3.3 Forms of Business**

There are three basic legal forms of business formation with some variations available depending on the entrepreneurs’ needs. The three basic legal forms are:-

**Legal Forms of Business Description**

**1)** Proprietorship Form of business with single owner who has unlimited liability, controls all decisions, and receives all profits. **2)** Partnership Two or more individuals having unlimited liability who have pooled resources to own a business **3)** Corporation Separate legal entity that is run by stockholders having limited liability These three basic legal forms are compared with regard to *ownership, liability, start-up costs,* *continuity, transferability of interest, capital requirements, management control, distribution* *of profits, and attractiveness for raising capital.* It is very important that the entrepreneur carefully evaluate the pros and cons of the various legal forms of organizing the new venture. This decision should be made before the submission of a business plan and request for venture capital.

**Activity**: Determine the aforementioned factors for those three types of business forms.

**3.4 Definition and Role/Importance of SMEs in Developing Countries**

**3.4.1. Definition of SMEs**

Small businesses are playing an important role in the industrial economy of the world. These are particularly important in the developing economies. Small business is predominant even in developed countries such as USA, Japan etc. There is a difference between small business owners and entrepreneurial ventures as well. An entrepreneurial venture often is a growth-oriented innovative company with product or service offerings that are new to the market. Small businesses could be entrepreneurial ventures. Most entrepreneurial ventures start as a small business. However, some discernible characteristics still differ them. Most small businesses’ owners work with known products and services aimed at incremental growth, and their innovation is focused on sales, marketing, and market expansion. Entrepreneurial ventures incorporate a different set of strategies. These entities are aimed at rapid growth and apply innovation and creativity at every node of the business process. They work with new offerings, and they face a lot more uncertainties; hence, their strategy calls for continuous work on mitigating uncertainty and risk reduction. Specifying size and standard to define small business is necessary because people adopt different standards for different purposes. For example, legislators may exclude small firms from certain regulations and specify ten employees as the cut-off point. Moreover, a business may be described as “small” when compared to larger firms, but “large” when compared to smaller ones. There are two approaches to define small business. They are: Size Criteria, and Economic/control criteria.

1. **Size Criteria**： even the criteria used to measure the size of businesses vary; size refers to the scale of operation. Some criteria are applicable to all industrial areas, while others are relevant only to certain types of business. For instance, some of the criteria used to measure size are: number of employees;  
volume, and value of sales turnover, asset size, and volume of deposits, total capital investment, volume/value of production, and a combination of the stated factors. Even though the number of employees-is the most widely used yardstick, the best criterion in any given case depends upon the user’s purpose. To provide a clearer image of the small firms, the following general criteria for defining a small business are suggested by Small Business Administration (SBA).  
• financing of the business is supplied by one individual or a small group. Only in a rare case would the business have more than 15 or 20 owners.

• Except for its marketing function, the firm’s operations are geographically localized.

• Compared to the biggest firms in the industry, the business is small.

• The number of employees in the business is usually fewer than 100.

This size criteria based definition of SMEs varies from country to country. All over the world, number of employees or capital investment or both has been used as the basis for defining SMEs.

2. **Economic/Control Criteria.** Size does not always reflect the true nature of an enterprise. In addition, qualitative characteristics may be used to differentiate small business from other business. The economic/control definition covers:

All four of these characteristics must be satisfied if the business is to rank as a small business.  
**I) *Market Share*: -** The characteristic of a small firm’s share of the market is that it is not large enough to enable it to influence the prices of national quantities of goods sold to any significant extent.  
**II) *Independence*: -** Independence means that the owner has control of the business himself/herself. It, therefore, rules out those small subsidiaries which though in many ways fairly autonomous, nevertheless have to refer to major decisions (e.g., on capital investment) to a higher level of authority.  
**III) *Personalized Management: -*** It is the most characteristics factor of all. It implies that the owner actively participates in all aspects of the management of the business, and in all major decision-making processes. There is little delegation of authority and one person is involved when anything material is involved.

**IV) *Technology*: -** Small business is generally labor intensive and only few are technology intensive.  
**V) *Geographical Area of Operation*: -** The area of operation of a small firm is often local. Generally, small business is a business that is privately owned and operated, with a small number of employees and relatively low volume of sales.

**3.4.2 Role/Importance of MSEs in Developing Countries**

Small and medium enterprises (SMEs) cover a wider spectrum of industries and play an important role in both developed and developing economies. Ethiopia is no exception and SMEs occupy a prominent position in the development of the Ethiopian economy. Some of the contributions are hereunder.  
**1) Large Employment Opportunities:** MSEs are generally labor-intensive. For every fixed amount of investment, MSE sector provides employment for more persons as against few persons in the large scale sector.

**2) Economical Use of Capital**: MSEs need relatively small amount of capital. Hence it is suitable to a country like Ethiopia where capital is deficient.  
**3) Balanced Regional Development/ Removing Regional Imbalance**/: Generally small enterprises are located in village and small towns. Therefore it is possible to have a balanced regional growth of industries. Ethiopia is a land of villages. Another problem is the continuous shifting of people from rural to urban areas which causes over-crowding in cities with slum conditions due to lack of social and medical amenities which require heavy investments. As a result, semi urban and rural areas remain deprived of the benefits of industrialization.

**4) Equitable Distribution of Wealth and Decentralization of Economic Power**: It removes the drawbacks of capitalism, abnormal profiteering, concentration of wealth and economic power in the hands of few.

**5) Unregulated Growth of Larg**e-scale industries results in concentration of economic· power in the hands of a few; and consequently, gross inequalities in the distribution of income and wealth will occur. On the other hand; income generated in a large number of small enterprises is dispersed more widely and its benefit is derived by the large segments of the society. This is due to wide spread ownership and decentralized location of small scale enterprises. In this way, small & medium scale enterprises bring about greater equality of income distribution.

**6) Dispersal over Wide Areas**- SMEs has a tendency to disperse over wider areas and they play a key role in the industrialization of a developing country.  
**7) Higher Standard of Living**: MSEs bring higher national income, higher purchasing power of people in rural and semi-urban areas.  
**8) Mobilization of Locals Resources/Symbols of National Identity**: The spreading of industries even in small towns and villages would encourage the habit of thrift and investment among the people of rural areas. Small scale businesses are locally owned and controlled, and can strengthen family and other social systems and cultural traditions. They are perceived as valuable in their own right as well as symbols of national identity.  
**9) Innovative and Productive /Simple Technology**: New but simple techniques of production can be adopted more easily by MSEs without much investment.

**10) Less Dependence on Foreign Capital/ Export Promotion**: MSEs use relatively low proportion of imported equipment and materials. The machinery needed for these industries can be manufactured within the country. Small and medium scale enterprises are opening up fresh avenues in the export market in our world.

**11) Promotion of Self Employment**: MSEs foster individual skill and initiative and promote self-employment particularly among the educated and professional class.  
**12) Protection of Environment**: MSEs help to protect the environment by reducing problem of pollution.  
**13) Shorter Gestation Period**: In these enterprises the time-lag between the execution of the investment project and the start of flow of consumable goods is relatively short.  
**14) Facilitate Development of Large Scale Enterprises**: by meeting their requirements of inputs, intermediate goods, spare parts etc. and by utilizing their output for further production.  
**15) Individual Tastes, Fashions, and Personalized Services**: Small businesses have the flexibility to adapt quickly to changes in the business or technological environment.  
**3.5 Setting up Small Scale Business**  
**Steps for Setting up the Entrepreneurial Venture** Once an individual decides to take up entrepreneurship as a career path, to be a job provider instead of a job seeker, s/he has to establish an enterprise. However, setting up of a small new enterprise is a very challenging as well as a rewarding task. Several problems are involved in this task. It is extremely important to take utmost care in identifying the product or service to be launched by the entrepreneur; otherwise it might prove to be a costly mistake. After tentatively identifying four to five ideas, s/he should go in for detailed assessment and feasibility study. This will help the entrepreneur to crystallize one idea in an objective and systematic manner, which will greatly enhance his/ her chances of success.

**Stage 1: Discovery:** The first stage of discovery is to identify opportunities that may form the basis of an entrepreneurial venture. It requires creative thinking to indentify issues that can benefit from an entrepreneurial vision. it involves to know more about your personal resources and attributes through some self-evaluation– what will you bring to the venture? What are your strengths and challenges? These will affect the type of venture you choose. and Identifying a problem and potential solution – a new venture has to solve a problem and meet a genuine need.  
**Stage 2 Evaluation:** By the end of first stage of discovery, you should have selected an idea worthy of further detailed investigation it involves Evaluating the idea as a business opportunity– find out information about the market need. Is the solution to this problem really wanted by enough customers? Investigate the feasibility of the proposed solution (technically, economically, socially, and legally). and Investigating and gathering the resources – How will the product/service get to market? How will it make money? What resources are required?  
**stage 3 Exploitation:** By the end of the second stage of evaluation, you should have identified an opportunity that has reasonable prospects of success, and analyzed what is required to launch it. The next stage is to make the final preparations and launch it into the market. It can be developed in three further steps: it includes Forming the enterprise to create value – set up a business entity and protect any intellectual property. Implementing the entrepreneurial strategy – activate the marketing, operating, and financial plans. and Planning the future – look ahead and visualize where you want to go.

**Environmental Analysis:** Entrepreneurship does not exist in a vacuum. It is affected by and affects the environment.

As the economies are getting internationally integrated, for an analysis of the environment of entrepreneurship you would be required to develop an understanding of macroeconomic, and industry/sector specific factors.  
**a) Macro Environment**  
The macro environment of an entrepreneur consists of the political, technological, social, legal and economic environments. All of these are not immediate part of the entrepreneur’s venture yet they have an impact on his/her enterprise.  
**b) Sectoral- Analysis** After having understood the general environment in which the business has to take birth, it is important to study the sector or industry conditions in which the entrepreneur proposes to launch a venture. The purpose of industry analysis is to determine what makes an industry attractive- this is usually indicated either by above normal profits or high growth rates.

**SWOT Analysis** At this stage, conducting a SWOT analysis will help the entrepreneur to clearly identify his/her own strengths and weaknesses as well as the opportunities and threats in the environment.  
*Strengths* are positive internal factors that contribute to an individual’s ability to accomplish his/her mission, goals and objectives. *Weaknesses* are negative internal factors that inhibit an individual’s ability to accomplish his/her mission, goals and objectives. An entrepreneur should try to magnify his strengths and overcome or compensate for his/her weaknesses.  
*Opportunities* are positive external options that an individual could exploit to accomplish his/her mission, goals and objectives. *Threats* are negative external forces that hinder an individual from accomplishing his/her mission, goals and objectives. These could arise due to competition, change in government policy, economic recession, technological advances etc. *Threats* in the environment can arise from competition, technological breakthroughs, change in government  
policies etc. S/he might possess certain unique skills or abilities, which along with his/ her knowledge and experience can provide him/ her cutting edge. An analysis of the above can give the entrepreneur a more realistic perspective of the business, pointing out foundations on which s/he can build future strengths and remove obstacles.

**3.6 Small Business Failure and Success Factors**  
**What Is Business Failure?** Even though business owners launch their ventures with the best of intentions and work long, hard hours, some businesses inevitably fail. Dun & Bradstreet, a financial research firm, defines a business failure as a business that closes as a result of either (1) actions such as bankruptcy, foreclosure, or voluntary withdrawal from the business with a financial loss to a creditor; or (2) a court action such as receivership (taken over involuntarily) or reorganization (receiving protection from creditors).

**Causes of Business Failure**

The rates of business failure vary greatly by industry and are affected by factors such as type of ownership, size of the business, and expertise of the owner. The causes of business failure are many and complex; however, the most common causes are inadequate management and financing. Although financial problems are listed as the most common cause of business failure, consider management’s role in controlling them. Could business failure due to industry weakness be linked to poor management? Yes, if the owner tried to enter an industry or market with no room for another competitor or responded only slowly to industry changes. High operating expenses and insufficient profit margins also reflect ineffective management. Finally, business failure due to insufficient capital suggests inexperienced management.

* ***Inadequate Management: -*** *Business* management is the efficient and effective use of resources. For small business owners, management skills are especially desirable—and often especially difficult to obtain. Lack of experience is one of their most pressing problems. Small business owners must be generalists; they do not have the luxury of specialized management. As a small business manager, you will probably have to make decisions in areas in which you have little expertise. Entrepreneurs are generally correct in pointing to internal factors as the reason for the failure of their businesses; these factors are the cause of 89 percent of such failures. Internal problems are those more directly under the control of the manager, such as adequate capital, cash flow, facilities/equipment inventory control, human resources, leadership, organizational structure, and accounting systems.
* ***Inadequate Financing: -*** Business failure due to inadequate financing can be caused by improper managerial control as well as shortage of capital. On the one hand, if you don’t have adequate funds to begin with, you will not be able to afford the facilities or personnel you need to start up the business correctly. On the other hand, if you do possess adequate capital but do not manage your resources wisely, you may be unable to maintain adequate inventory or keep the balance needed to run the business. Other common causes of business failure include *Neglect, Fraud, and Disaster*.
* ***Neglect***occurs whenever an owner does not pay a due attention to the enterprise. One of the most common mistakes is to neglect to plan for the future because planning seems too hard or time-consuming. Planning what you want to do with your business, where you want it to go, and how you’re going to get there are prerequisites for a sound business.
* ***Fraud***involves intentional misrepresentation or deception. If one of the people responsible for keeping the business’s books begins purchasing materials or goods for himself or herself using the business's money, the business might find itself bankrupt before too long.
* *Disaster* refers to some unforeseen happening. If a hurricane hits the area and destroys the property in the company's yard, the loss may require the firm to declare bankruptcy. The same is true for fires, burglaries, robberies, or extended strikes.

**Business Termination versus Failure** There is a difference between a business termination and a business failure. A termination occurs when a business no longer exists for any reason. A failure occurs when a business closes with a financial loss to a creditor. Reasons for a termination abound. The owner may have an opportunity to sell her business to someone else for a healthy profit, or be ready to move on to a new business or to retire, or s/he may have simply lost interest in the business. The market for the business’s product may have changed or become saturated. Perhaps the owner has decided it would be more appealing to work for someone else. In other cases, businesses may change form. A partnership may be restructured as a corporation, or a business may move to a new location. Businesses that undergo such changes are considered terminated even though they continue in another form.

**3.6.2 Small Business Success Factors**

When large and small businesses compete directly against one another, it might seem that large businesses would always have a better chance of winning. In reality, small businesses have certain inherent factors that work in their favor. You will improve your chances of achieving success in running a small business if you identify your competitive advantage, remain flexible and innovative, cultivate a close relationship with your customers, and strive for quality. It may come as a surprise, but big businesses need small businesses a symbiotic relationship exists between them. Small businesses perform more efficiently than larger ones in several areas. For example, although large manufacturers tend to enjoy a higher profit margin due to their economies of scale, small businesses are often better at distribution. Most wholesale and retail businesses are small, which serves to link large manufacturers more efficiently with millions of consumers spread all over the world.  
Small business success factors can be seen the same as the efforts exerted in reversing the factors of failure. There are several positive steps in addition to planning that business owners can take to improve a firm’s chance for success. by understanding why business fail, entrepreneurs can discover ways to tilt the scales towards success. These success factors are categorized as:-

**1. Conducive Environment** Successful small enterprises do not emerge, and thereafter survive and grow unless the environment is conductive. *Political***,** *economic***,** *technological and socio-cultural factors* in the environment impinge upon the life of the small enterprises and generate much of the needs required for their existence.

* **Political Climate: -**  Small scale entrepreneur will need positive and encouraging measures by government and political constituencies to establish private investment. Such measures could include liberal or nonrestrictive investment policy, creation of promotional agencies, creation of industrial estates and free trade zones and availability of low-cost loan capital for private investors.
* **The Economic Environment: - An** analysis of the economic environment is particularly helpful in investment decision, market measurement and in forecasting. The general state of the economy dictates what the small enterprise will need especially since it is handicapped in obtaining capital and credit owning to greater unit costs of small transactions, greater risks involved, etc.
* **Technology: -** Technological advances in the environment create new needs for the small entrepreneur as far as adaptation and adjustment is concerned. Small scale entrepreneur needs to learn how to adjust to the new technological environment surrounding him/her, or needs to take a set of advance technologies and bring these to his/her own level in the small enterprise. Either way, constant reexamination is needed for possible utilization and improvement of existing technologies.
* **Socio-Cultural Environment: -** Finally, the socio-cultural environment also creates a very important climate for the survival of the enterprises.

2. **Adequate Credit Assistance** Small enterprise development cannot be ensured without arrangement for financing. Adequate and timely supply of credit is critical for new entrepreneurs to emerge especially from a wide base. A great majority of small and medium business activities have come about because of special financing programs offered to them. Thus, requirements are less strict in terms of lower interest rates than the prevailing commercial rates; less collateral requirements and lower equity ratio; various assistance schemes such as preparing the project study; etc.

3. **Markets and Marketing Support** Market for a small enterprise in a developing country can be quite a problem. The small business entrepreneur will be in competition not only with locally mass-produced goods but even imports. Small enterprises can brand together and sell their products as one body through closely-knit associations or organizations. The government too can take an active part in marketing specific products or assisting small groups of entrepreneurs in selling their products.  
**3.7 Classification of Enterprises in Ethiopian Context**

1. **In Case of Manufacturing Enterprise (Manufacturing, Construction and Mining):**

* ***A Micro Enterprise*** is one in which the +- and operates with 5 people including the owner.
* ***Small Enterprises*** is one in which the investment in plant and machinery (a paid up capital of total asset) of birr100, 000 (one hundred thousand) and not more than Birr 1.5 million; and operates with 6-30 persons.

2. **In Case of Service Enterprise (Retailing, Transport, Hotel and Tourism, ICT and**  
**Maintenance)**

* ***A micro enterprise*** is one with the values of total asset is not exceeding Birr 50,000(fifty thousands); and operates with 5 persons including the owner of the enterprise.
* ***Small Enterprises*** is one in which the total asset value or a paid up capital of of birr100, 000 (one hundred thousand) and not more than Birr 1.5 million; and operates with 6-30 persons.

When ambiguity is encountered between manpower and total assets as explained above, total asset is taken as primary yardstick.  
**Priority Sectors and Sub-Sectors for MSEs Engagement In Ethiopia**

1. ***Manufacturing* Sector-** This is the one which comprises textile and garment; leather and leather products; food processing and beverage; metal works and engineering wood works including furniture and ornaments service; and agro-processing.

2. **Construction Sectors-** This is the one which comprises **s**ub-contracting; building materials; traditional mining works; cobble stone; infrastructure sub-contract; and prestigious goods

3. **Trade Sectors- This** is the one which comprises whole sale of domestic products; retail sale of domestic products and raw materials supply.

4. **Service Sectors-** This is the one which comprises small and rural transport service; café and restaurants; store service; tourism service; canning/packing service; management service; municipality service; project engineering service; product design & development service; maintenance service; beauty salon; and electronics software development; decoration and internet café.  
 5. **Agriculture Sector (Urban Agriculture**) - This is the one which comprises modern livestock raring; bee production; poultry; modern forest development; vegetables and fruits; modern irrigation; and animal food processing.  
**Levels of MSEs in Ethiopia**  
**Start-up:-** Start up level refers to enterprises that incorporate people who are interested to establish MSE and those who completed the required profession/skill from various institutions and innovated by legally either in the form of association or private. It is a level where an enterprise begins production and service under legal framework or legal entity.  
**Growth Level: -** An enterprise is said to be at growth level when an enterprise become competent in price, quality and supply and profitable using the support provided. At this level, the enterprise man power and total asset is larger than at startup level; and use book keeping system.  
**Maturity Level: -** Maturity level means when an enterprise able to be profitable and invest further by fulfilling the definition given to the sector and using the support provided.  
**Growth- Medium Level:-** An enterprise is said to be transformed from small to medium level of growth is when it enabled to be competent in price, quality and supply using the support given to the level.  
**3.8 Main Supporting Packages for MSEs Development in Ethiopia**

When entrepreneurs are deciding to involve and develop MSEs in Ethiopia, they are more likely entitled with some supporting packages which include awareness creation about the sector; provision of legal services, to form legal business enterprises; providing Technical and business management training; financial support based on personal saving, 20/80 (the beneficiaries are save 20% and the MFIs provide Loan 80% of the projects); facilitate working premises; industry extinction services and BDS provision; bookkeeping and audit services.

**3.9 Problems of Small Scale Business in Ethiopia**

Small-scale businesses have not been able to contribute substantially to the economic development, particularly because of financial, production, and marketing problems. These problems are still major handicaps to their development. Lack of adequate finance and credit has always been a major problem of the Ethiopian small business. Small-scale units do not have easy access to the capital and industrial sources because they mostly organized on proprietary and partnership basis and are of very small size and partly because of the limited profit, they search for funds for investment purposes. Consequently, they approach traditional money lenders who charge extra high rate of interest hence small enterprise continue to be financially weak. Small scale enterprises find it difficult to get raw materials of good quality at reasonable prices in the field of production. Furthermore, the techniques of production, which the enterprises have adopted, are usually outdated. Because of their poor financial position they are not able to buy new equipment, consequently their productivity suffers. Small business’s owner can avoid some of the common pitfalls that lead to business failure by knowing the business in depth; developing a solid business plan; managing financial resources; understanding financial statements; and learning to manage people effectively.   
**3.10 Organizational Structure and Entrepreneurial Team Formation**

We can perceive from the experiences of companies the importance of employees and their loyalty and commitment to the organization. Also significant to potential investors is the management team and its ability and commitment to the new venture. Investors will usually demand that the management team not attempt to operate the business as a sideline or part-time venture while employed full time elsewhere. It is assumed that the management team is prepared to operate the business full time and at a modest salary. It is unacceptable for the entrepreneurs to try to draw a large salary out of the new venture, and investors may perceive any attempt to do so as a lack of psychological commitment to the business.  
**Designing the Organization:**  Generally, the design of the initial organization will be simple. In fact, the entrepreneur may find that he or she performs all the functions of the organization alone. This is a common problem and a significant reason for many failures.  
the entrepreneur sometimes thinks that he or she can do everything and is unwilling to give up responsibility to others or even include others in the management team. In most cases when this occurs, the entrepreneur will have difficulty making the transition from a start-up to a growing, well-managed business that maintains its success over a long period of time. All the design decisions involving personnel and their roles and responsibilities reflect the formal structure of the organization. In addition to this formal structure, there is an informal structure or organization culture that evolves over time that also needs to be addressed by the entrepreneur. For many new ventures, predominantly part-time employees may be hired, raising important issues of commitment and loyalty. The design of the organization will be the entrepreneur’s formal and explicit indication to the members of the organization as to what is expected of them. Typically, these expectations can be grouped into the following five areas:-  
***Organization*** *structure*- This defines members’ jobs and the communication and relationship these jobs have with each other. These relationships are depicted in an organization chart.

* *Planning, measurement, and evaluation schemes*- All organization activities should reflect  
  the goals and objectives that underlie the venture’s existence.
* *Rewards*- Members of an organization will require rewards in the form of promotions, bonuses, praise, and so on. The entrepreneur or other key managers will need to be responsible for these rewards.
* *Selection criteria*- The entrepreneur will need to determine a set of guidelines for selecting individuals for each position.
* Training- Training, on or off the job, must be specified. This training may be in the form of formal education or learning skills.

**3.10.3 Building the Management Team and a Successful Organization Culture**

In conjunction with the design of the organization, the entrepreneur will need to assemble the right mix of people to assume the responsibilities outlined in the organization structure. Some of the issues identified in the organization design will be revisited here since they are not only critical to the building of the team but are just as important in establishing a positive and successful organization culture. This strategy must be maintained through the stages of start-up and growth of the enterprise. There are some important issues to address before assembling and building the management team. In essence, the team must be able to accomplish three functions:- Execute the business plan; Identify fundamental changes in the business as they occur and Make adjustments to the plan based on changes in the environment and market that will maintain profitability. ***First***, the entrepreneur’s desired culture must match the business strategy outlined in the business plan. ***Second***, the leader of the organization must create a workplace where employees are motivated and rewarded for good work. ***Third***, the entrepreneur should be flexible enough to try different things. ***Fourth***, it is necessary to spend extra time in the hiring process. There is sometimes a tendency to want to hurry the process of finding the appropriate skills to fill the organization’s needs.

***Next***, the entrepreneur needs to understand the significance of leadership in the organization

**CHAPTER 4: PRODUCT/SERVICE DEVELOPMENT**  
**4.1 INTRODUCTION**

In Entrepreneur’s business, product/service development is the term used to describe the complete process of bringing a new product or service in the market and it's an ongoing practice in which the entire business is looking for opportunities as new products provide growth promise to businesses that allow them to strengthen their market position. The new product development process involves the idea generation, product design, and detail engineering; and also involves market research and marketing analysis. Intense global competition, short product and technology lifecycles, unpredictable consumer buying patterns and possible market stagnation makes new product development a critical activity in most businesses.

**4.2 The Concept of Product/Service Technology**

Many entrepreneurs find it difficult to identify a new product/service or a new market opportunity. To start and expand a small venture, an entrepreneur needs to identify opportunities for domestic and/or international expansion. As the new venture grows and matures a need for different management skills can occur as well as for a new infusion of the entrepreneurial spirit (corporate entrepreneurship). Organization's success is dependent on customer satisfaction and delight. Customer satisfaction is achieved through the development of product and service, which have all attributes required by the customer. A success product or services do not only have an attractive package design but should be also able to provide robust performance. Thus, product design must be practical enough for production and powerful enough to provide a competitive advantage. The essence of product design is to satisfy customer and maximizes the value for the customer at minimum cost. The merchandise or service should also be able to meet primary needs and desire of the customer. This may not require development of new merchandise, but an enhancement to existing merchandise or service. Most companies apparently are introducing a wide variety of smaller, more efficient, and more intelligent products, coupled with a leaner, more efficient approach to operation. The goal is to create products and services by identifying an emerging trend and to match that trend with the right technology and understanding of the purchasing dynamics. A successful startup depends on its distinctive and compelling proposition. There also seems to be a popular myth that anyone can be successful by simply working on any given idea or opportunity. This isn’t true! You can’ t. Most businessmen are very knowledgeable about the merchandise before they start, since even experienced operators will run into unexpected troubles when they start their new business.

**4.3 Product/Service Development Process**

Once the opportunity is selected, and a business model has been designed, the next step is to develop a commercial version of the opportunity which in most cases is either a product or a  
94 service. One of the essential characteristics of a successful business is exemplified by its ability to continuously and rapidly develop new or improved versions of existing products that deliver values more than customers expect (*Palgrave, 2019.)* Product development is the process through which companies react to market signals, respond to changes in customer demand, adopt new technologies, foray into new areas, and ensure continuous growth. It is a core process in achieving strategic objectives, renewal of the company business model and deterring competition from displacing the company from its market position. The various stages of new product development process are explained next:

1. **New Idea Generation** The new product development process starts with search for ideas. Companies have to encourage any new idea coming. The key to successful domestic and international entrepreneurship is to develop an idea that has a market for the new product/service idea conceived. Some of the more fruitful sources of ideas for entrepreneurs include consumers, existing products and services, distribution channels, the federal government, and research and development.

2. **Idea Screening** In the 2nd stage, the purpose is to lessen the number of ideas to few vital/valuable ideas. The ideas should be written down and reviewed each week by an idea committee who should sort the ideas into three groups- *Promising Ideas, Marginal Ideas, and Rejects*: Each promising idea should be researched by committee member.

3. **Concept Development and Testing** Attractive ideas must be refined into fast able product concepts since people do not purchase ideas but they buy concepts. Any product idea can be turned into several product concepts. The questions asked probably include:-Who will use the product? What benefits should the product provide? When will people consume the produced?  
*Concept Testing*: - calls for testing product concepts with an appropriate group of target consumers/customers, and then getting the consumers’ reactions. At this stage, the concepts can be in words or picture description.

4. **Marketing Strategy Development:** After testing the new product the concerned body must develop a preliminary marketing strategy plan for introducing the new product into the market. The marketing strategy will undergo further refinement in subsequent stages. The marketing strategy plan consists of three parts: (1) Market size, structure, behavior ;( 2) Planned price, distribution strategy, and marketing budget of the 1 st year; and (3) Long run sales and profit goals, marketing mix strategy.

5. **Business Analysis** After management develops product concept and marketing strategy, it can evaluate the proposals’ business attractiveness. Management needs to prepare sales, cost and profit projections to determine whether they satisfy the company's objective or not.  
*Estimated Total Sales: -* Management needs to estimate whether sales will be high enough to yield satisfactory profit.  
*Estimating Cost and Profits****: -*** After sales forecast the management should estimate the expected cost and profit at various levels of sales volume. The company can use other financial measure to evaluate the merit of a new product proposal. The simplest is ***breakeven analysis***.

6. **Product Development** If product concept passes the business test, it moves to R&D or engineering to be developed to one or more physical version of the product concept. Its goal is to find a proto type that the consumers/customers see as embodying the key attribute described in the product concept statement, Scientists must not only design the products’ required functional characteristics but also know how to communicate its psychological aspects through physical cues and how will the consumer/customer react to different colors, sizes, weight & other physical cues. When the prototypes are ready, they must be put through regroups functions and consumer/customer tests. Functional tests are conducted under laboratory & field conditions to make sure that the product performs safely and effectively (Durability, Speed, Cost, etc) Consumer testing can take variety of forms, from bringing consumers/customers into laboratory to giving them samples to use in their homes.

7. **Market Testing** After management is satisfied with the products’ functional and psychological performance, the product is ready to be dressed up with the brand name. The goals are to test the new product is more authentic consumer/customer settings and to learn how large the market is and how consumers/customers and dealers react to handling, using and repurchasing the actual product. Most companies know that market testing can yield valuable information about buyers, dealers, marketing program effectiveness, market potential & other matters.  
8. **Commercialization**: *When (Timing):-* In commercializing, market entry timing is critical. If the company hears about a competitor nearing the end of its development work, it will face three choices. ***First Entry***. Under this category, the firm usually enjoys the "first mover advantage" of locking up key distributors & gaining reputation. ***Late Entry Strategy***- which has three advantages include:-  
• The competition will have borne the cost of educating the market;  
• The competing product may reveal fault that the late entrant can avoid; and  
• The company can learn the size of the market. ***Parallel Entry-*** can be also chosen by the company to get in the market. The strategy to work, a prospective businessman can take the advantage of opting for the latest technology and production process and operate at higher volume of operation. This leads to reduced production cost and production of quality goods and services.

*Where (Geographical Strategy):-* The company must decide whether to launch the new product in a single locality, a region/several regions, in the national/international market.

*To Whom (Target-Market-Prospect):-* Within the rollout markets, the company must target its distribution and promotion to the best prospect group. Prime prospects for a new consumer/customer’s product would ideally have the following characteristics: They would be early adapters; heavy users; Opinion leaders; and could be reached at low cost.  
*How (Introductory Markets Strategy****):-*** To sequence and coordinate many actives involved in launching a new product may/can use network-planning techniques such as *Critical Path*  
*Scheduling (CPS).*  
 **4.4 Legal and Regulatory Frameworks for Entrepreneurs**

Since there are many options that an entrepreneur can choose in setting up an organization, it will be necessary to understand all the advantages and disadvantages of each regarding such issues as liability, taxes, continuity, transferability of interest, costs of setting up, and attractiveness for raising capital. Legal advice for these agreements is necessary to ensure that the most appropriate decisions have been made. One of the challenges the novice entrepreneur will face as she goes into business understands the regulatory environment which is made up of numerous laws and regulations. To operate as a legal businessperson and protect the business from unnecessary suits and liabilities, the entrepreneur needs to understand the various laws that govern his/her business. Following are the key legal issues for the entrepreneur.  
**4.5 Intellectual Property Protection/Product/Service Protection**  
**4.5.1 what is Intellectual Property?** Intellectual Property which includes patents, trademarks, copyrights, and trade secrets represents important assets to the entrepreneur and should be understood even before engaging the services of an attorney. Too often entrepreneurs, because of their lack of understanding of intellectual property, ignore important steps that they should have taken to protect these assets. Intellectual property is a legal definition of ideas, inventions, artistic works and other commercially viable products created out of one's own mental processes. In the same sense that real estate titles establish ownership of tangible items, intellectual property is protected by such legal means as patents, copyrights, and trademark registrations. In order to enjoy the benefits arising from the exclusive ownership of these properties, the entrepreneur needs to protect these assets by the relevant law. This is the reason why’ experts strongly recommend that those in creative fields seek protection through official registration of their intellectual properties.  
**4.5.2 Patents:**  An entrepreneur who invents a new thing or improves an existing invention needs to get legal protection for her invention through a patent right. A patent is a contract between an inventor and the government in which the government, in exchange for disclosure of the invention, grants the inventor the exclusive right to enjoy the benefits resulting' from the possession of the patent. Utility Patent: A utility patent protects any new invention or functional improvements on existing inventions. Design Patent: This patent protects the appearance of an object and covers new, original, ornamental, and unobvious designs for articles of manufacture. Like utility patents, design patents provide the inventor with-exclusive right to make, use and/or sell an item having the ornamental appearance protected by the patent. This patent is appropriate when the basic product already exists in the marketplace and is not being improved in function but only in style. These patents are particularly important to companies such as shoe producers and product package design firms that need to protect their ornamental designs. A patent provides the owner with exclusive rights to hold, transfer, and license the production and sale of a product/process. Patents are property rights that can be sold and transferred, willed as well as licensed and at times used as collateral.  
**What Can Be Patented Then?**  
• *Processes*: Methods of production, research, testing, analysis, technologies with new applications.  
• *Machines*: Products, instruments, physical objects.  
• *Manufactures*: Combinations of physical matter not naturally found.  
• *Composition of matter*: Chemical compounds, medicines, etc.  
**4.5.3 Trademarks** A trademark may be a word, symbol, design, or some combination of such, or it could be a slogan or even a particular sound that identifies the source or sponsorship of certain goods or services. These are distinctive names, marks, symbols or motto identified with a company’s product or service and registered by government offices. Unlike the patent, a trademark can last indefinitely, as long as the mark continues to perform its indicated function. Trademarks unlike patents are periodically renewed unless invalidated by cancellations, abandonment, or other technical registration/renewal issues.  
**Benefits of a Registered Trademark**  
• It provides notice to everyone that you have exclusive rights to the use of the mark throughout the territorial limits of the country.  
• It entitles you to sue in federal court for trademark infringement, which can result in recovery of profits, damages, and costs.  
• It establishes incontestable rights regarding the commercial use of the mark.  
• It establishes the right to deposit registration with customs to prevent importation of goods with a similar mark.  
• It entitles you to use the notice of registration (®).  
• It provides a basis for filing trademark application in foreign countries.  
**4.5.4 Copyrights**

Copyright is a right given to prevent others from printing, copying, or publishing any original works of authorship. Copyrights provide exclusive rights to creative individuals for the protection of literary or artistic productions. It protects original works of authorship including literary, dramatic, musical, and artistic works, such as poetry, novels, movies, songs, computer software, and architecture. They pertain to intellectual property. Usually copyrights are valid for the life of the inventor plus a few decades.  
**4.6 The Intellectual Property System in Ethiopia**

Ethiopia became a party to the convention establishing the world Intellectual Property Organization (WIPO) in February 1998 right after some time the Country had joined the Nairobi Treaty on the Protection of the Olympic Symbol in 1981. It is a member of the Treaty establishing the Common Market for Eastern and Southern Africa (COMESA) which was formed in 1994, the Partnership Agreement between members of the African, Caribbean and Pacific (ACP) Group of States and the European Union (EU). The Ethiopian Government established the Ethiopian Intellectual Property Office in the year 2003 containing the understated Objectives:-  
• To facilitate the provision of adequate legal protection for and exploitation of intellectual property in the country;  
• To collect, organize and disseminate technological information contained in patent documents and encourage its utilization;  
• To study, analyze and recommend policies and legislation on intellectual property to the government; and  
• To promote knowledge and understanding of intellectual property among the general public; The existing laws and directives in Ethiopia in the field of Intellectual Property (IP) are the Patent Proclamation and the Implementing Regulation, the Copyright and Related Rights Proclamation and The Trademark Registration Directive. According to the proclamation in order to be granted a patent, an invention must fulfill three conditions- (1) it must be new- It should never have been published or publicly used before; (2) It should be capable of industrial application- It must be something which can be industrially manufactured or used; and (3) It must be "non-obvious”- It should not be an invention which would have occurred to any specialist working in the relevant field. The proclamation excludes the following from patentability:-  
• Inventions contrary to public order or morality;  
• Plant or animal varieties or essentially biological processes for the production of plants or animals; and  
• Schemes, rules or methods for playing games or performing commercial and industrial activities and computer programs;  
• Discoveries, scientific theories and mathematical methods; and  
• Methods for treatment of the human or animal body by surgery or therapy as well as diagnostic methods practiced on the human or animal body. Rights of a patentee include making, using and exploiting the patented invention in any other way. Any person who wants to use the patented invention has to get the authorization of the owner/inventor. The patentee does not have import monopoly right over the products of the patented invention in Ethiopia. There are certain limitations of rights of the patentee included in the proclamation such acts done for non-commercial purposes; the use of the patented invention solely for the purposes of  
scientific research and experimentation; the use of patented articles on aircraft, land vehicles or vessels of other countries which temporarily or accidentally enter in to the air space, territory or waters of Ethiopia; acts in respect of patented articles which have been put on the market in Ethiopia by the owner of the patent or with his/her consent; the use of the patented invention for national security, nutrition, health or for the development of vital sectors of the economy, subject to payment of an equitable remuneration to the patentee; the duration of a patent is 15 years which may be extended for a further period of five years if proof is furnished that the invention is properly worked in Ethiopia.  
**Trademark Directive** is issued in the country in 1986 with the following objectives in that it helps:-  
• To centrally deposit trademarks which are used by local and foreign enterprises to distinguish their goods or services;  
• To distinguish the products or services of one enterprise from those of other enterprises and prevent consumers from being victims of unfair trade practices;  
• To provide information on trademark ownership and right of use when disputes arise between parties;  
• To provide required information on trademarks to government and individuals; and  
• Protection is granted after publication of cautionary notice;  
**Copyright** is protected on the basis of the copyright and related rights proclamation issued in 2004. The proclamation gives protection to literary, artistic and scientific works which include books, pamphlets, articles, computer programs and other writings; speeches, lectures, addresses, sermons, and other oral works; dramatic, dramatic-musical works, pantomimes, choreographic works, and other works created for stage production; musical works, with or without accompanying words; audiovisual works and sound recordings works of architecture; works of drawing, painting, sculpture, engraving, lithography, tapestry, and other works of fine arts; photographic and cinematographic works; illustrations, maps, plans, sketches, and three dimensional works related to geography, topography, architecture or science; derivative works; and collection of works, collection of mere data (databases) whether readable by machine or other form. The Proclamation gives protection to:  
• Works of authors who are nationals of or have their habitual residence in Ethiopia;  
• Works first published in Ethiopia; or works first published in another country and published within thirty days in Ethiopia;  
• Audio-visual works whose producer has his headquarter or habitual residence in Ethiopia; and  
• Works of architecture erected in Ethiopia and other artistic works incorporated in a building or other structure located in Ethiopia. The author of a work shall be entitled to protection, for his work upon creation where it is an original work; and written down, recorded, fixed or otherwise reduced to any material form. Quality of the work and the purpose for which the work may have been created is not taken in to consideration. The rights of performers, producers of phonograms and broadcasting organizations are also protected by law. Copyright is protected for the life of the author plus fifty years. Fifty years for the rights of performers and producers of sound Recordings and 20 years for the rights of broadcasting organizations.

**CHAPTER 5: MARKETING**  
**5.1 INTRODUCTION**

Business firms and non-profit organizations engage in marketing. Products marketed include goods as well as services, ideas, people, & places. Marketing activities are targeted at market consisting of product purchasers who may be individuals and groups that influence the success of an organization. The foundation of marketing is exchange. In which one party provides to another party something of value in return for something else of value. In a broad sense, marketing consists of all activities designed to generate or facilitate an exchange intended to satisfy human needs. The concept of market is very important in marketing. market is a group of buyers and sellers interested in negotiating the terms of purchase/sale for goods or services. The negotiation work may be conducted face-to-face at a certain place or it may be done through other means of communication, such as correspondence, phone, cable, or it may be done through business middlemen, e.g., brokers and commission agents. This chapter discusses about marketing and its basic components.

**5.2 Meaning and Definitions of Marketing**

Marketing can occur any time with one social unit (person or organization) who strives to exchange something of values with another social unit. Thus, the essence of marketing is a transaction or exchange. In this broad sense, marketing consists of activities designed to generate and facilitate exchange intended to satisfy human needs or wants. Marketing has been defined in various ways. The definitions that serve our purpose best are as follows:

1. Marketing is a social and managerial process by which an individual or group obtain what they need and want through creating, offering and exchanging of product of values with others (Philip Kotler,2012).

2. Marketing is the total business activity designed to plan, price, promote and distribute want satisfying products to target market to achieve organizational goal (William J.Stanton, 1984).

3. Marketing is the creation and delivery of standard of living to society (Paul. Mazor, 2005).

4. Marketing management is the process of planning and executing, the conception, pricing, promoting and distributing of ideas, goods and services to create an exchange that satisfy individual or group objectives (American marketing Association, 2015).

5. Marketing is the effort to identify and satisfy customers’ needs and wants. The above definitions of marketing reset on the following core concepts: needs, wants and demands products (Goods, Services and Idea), value, cost and satisfaction: exchange and transaction; Relationship and Networks; market; and marketers and prospects. it answers the following questions:

**Who are your customers?** Your customers are the people or other businesses that want your products/ services and are willing to pay for them. They include; People who are buying from you now. People you hope will buy from you in the future. People who stopped buying from you but you hope to get them back.  
**What are my customer’s needs and wants?** An important point to note is that customers want to look at different products so that they can choose what they like best. Some customers want a different design and others want high quality and are willing to pay extra for that.  
**How can I satisfy my customers’?** You need to do everything to find out who your customers are and what they need and want in order to satisfy them improve your sales and make a profit. You need to find out; Products/services your customers want. Price your customers are willing to pay. Location of your business in-order to reach your customers (Place). Promotion to use to inform your customers and attract them to buy your products or services.  
**5.3 Core Concepts of Marketing**  
**5.3.1 Needs, Wants and Demand**

A person at any given time has a need. This need arises out of physical or psychological imbalances. Marketing starts with human needs and wants. People need food, air, water, clothing and shelter to survive. Beyond this, people have a strong desire for recreation, education and other services. Let see terms related with this as follow:  
☞ **Need**: - Human Need is a state of deprivation of some basic satisfaction. People require food, clothing, shelter, safety and belonging and esteem.  
☞ **Wants**: - Wants are desires for specific satisfiers of needs. Human wants are continually shaped and reshaped by social forces and institutions including churches, schools, families and business cooperation. Eg. A person needs food but wants spaghetti  
☞ **Demands**: - Demands are wants for specific products that are backed by ability and willingness to buy them. Wants become demand when supported by purchasing power. Companies must therefore measure not only how many people want their product but, more importantly how many would actually be willing and able to buy it.  
☞ **Product**: - is anything that can be offered to satisfy a need or want. Products broadly classify as tangibility and intangibility features.  
☞ **Value**: - is the consumer’s estimate of the products overall capacity to satisfy his or her needs.  
☞ According to DeRose, value is “the satisfaction of customer requirement at the lowest cost of acquisition, ownership and use”.  
☞ **Cost**: - is the amount of money that are going to be expended or already incurred to acquire a product.  
☞ **Exchange**: - is the act of obtaining a desired product from someone by offering something in return.  
☞ **Transaction**: - is the trade of values between two parties.  
☞ **Market: -** consists of all the potential customers sharing a particular need or want who might be willing and able to engage in exchange to satisfy their need or want.  
**5.4 Importance of Marketing**

On the average, about 50 cents of each dollar we spend as consumers goes to cover marketing costs. The money pays for designing the products to meet our needs, making products readily available when and where we want them, and informing us about producers. These activities add want satisfying ability or what is called utility, to products. A customer purchases a product because it provides satisfaction. That something that makes a product capable of satisfying want is its utility. And it is through marketing that much of a products utility is created. Then potential buyers must be informed about the products existence and the benefits it offers through various forms of promotion. The kinds of utility that marketing provides in the process are as follows:  
**1. Form Utility:** Form utility is associated primarily with production- the physical or chemical changes that make a product more valuable. When timber is made into furniture, form utility is created. This is production, not marketing

**2. Place Utility:** Place utility exists when a product is readily accessible to potential customers. So physically moving the products to a store near the customers add to its value.  
**3. Time Utility:** Time utility means having a product available when you want it.

**4. Information Utility:** Information utility is created by informing prospective buyers that a product exists. Unless you know a product exists and where you can get it, the product has no value. Advertising that describes a sales person answering a customer questions about the durability of a product creates information utility. Image utility is a special type of information utility. It is the emotional or psychological values that a person attaches to a product or brand because of its reputation or social standing.  
**5. Possession Utility:** Possession utility is created when a customer buys the product-that is, ownership is transferred to the buyer. Thus, for a person to consume and enjoy the product, a transaction must take place. This occurs when you exchange your money for a product.

**5.5 Marketing Philosophies**

Large-scale marketing activities in the world did not take shape until the industrial revolution is the latter part of the 1800s. Clearly, marketing activities should be carried out under a wellthought out philosophy of efficient, effective and socially responsible marketing. There are five competing concepts under which organizations can choose to conduct their marketing activities:

**1. The Production Concept:** The production concept is one of the oldest concepts in business. The production concept holds that consumers will favor products that are widely available and low in cost. Managers of production-oriented organization concentrate on achieving high production efficiency and wide distribution. The assumption that consumers are primarily interested in product availability and low price holds in at least two situations.

**2. The Product Concept:** Other businesses are guided by the product concept. The product concept holds that consumers will favor those products that offer the most quality, performance or innovative features. Under the concept, mangers assume that buyers admire well-made products and can appraise product quality and performance. In such situation, customers are ready to pay high prices for product extra features. Product-oriented companies often design their products with little or no customer input. They trust that their engineers will know how to design or improve the product.  
**3. The Selling Concept/Sales Concept:** The selling concept (or sales concept) is another common approach. The selling concept holds that consumers, if left alone, will ordinarily not buy enough of the organization product. The organization must therefore undertake an aggressive selling and promotion effort. This concept assumes that consumers typically show buying inertia or resistance and must be coaxed into buying. It also assumes that the company has made available a whole battery of effective selling and promotion tools to stimulate more buying. The selling concept is practiced more aggressively with unsought goods, those goods that buyers normally do not think of buying, such as insurance, encyclopedia, and funeral plots.

**4. The Marketing Concept:** The marketing concept is a business philosophy that challenges the three concepts we just discussed. Its central tents crystallized in the mid-1950s. The marketing concept holds that the key to achieving organizational goals consists of being more effective than competitors in integrating marketing activities toward determining and satisfying the needs and wants of target markets. The marketing concept has been expressed in many colorful ways: “Meeting needs profitably” “Find wants and fills them” “Love the customers, not the product etc.”

**5. The Societal Marketing Concept:** The societal marketing concept holds that the organization should determine the needs, wants and interests of target markets. It should then deliver the desired satisfactions more effectively and efficiently than competitors in a way that maintains or improves the consumers and the society’s well-being. The societal marketing concept holds that the organization’s task is to determine the needs, want, and interests of target markets and to deliver the desired satisfactions more effectively and efficiently than competitors in a way that preserves or enhances the consumers and the society’s wellbeing.

6. **Relationship Marketing:** Relationship marketing is the practice of building long term satisfying relations with key parties customers, suppliers, distributors- in order to retain their long term preferences and business. The ultimate outcome of relationship marketing is the building of a unique company asset called a marketing network. In this case, customer experience rather than customer satisfaction is the most critical component in relationship marketing.

**5.6 Marketing Information Systems**

Every firm must organize the flow of information to its marketing managers. Companies are studying their manager’s information needs and designing marketing information system to meet these needs. A marketing information system consists of people, equipment and procedure to gather, sort, analyze, evaluate and distribute needed timely and accurate information to marketing decision makers. The marketing managers to carry-out their analysis, planning, implementation, and control responsibilities, they need information about development in the marketing environment. The role of the information system is to assess the manager’s information needs, develop the needed information, and distribute the information is a timely fashion to the marketing managers. The needed information is developed through internal company records, marketing intelligence activities, marketing research, and marketing decision support analysis.  
**5.6.1 Marketing Research**

Marketing research is the systematic and objective identification, collection, analysis, and dissemination of information for the purpose of assisting management in decision making related to the identification and solution of problems and opportunities in marketing. Thus, systematic planning is required at all the stages of the marketing research process. The procedures followed at each stage are methodologically sound, well documented, and, as much as possible, planned in  
 advance. It uses the scientific method in that data are collected and analyzed to test prior thinking or hypotheses. Marketing research is objective. It attempts to provide accurate, impartial information.

**The Role of Marketing Research In Decision Making:** There are three Functional Roles of Marketing Research. These are:

* Descriptive Function - the gathering and presentation of statements of fact.
* Diagnostic (analytical) Function - The explanation of data.
* Predictive Function - Specification of how to use the descriptive and diagnostic research to predict the result of a planned marketing decision.****

**Marketing Research Components:** Marketing researchers deal with many aspects of a market including the following

* Market size:
* Market Share:
* Market penetration:
* Brand equity research
* Buyer decision processes research –
* Customer Satisfaction Research
* Distribution channel audits -
* Marketing effectiveness and analytics -
* Positioning research –
* Price elasticity testing –
* Sales forecasting -
* Segmentation research
* Test marketing

**Marketing Research Process** Since research is a process which consists of a number of steps to be accomplished in a logical and systematic manner marketing research consists of the following related phases:  
**Step 1: Define the research purpose or objectives** The following questions help to establish objectives:Where potential customers buy the product? why they purchase there? What is the size of the market? How much of it can your business capture? and alike.

**Step 2**: **Research Design Formulation** The research design is a ***blueprint*** for conducting the marketing research. More formally, formulating the research design involves the following steps:

⮚ Study period and place determination.  
⮚ Qualitative data collection methods.  
⮚ Methods of collecting quantitative data

⮚ Definition of the information needed.  
⮚ Questionnaire design.  
⮚ Measurement and scaling procedures.  
⮚ Sampling process and sample size.  
⮚ Plan of data analysis

**Step 3**: **Gather at this stage secondary data**, A data which is originally collected by others for their own purpose, but such data can be used by the researcher when it is relevant to the current study. Secondary data: it Is less expensive.Can be acquired within or outside the venture. But, may be out-dated and less valid.  
**Step 4.Gather Primary Data** Primary data collection techniques can be categorized as; Observational techniques-do not involve contact with respondents; Focus groups and Experimentation-investigates cause and effect relationships. Survey techniques- generate data by asking people questions and recording their responses. The following are examples of survey techniques.

**Step 5: Data Processing and Analysis** Data processing includes the editing, coding, transcription, and verification of data. And data analysis, guided by the plan of data analysis, gives meaning to the data that have been collected. Research results should be evaluated and interpreted in response to the research objectives.  
**Step 6**: **Report Preparations and Presentation** At the end the research results will be written in a report form and presented to the concerned parties. The report includes: The specific research questions identified, Describes the research approach, The research design, The data collection methods, and sampling procedures, The data processing and analysis procedures, The major findings and suggestions for actions.  
 **5.6.2 Marketing Intelligence**

Market intelligence is the systematic process of gathering, analyzing, supplying and applying information (both qualitative and quantitative) about the external market environment. Intelligence is evaluated information. Marketing intelligence is used to determine:  
❖ Current and future market needs,  
❖ Changes in the business environment that may affect the size and nature of the market in the future.  
❖ Environment that may affect the size and nature of the market in the future.  
**The Importance of Marketing Intelligence** Marketing intelligence provides the following benefits;

▪ Market and customer orientation   
▪ Identification of new opportunities.  
▪ Smart segmentation.  
▪ Early warning of competitor moves.  
▪ Minimizing investment risks.  
▪ Quicker, more efficient

**Ways to Undertake Marketing Intelligence**

i. **Unfocused scanning:** Any information that may be useful is gathered without any specific purpose in mind.  
ii. **Semi-focused scanning:** no specific purpose**.** The manager is not in search of particular pieces of information that he/she is actively searching but does narrow the range of media that is scanned. For instance, the manager may focus more on economic and business publications, broadcasts etc. and pay less attention to political, scientific or technological media.

iii. **Informal search: -** limited and unstructured attempt to obtain information for a specific purpose. For example, entering the business of importing frozen fish from a neighbouring country may make informal inquiries as to prices and demand levels of frozen and fresh fish. iv. **Formal search: -** this is a purposeful search for information in some systematic way. Marketing intelligence is carried out by the manager him/herself rather than a professional researcher. Scope of the search in this case is likely to be narrow and far less intensive (less rigorous) than marketing research.  
**5.6.3 Competitive Analysis**

Competitive analysis refers to determining the strengths and weaknesses of competitors and designing ways to take opportunities or tackle threats posed by competitors.  
**Uses of Competitive Analysis** Competitive analysis is important for businesses since it has the advantages stated as follow:  
☞ It helps management understand its competitive advantages/ disadvantages relative to competitors.  
☞ It generates understanding of competitors’ past, present (and most importantly) future strategies.  
☞ It provides an informed basis to develop strategies to achieve competitive advantage in the future (e.g. how will competitors respond to a new product or pricing strategy?)  
☞ It helps forecast the returns that may be made from future investments. Competitive analysis is a method of gathering data about competitors from different sources

**Steps of Competitive Analysis** Every business owner should have a complete understanding of the competitive landscape in the marke. The following provides a step-by-step process in creating your competitive analysis.  
**1) Identify your competitors:** Determine both local and international competitors. Be sure to define the competitive landscape broadly. Your competitor includes anything that could draw customers away from your business.  
**2) Gather information about competitors:** At this stage you need to know; what markets or market segments your competitors serve; what benefits your competitors offer; why customers buy from them; and as much as possible about their products and/or services, pricing, and promotion strategies.  
**3) Gathering Information on Competitors**  
To gather information about your competitor you can go either to your competitors’ company site or to the company's Web site (if any) using which you can learn about; promotion strategies by visiting their business site; prices; your competitors’ customers; vendors or suppliers, and their employees; trade shows; and publicly available information **-** from Newspapers, magazines, press releases and online publications.  
**4) Analyzing the Competition** After studying the information you have gathered about each of your competitors, ask yourself these primary questions:  
☞ How are you going to compete with that company?  
☞ Is there a particular segment of the market that your competitor has overlooked?  
☞ Is there a service that customers or clients want that your competitors do not supply?  
**5) Develop a pricing:** The last step in the process is to develop a pricing model that represents what you are offering the market and the value you bring to your target buyers.

**5.7. What Is Marketing Strategy?**

A marketing strategy is a process that can allow an organization to concentrate its limited resources on the greatest opportunities to increase sales and achieve a sustainable competitive advantage.  
 Marketing strategy is a method of focusing an organization's energies and resources on a course of action which can lead to increased sales and dominance of a targeted market. A marketing strategy combines product development, promotion, distribution, pricing, relationship management and other elements; identifies the firm's marketing goals, and explains how they will be achieved, ideally within a stated timeframe.  
**1. Pricing Strategy** Price is the value placed on what is exchanged. Something of value is exchanged for satisfaction and utility, includes tangible (functional) and intangible (prestige) factors. It can even be barter. Price is often the only element the marketer can change quickly in response to demand shifts. It relates directly to total revenue TR = Price \* Quantity Profit = TR – TC Where, TR=Total Revenue, TC=Total Cost Pricing strategies are subject to incredibly complex environmental and competitive forces. A company sets no single price, but rather a pricing structure that covers different items in its line. This pricing structure changes through time as products pass through their life cycles. To come up with this situations marketers use dynamic pricing strategies. The following are some of pricing strategies mostly applicable in the real world scenario.  
***i) Price Skimming****:* this is a type of marketing strategy that firms use by charging the highest possible price that buyers who most desire the product will pay. It attracts a market segment that is more interested in quality, status, uniqueness etc. In this case, consumers’ demand must be inelastic.  
***ii) Penetration Pricing:*** In this strategy, prices of products are reduced compared to competitors’ price for the same product to penetrate into markets and to increase sales. However, the quality of the product should not be lower as compared to other competitors’ product. It should be again noted that the cost of production should be lower to the extent that can enable the firm to get the desired profit. This is appropriate when the demand is elastic.  
***iii) Cost-plus pricing*:** Any amount that is above unit cost may be considered.  
***iv) Mark-up pricing****:* A certain percentage of the selling price is added to unit cost.  
***v) Competition Oriented Pricing:*** Considers competitors prices primarily; but the market type matters.  
***vi) Odd-even pricing***: This is Psychological pricing method based on the belief that certain prices or price ranges are more appealing to buyers. This method involves setting a price in odd numbers (just under round even numbers) such as $49.95 instead of $50.00

**2. Promotion Strategies** Promotion is the communication of the company and its products to customers. Promotional strategy is choosing a target market and formulating the most appropriate promotion mix to influence it. An organization’s promotional strategy can consist:  
***i) Advertising***: It is any paid form of non-personal, one-way, mass communication about an organization, good, service, or idea by an identified sponsor.  
***ii) Personal selling****:* This is the two-way flow of communication between a buyer and seller, often in a face to face encounter, designed to influence a person’s or group’s purchase decision.  
***iii) Public relations:*** Public relation is a form of communication that seeks to change the perceptions of customers, shareholders, suppliers, employees and other publics about a company and its products.  
***iv) Sales promotion****:* This promotion type involves short term incentives of value such as discounts, free samples, and prizes to be offered to arouse interest of customers in buying the good/service.

**3. Distribution Strategies** A successful product or service means nothing unless the benefit of such a service can be communicated clearly to the target market. For product-focused companies, establishing the most appropriate distribution strategies is a major key to success, defined as maximizing sales and profits. Unfortunately, many of these companies often fail to establish or maintain the most effective distribution strategies

▪ **Direct channels:** In this type of channel, producers and end users directly interact.  
▪ **Indirect channels:** In this type of channel intermediaries are inserted between seller and buyer. Intermediaries include Merchant Wholesalers, retailers, dealers, agents,  
brokers; and manufacturer’s branches and offices. Decisions about marketing channels, which help producers deliver goods and services to their target markets, are among the most critical tasks facing management-because the channels that  
are chosen intimately affect all of the other marketing decisions. The following factors should be considered to select the best channel under the condition of using best distribution strategy.  
▪ ***Company Factors***: financial, human and technological capabilities of a company to do its business activities.  
▪ ***Market Characteristics***: Geography, market density, market size, target market  
▪ ***Product Attributes***: perishability, value and sophistication of the product

***Environmental Forces***: those forces that affect the business like competition, technology and culture.  
**5.8 Selling and of Customer Service**

Many employees have unclear understanding of what customer service really is. There are indications everywhere that there are customer service problems that demand solutions. How service providers do their jobs, how fast and accurately they process paper works, how successfully they pursue accounts, and how effective they are in taking the next step to develop customer loyalty, will determine an organization's success in serving customers. It is because of these reasons that customer service delivery improvement programs fail in some instances. Customer service is what happens between the customer determining his/her needs and receiving the desired benefits. However, most service providers do not appropriately understand what service delivery really means. For this reason, many organizations fail to improve the level of their customer service delivery.

**5.8.1 The Concept of Service**

Service refers to any activity undertaken to fulfil customer’s needs. It is any act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a physical product. Distinctive features of services include intangibility, inseparability, variability, and perishability as opposed to goods. The feature of intangibility shows that pure services cannot be defined in terms of the physical dimensions; or the customer cannot see or feel them before purchase. The concept of inseparability, on the other hand, refers that production and consumption of services are inseparable; the 'sale' occurs just before both. There are also features of variability and perishability associated in service. Services are highly variable, because they depend on who provides them, and when and where they are provided. In addition to this, services are produced and consumed at the same point, and are totally perishable right after use. Service cannot be reproduced as a concert object and it can vary from one moment to the next. Based on this concept, service is characterized as; situational, difficult to measure, subjective and influenced by the service provider.

**5.8.2 The Concept of Customer**

Customer is a person or organization that buys a product or service either for use or for resale. Customers can be internal (e.g. member of the organization) or external (customers coming from outside). A thorough understanding of the concept of customer service enables organizations to provide quality service by using proper service management approaches.  
**5.8.3 Strategic Activities needed for Quality Customer Service Delivery**

Organizations should identify important strategic activities to ensure consistent, efficient and excellent customer service delivery using continuous improvement philosophy. Especially, the following specific areas should be considered: 1. Establishing a clear customer service strategy. 2. Ensuring that correct people are in place, with the correct skills to deliver outstanding personal service. 3. Establishing clear material service delivery processes. 4. Improving in terms of process improvement, quality monitoring and recovery continuously. 5. Participatory Management.

**5.8.4 Customer Handling and Satisfaction**

Customer handling and satisfaction is a key for successful organizations. Managers and employees should work hand-in-hand to improve their service delivery programs. Existing customers must be satisfied with the existing service. Existing customers are also means of potential customers. What is expected from successful service providers in this regard are the following. Poor service/defective service is the causes of loss and bankruptcy for many organizations. Many organizations, especially business organizations worried about the reduction of sales or profitability due to lost customers/ or gradual reduction of customers. Organizations invest huge cost to increase market share by using advertisement or different sales promotion techniques. But the first most important principle here is not losing a single customer. Retaining existing customers, however, requires systematic handling. Also take into account that the major reasons to lose customers are: Poor service, Poor quality and Rude behaviour.   
 **Considering Customers as an Invaluable Asset** The value of one customer is infinite, and you cannot possibly calculate it. This includes, sales to him in his lifetime as well as to customers he generates for you through word of mouth. This means, your most precious asset is your customer.

**Reducing Customer Complaints** Every single complaint should be treated as an opportunity to improve the quality of your products and services. A complaining customer is a very fair person. Turn customer discontent to your advantage.

**Place Yourself in The Customer’s Shoes** You have the right to choose your customers but not the luxury to compromise on your level of service. Get rid of the unwanted customer but do it with tact. Part with the unwanted customer with a smile and a handshake. Place yourself in the customer’s shoes. ‘Do unto your customer as you would have done unto you’.

**CHAPTER 6: BUSINESS FINANCING**

**6.1 INTRODUCTION**

Sourcing money may be done for a variety of reasons. Traditional areas of need may be for capital asset acquisition- new machinery or the construction of a new building. The development of new products can be costly but capital may be required. Such developments are financed internally, whereas capital for the acquisition of machinery may come from external sources. In this day and age of light liquidity, many organizations have to look for short term capital in the way of loans, working capital etc., in order to provide a cash flow cushion. This chapter discusses about financing of firms.

**6.2 Financial Requirements**

All businesses need money to finance a host of different requirements. In looking at the types and adequacy of funds available, it is important to match the use of the funds with appropriate funding methods.

**1) Permanent Capital**

The permanent capital base of a small firm usually comes from equity investment in shares in a limited company or share company, or personal loans to form partners or to invest in sole proprietorship. It is used to finance the start - up costs of an enterprise, or major developments and expansions in its life - cycle. It may be required for a significant innovation, such as a new product development. Equity from private investors may also be sought to take a small firm into the medium or large size category or as an exit route for the original investors. Ideally, permanent capital is only serviced when the firm can afford it; investment in equity is rewarded by dividends from profits, or a capital gain when shares are sold. It is not therefore a continual drain from the cash flow of a company, such as a loan, which needs interest and capital repayments on a regular basis. Equity capital usually provides a stake in the ownership of the business, and therefore the investor accepts some element of risk in that returns are not automatic, but only made when the small firm has generated surpluses.

**2) Working Capital**

It is short-term finance. Most small firms need working capital to bridge the gap between when they get paid, and when they have to pay their suppliers and their overhead costs. Requirements for this kind of short-term finance will vary considerably by business type. For example, a manufacturer or small firm selling to other businesses will have to offer credit terms, and the resulting debtors will need to be financed; the faster the growth, the more the debtors, and the larger the financial requirement.

However, even these types of business may need working capital to fund temporary loses, caused by seasonal fluctuations, or to cope with prepayment of expenses such as rent payable in advance. Although short-term finance is normally used to fund the trading of a business, it is also sometimes needed to purchase assets, which are short-lived such as company vehicles, which may be changed every 4 or 5 years.

**3) Asset Finance**

It is medium to long term finance. The purchase of tangible assets is usually financed on a longer-term basis, from 3 to 10 years, or more depending on the useful life of the asset. Plant, machinery, equipment, fixtures, and fittings, company vehicles and buildings may all be financed by medium or long-term loans from a variety of lending bodies.

**6.3 Sources of Financing**

Financial resources are essential for business, but particular requirements change as an enterprise grows. Obtaining those resources in the amount needed and at the time needed can be difficult for entrepreneurial ventures because they are generally considered more risky than established enterprises.

Managing assets effectively is crucial because underwriting assets creates liabilities that, if uncontrolled, can devastate a business. Cash is the most important asset to manage, and to generate cash, business must generate sales.

Assets management for the start-up entrepreneur is a matter of determining what is needed to support sales, and then gaining access to those assets at the optimum cost. The term “gaining access” is used because there are alternatives other than a cash purchase of assets. Equipment can be leased, for example, and office furniture can be rented. Manufactured products initially can be subcontracted rather than made, thereby avoiding the expense of procuring materials, equipment, and plant facilities. Entrepreneurs, therefore, have choices about what assets to obtain, when they must be obtained, and how to gain access to them.

The critical issue in financing is to assure sufficient cash flow for operations, as well as to plan financing that coincides with changes in the enterprise. Businesses obtain cash through two general sources, equity or debt, and both can be obtained from literally hundreds of different sources. The various sources of finance may be broadly be classified as follows:

**6.3.1 Internal Sources (Equity capital)**

Owner’s capital or owner’s equity represents the personal investment of the owner(s) in a business and it is sometimes called risk capital because these investors assume the primary risk of losing their funds if the business fails. However, if the venture succeeds, they also share in the benefit.

**Sources of Equity Capital**

**1. *Personal saving:*** The first place entrepreneurs should take for startup money is in their own pockets. As a general rule, entrepreneurs should provide at least half of the start- up funds in the form of equity capital.

**2. *Friends and relatives:*** After emptying their own pockets, entrepreneurs should turn to friends and relatives who might be willing to invest in the business. The entrepreneur is expected to describe the opportunities and threats of the business.

**3. *Partners:*** An entrepreneur can choose to take on a partner to expand the capital formation of the proposed business.

**4. *Public stock sale (going public):*** In some case, entrepreneurs can go public by selling share of stock in their corporation to outsiders. This is an effective method of raising large amounts of capital.

**5. *Angels:*** These are private investors (or angles) who are wealthy individuals, often entrepreneurs, who invest in the startup business in exchange for equity stake in these businesses.

**6. *Venture capital companies*:** Are private, for profit organizations that purchase equity positions in young business expecting high return and high growth potential opportunity. They provide start -up capital, development funds or expansion funds.

**6.3.2 External Sources (Debt capital)**

Borrowed capital or debt capital is the external financing that small business owner has borrowed and must repay with interest. There are different sources as discussed here below:

**I) Commercial banks**: Commercial banks are by far the most frequently used source for short term debt by the entrepreneur. In most cases, commercial banks give short term loans (repayable within one year or less) and medium term loan (maturing in above one year but less than five years), long term loans (maturing in more than five years).

To secure a bank loan, an entrepreneur typically will have to answer a number of questions, together with descriptive commentaries.

* What do you plan to do with the money?
* When do you need it?
* How much do you need?
* For how long do you need it?
* How will you repay the loan?

**Bank Lending Decision:-**The small business owner needs to be aware of the criteria bankers use in evaluating the credit worthiness of loan applications. Most bankers refer to the five C’s of credit in making lending decision. The five C’s are capital, capacity, collateral, character, and conditions.

**1. *Capital:*** A small business must have a stable capital base before a bank will grant a loan.

**2. *Capacity:*** The bank must be convinced of the firm’s ability to meet its regular financial obligations and to repay the bank loan.

**3. *Collateral:*** The collateral includes any assets the owner pledges to the bank as security for repayment of the loan.

**4. *Character:*** Before approving a loan to a small business, the banker must be satisfied with the owner’s character. The evaluation of character frequently is based on intangible factors such as honesty, competence, willingness to negotiate with the bank.

**5. *Conditions:*** The conditions surrounding a loan request also affect the owner’s chance of receiving funds. Banks consider the factors relating to the business operation such as potential growth in the market, competition, location, and loan purpose. Another important condition influencing the banker’s decision is the shape of the overall economy including interest rate levels, inflation rate, and demand for money.

**II) Micro Finances**: provide financial services mainly to the poor, micro and small enterprises.

**III) Trade Credit**: It is credit given by suppliers who sell goods on account. This credit is reflected on the entrepreneur’s balance sheet as account payable and in most cases it must be paid in 30 to 90 or more days.

**IV) Equipment Suppliers**: Most equipment vendors encourage business owners to purchase their equipment by offering to finance the purchase.

**V) Account receivable financing**: It is a short term financing that involves either the pledge of receivables as collateral for a loan.

**VI) Credit unions**: Credit unions are non-profit cooperatives that promote savings and provide credit to their members. But credit unions do not make loans to just any one; to qualify for a loan an entrepreneur must be a member.

**VII) Bonds:** A bond is a long term contract in which the issuer, who is the borrower, agrees to make principal and interest payments on specific date to the holder of the bond. Bonds have always been a popular source of debt financing for large companies in the western world.

**VIII) Traditional Sources of Finance:** “Idir”, “equib”

**6.4 Lease Financing**

Lease financing is one of the important sources of medium- and long-term financing where the owner of an asset gives another person, the right to use that asset against periodical payments.

The owner of the asset is known as lessor and the user is called lessee. The periodical payment made by the lessee to the lessor is known as lease rental. Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

**6.4.1 Types of Lease**

Depending upon the transfer of risk and rewards to the lessee, the period of lease and the number of parties to the transaction, lease financing can be classified into two categories. Finance lease and operating lease.

**1) Finance Lease**

It is the lease where the lessor transfers substantially all the risks and rewards of ownership of assets to the lessee for lease rentals. In other words, it puts the lessee in the same condition as he/she would have been if he/she had purchased the asset. Finance lease has two phases: The first one is called primary period. This is non-cancellable period and in this period, the lessor recovers his total investment through lease rental. The primary period may last for indefinite period of time. The lease rental for the secondary period is much smaller than that of primary period.

**2) Operating Lease**

Lease other than finance lease is called operating lease. Here risks and rewards incidental to the ownership of asset are not transferred by the lessor to the lessee. The term of such lease is much less than the economic life of the asset and thus the total investment of the lessor are not recovered through lease rental during the primary period of lease. In case of operating lease, the lessor usually provides advice to the lessee for repair, maintenance and technical knowhow of the leased asset and that is why this type of lease is also known as service lease.

**Advantages and Disadvantages of Lease Financing**

At present leasing activity shows an increasing trend. Leasing appears to be a cost-effective alternative for using an asset. However, it has certain advantages as well as disadvantages.

The advantages of lease financing from the point of view of lessor are summarized below:

* **Assured Regular Income:** Lessor gets lease rental by leasing an asset during the period of lease which is an assured and regular income.
* **Preservation of Ownership:** In case of finance lease, the lessor transfers all the risk and rewards incidental to ownership to the lessee without the transfer of ownership of asset. Hence the ownership lies with the lessor.
* **Benefit of Tax:** As ownership lies with the lessor, tax benefit is enjoyed by the lessor by way of depreciation in respect of leased asset.
* **High Profitability:** The business of leasing is highly profitable since the rate of return based on lease rental, is much higher than the interest payable on financing the asset.
* **High Potentiality of Growth:** The demand for leasing is steadily increasing because it is one of the cost efficient forms of financing. Economic growth can be maintained even during the period of depression. Thus, the growth potentiality of leasing is much higher as compared to other forms of business.
* **Recovery of Investment:** In case of finance lease, the lessor can recover the total investment through lease rentals.

Lessor suffers from certain limitations which are discussed below:

* **Unprofitable in Case of Inflation**: Lessor gets fixed amount of lease rental every year and they cannot increase this even if the cost of asset goes up
* **Double Taxation:** Sales tax may be charged twice. First at the time of purchase of asset and second at the time of leasing the asset.
* **Greater Chance of Damage of Asset:** As ownership is not transferred, the lessee uses the asset carelessly and there is a great chance that asset cannot be useable after the expiry of primary period of lease.

**6.5 Traditional Financing in Ethiopian (Equib/Edir, Etc.)**

While Ethiopia has one of the least-developed formal financial sectors in the world, it possessed a rich tradition in indigenous, community-based groups such as savings and credit associations and insurance like societies. These "iqub" and "idir" groups provide a source of credit and insurance outside the formal sector but much rooted in Ethiopian society.

An iqub is a form of savings. People voluntarily join a group and make a mandatory contribution (every week, pay period or month or example). The "pot" is distributed on a rotating basis determined by a drawing at the beginning of the iqub. Amounts contributed vary according to the ability of the participants.

While ‘*Iqub*’ is a means of savings and may be substitute for formal banking credit, "Idirs" are burial societies that provide a traditional form of insurance. Idir contributions are used to pay for expenses in the event of the death of a family member. Idir is the only means, other than personal savings, to pay for these expenses. Idir associations are also forming the basis for some foreign assistance programs, particularly those focused on HIV/AIDS treatment and prevention.

**6.6 Crowd Funding**

Crowd funding is a method of raising capital through the collective effort of friends, family, customers, and individual investors or even from the general public. This approach taps into the collective efforts of a large pool of individuals primarily online via social media and crowd funding platforms and leverages their networks for greater reach and exposure.

**6.6.1 How is Crowd Funding Different?**

Crowd funding is essentially the opposite of the mainstream approach to business finance.

Traditionally, if you want to raise capital to start a business or launch a new product, you would need to pack up your business plan, market research, and prototypes, and then shop your idea around to a limited pool or wealthy individuals or institutions. These funding sources included banks, angel investors, and venture capital firms, really limiting your options to a few key players.

Crowd funding platforms, on the other hand, turns that funnels on-end. By giving you, the entrepreneur, a single platform to build, showcase, and share your pitch resources, this approach dramatically streamlines the traditional model.

**6.6.2 The Benefits of Crowd funding**

From tapping into a wider investor pool to enjoying more flexible fund raising options, there are a number of benefits to crowd funding over traditional methods. Here are just a few of the many possible advantages:

Reach**:** By using a crowd funding platform like Fundable, you have access to thousands of accredited investors who can see, interact with, and share your fund raising campaign.

Presentation**:** By creating a crowd funding campaign, you go through the invaluable process of looking at your business from the top level its history, traction, offerings, addressable market, value proposition, and more and boiling it down into a polished, easily digestible package.

PR & Marketing**:** From launch to close, you can share and promote your campaign through social media, email newsletters, and other online marketing tactics.

Validation of Concept**:** Presenting your concept or business to the masses affords an excellent opportunity to validate and refine your offering. As potential investors begin to express interest and ask questions, you’ll quickly see if there’s something missing that would make them more likely to buy in.

Efficiency**:** One of the best things about online crowd funding is its ability to centralize and streamline your fund raising efforts. By building a single, comprehensive profile to which you can funnel all your prospects and potential investors, you eliminate the need to pursue each of them individually. So instead of duplicating efforts by printing documents, compiling binders, and manually updating each one when there’s an update, you can present everything online in a much more accessible format, leaving you with more time to run your business instead of fundraising.

**6.6.3 Types of Crowd Funding**

Just like there are many different kinds of capital round raises for businesses in all stages of growth, there are a variety of crowd funding types. Which crowd funding method you select depends on the type of product or service you offer and your goals for growth.

The 3 primary type’s are donation-based, rewards-based, and equity crow funding.

1) **Donation-Based Crowd Funding**

Broadly speaking, you can think of any crowd funding campaign in which there is no financial return to the investors or contributors as donation-based crowd funding. Common donation based crowd funding initiatives include fund raising for disaster relief, charities, nonprofits, and medical bills.

2) **Rewards-Based Crowd Funding**

Rewards-based crowd funding involves individuals contributing to your business in exchange for a “reward,” typically a form of the product or service your company offers. Even though this method offers backers a reward, it’s still generally considered a subset of donation-based crowd funding since there is no financial or equity return.

3) **Equity-Based Crowd Funding**

Unlike the donation-based and rewards-based methods, equity-based crowd funding allows contributors to become part-owners of your company by trading capital for equity shares. As equity owners, your contributors receive a financial return on their investment and ultimately   
receive a share of the profits in the form of a dividend or distribution.

**6.7 Micro Finances**

**6.7.1 What is Micro Finance?**

Microfinance is a term used to describe financial services, such as loans, savings, insurance and fund transfers to entrepreneurs, small businesses and individuals who lack access to banking services with high collateral requirements. Essentially, it is providing loans, credit, access to savings accounts – even insurance policies and money transfers to small business owners, entrepreneurs (many of whom live in the developing world), and those who would otherwise not have access to these resources.

**6.7.2 Importance of MFIs**

Microfinance is important because it provides resources and access to capital to the financially underserved, such as those who are unable to get checking accounts, lines of credit, or loans from traditional banks. Without microfinance, these groups may have to resort to using loans or payday advances with extremely high interest rates or even borrow money from family and friends. Microfinance helps them invest in their businesses, and as a result, invest in themselves.

While microfinance can certainly benefit those stateside, it can also serve as an important resource for those in the developing world.

While some have lauded microfinance as a way to end the cycle of poverty, decrease unemployment, increase earning power, and aid the financially marginalized, some experts say that it may not work as well as it should, even going so far as to say it’s lost its mission. Others argue that microfinance simply makes poverty worse since many borrowers use microloans to pay for basic necessities, or their businesses fail, which only plunges them further into debt.

However, other expert’s say that microfinance can serve as a valuable tool for the financially underserved when used it properly. They also cite the industry’s high repayment rate as proof of its effectiveness. Either way, microfinance is an important topic in the financial realm, and if done correctly, could be a powerful tool for many.

**6.7.3 Micro Finances in Ethiopia**

Micro-finance in Ethiopia has its origin in traditional informal method used to accumulate saving and access credit by people who lacked access to formal financial institutions.

The microfinance industry is growing in terms of number and size. The MFIs in Ethiopia have been able to serve the productive poor people mainly with savings, credit, money transfer, micro insurance and other related services. Governmental and other developmental organizations have played a vital role for impressive performance the microfinance sector in the country.

The known micro finance institutions in different regions of Ethiopia with more than 90% market share are

1. Amhara Credit and Savings Ins. (ACSI) S.C.

2. Dedebit Credit and Savings Ins. (DECSI) S.C.

3. Oromiya Credit and Savings Ins. S.C (OCSCO).

4. Omo Credit and Savings Ins. S.C.

5. Addis Credit and Savings Institution S.C.(ADCSI)

**6.7.3.1 Types of Activities Carried Out by Ethiopian MFIs**

MFIs are allowed to carry out the following activities:

* Accepting both voluntary and compulsory savings as well as demand and time deposits
* Extending credit to rural and urban farmers and people engaged in other similar activities as well as micro and small scale rural and urban entrepreneurs.
* Drawing and accepting drafts payable within Ethiopia Micro-insurance business as prescribed by NBE,
* Purchasing such income generating financial instruments as treasury bill and other income generating activities,
* Acquiring, maintaining and transferring any movable and immovable property including premises for carrying out its business,
* Supporting income generating projects of urban and rural micro and small scale operators,
* Rendering managerial, marketing, technical and administrative advice to customers and assisting them to obtain services in those fields,
* managing funds for micro and small scale business,
* Providing money transfer services,
* Providing financial leasing services,

**CHAPTER 7 MANAGING GROWTH AND TRANSITION**

**7.1 INTRODUCTION**

This chapter discusses about managing growth and transition to more formalization of organization. Entrepreneurs at the initial stage focus on resource mobilization. However, once companies reach to growth stage, they must continue to grow with proper management and leadership. The success of an entrepreneur in this process depends upon controllable and uncontrollable variables. In developing countries such as Ethiopia, the environment is not business friendly and a lot of challenges will start to emerge as the business grows. This chapter discusses about the challenges of growth, business ethics and corporate social responsibility.

**7.2 Timmons Model of Entrepreneurship**

**What key aspects does an entrepreneur need to manage to start and grow a business?**

To answer this question, we used Timmons basic model of entrepreneurship.

According to Timmons, success in creating a new venture is driven by a few central themes that dominate the dynamic entrepreneurial process: it takes **opportunity**, a lead **entrepreneur** and an **entrepreneurial** **team**, **creativity**, **being careful with money**, and an **integrated, holistic, sustainable and** **balanced approach to the challenges ahead**. These controllable components of the entrepreneurial process can be assessed, influenced and altered. The entrepreneur searches for an opportunity, and on finding it, shapes the opportunity into a high-potential venture by drawing up a team and gathering the required resources to start a business that capitalizes on the opportunity, the entrepreneur risks his or her career, personal cash flow and net worth.

According to the model, for an entrepreneur to create a successful venture, they must balance three key components indicated earlier as elaborated here below:

1. **Opportunities**: rather than developing a perfect business plan, Timmons suggests that the entrepreneur’s first and most important step is to identify and evaluate a solidly viable market opportunity, where after the business plan and funding will follow. Problems in the environment become opportunities for entrepreneurs.

As stated earlier, Timmons model dictates that the entrepreneurial process does not start with business plan, money, strategy, networks or team. The Timmons model believes strongly that entrepreneurship is nothing but opportunity driven. Opportunities are more essential than the talent or competence of lead entrepreneur and the team because a right opportunity identified ensures long- term success of the business. A good idea does not necessarily bring about a great business. An excellent idea is found when product or services could be positioned to create or add values to customer, remains attractive, durable and timely.

2. **Teams**: once an opportunity has been identified, it is critical to gather a good team of people to unlock the potential of the opportunity. Team members do have defined roles. For instance, the success of a football team is determined by the qualities of team members as goal keeper, defense, midfield and attacking teams. Likewise, people in the team have different roles, weaknesses and strengths. No one is complete in all aspects. Teams do have also evolutionary stages for maturity.

According to Timmons model, a good team can lead to great success and a badly formed team can waste great idea which is disaster to any form of business. Among all resource, only a good team can unlock a high potential with any opportunity and manage the pressure related to growth.

The two major roles of the team, relative to the other critical factors are:

* Removing the ambiguity and uncertainty of the opportunity by applying creativity (inventiveness).
* Providing leadership to manage the available resources in the most effective manner by interacting with exogenous (external) forces and the capital market context that keeps changing constantly.

3. **Resources:** finding and managing appropriate resources requires different skills than finding and managing good people, but it is equally important for eventual success. Resources may include tangible and intangible resources. Knowledge, goodwill, information, etc., are intangible resources. Buildings, land, information technology, human resource, money, etc., are tangible resources.

Timmons suggests that balancing, or successfully juggling, these three dynamic factors is key to achieving business success. These factors are to be primarily managed through creativity, communication and leadership, to help bring the opportunity to a viable business model.

As stated earlier, the Timmons model stimulates the focus on opportunities rather than threats or limitations. It brings an academically tested approach to creating new ventures, at least in concept, written down in a business plan, describing where the fits and gaps are among the three key factors of the model.

The three critical factors of entrepreneurship in the model (opportunities, team and resources) are therefore not easy to manage separately; changes in one factor have a strong influence on the other factors.

**7.3 New Venture Expansion Strategies**

**7.3.1 Introduction**

All successful small business startups eventually face the issue of handling business expansion or growth. Business expansion is a stage of a company's life that is troubled with both opportunities and perils. On the one hand, business growth often carries with it a corresponding increase in financial fortunes for owners and employees alike. In addition, expansion is usually seen as a validation of the entrepreneur's initial business startup idea, and of his or her subsequent efforts to bring that vision to fruition. But business expansion also presents the small business owner with myriad issues that have to be addressed. Growth means that new employees will be hired who will be looking to the top management of the company for leadership. Growth means that the company's management will become less and less centralized, and this may raise the levels of internal politics, protectionism, and disagreement over what goals and projects the company should pursue. Growth means that market share will expand, calling for new strategies for dealing with larger competitors. Growth also means that additional capital will be required, creating new responsibilities to shareholders, investors, and institutional lenders. Thus, growth brings with it a variety of changes in the company's structure, needs, and objectives.

**7.3.2 Methods of Growth**

Small businesses can expand their operations by pursuing any number of avenues. The most common place methods by which small companies increase their business are incremental in character, i.e., increasing product inventory or services rendered without making wholesale changes to facilities or other operational components.

Common routes of small business expansion include the following common options:

* Growth through acquisition of another existing business (almost always smaller in size)
* Offering franchise ownership to other entrepreneurs,
* Licensing of intellectual property to third parties, (license for the use of certain innovative models on fee basis may be given to certain companies). This is very common for Software products.
* Establishment of business agreements with distributorships and/or dealerships,
* Pursuing new marketing routes (such as catalogs),
* Joining industry cooperatives to achieve savings in certain common areas of operation, including advertising and purchasing,
* public stock offerings (selling shares to investors and to the general public),
* Employee stock ownership plans (entrepreneurs may give/sell shares to employees as incentive for motivation.

Through this process, employee owned companies may be established. The growth process begins with an honest assessment of strengths and weaknesses. Given those skills, the organization then identifies the key markets or types of future market opportunities the company is likely to capture. This, of course, raises another set of issues about how to best develop the structures and processes that will further enhance the organization's core capabilities.

**7.3.3 The Ansoff Matrix – Growth Strategy**

**What is our business growth strategy in relation to new or existing markets and products?**

The Ansoff Matrix is a strategic-planning tool that provides a framework to help executives, senior managers, and marketers devise strategies for future growth. It is named after Russian

American Igor Ansoff, who came up with the concept. Ansoff suggested that there were effectively only two approaches to developing a growth strategy; through varying what is sold (product growth) and who it is sold to (market growth).

Igor Ansoff created the product/market matrix to illustrate the inherent risks in four generic growth strategies as summarized here below:

1. **Market penetration / consumption** – the firm seeks to achieve growth with existing products in their current market segments, aiming to increase market share. This is a low risk strategy because of the high experience of the entrepreneur with the product and market.

2. **Market development** – the firm seeks growth by pushing its existing products into new market segments. Market development has medium to high risk.

3. **Product development** – the firm develops new products targeted to its existing market segments. This alternative growth strategy is characterized by medium to high risk due to lack of experience about the new product.

4. **Diversification** – the firm grows by developing new products for new markets. This is high risk option as entrepreneurs do not have experience about the product and the market.

**7.3.3.1 Selecting a Product-Market Growth Strategy**

**I) Market penetration / consumption:**

Market penetration and consumption covers products that are existent in an existing market. In this strategy, there can be further exploitation of the products without necessarily changing the product or the outlook of the product. This will be possible through the use of promotional methods, putting various pricing policies that may attract more customers, or one can make the distribution more extensive.

Market penetration or consumption can also be increased by coming up with various initiatives that will encourage increased usage of the product.

In market penetration / consumption, the risk involved is usually the least since the products are already familiar to the consumers and so is the established market.

**II) Market development**

In this strategy, the business sells its existing products to new markets. This can be made possible through further market segmentation to aid in identifying a new clientele base. This strategy assumes that the existing markets have been fully exploited thus the need to venture into new markets. There are various approaches to this strategy, which include: new geographical markets, new distribution channels, new product packaging, and different pricing policies.

Going into new geographies could involve launching the product in a completely different market. New distribution channels could entail selling the products via e-commerce or mail order. Selling through e-commerce may capture a larger clientele base since we are in a digital era where most people access the Internet often. In new product packaging, it means repacking the product in another method or dimension. That way it may attract a different customer base. In different pricing policies, the business could change its prices so as to attract a different customer base or create a new market segment.

**III) Product development**

With a product-development growth strategy, a new product is introduced into existing markets.

Product development can be from the introduction of a new product in an existing market or it can involve the modification of an existing product. By modifying the product one could change its outlook or presentation, increase the product’s performance or quality. By doing so, it can be more appealing to the existing market.

**IV) Diversification**

This growth strategy involves an organization marketing or selling new products to new markets at the same time. It is the most risky strategy as it involves two unknowns:

* New products are being created and the business does not know the development problems that may occur in the process.
* There is also the fact that there is a new market being targeted, which will bring the problem of having unknown characteristics.

For a business to take a step into diversification, they need to have their facts right regarding what it expects to gain from the strategy and have a clear assessment of the risks involved. There are two types of diversification – related diversification and unrelated diversification.

In related diversification, the business remains in the same industry in which it is currently operating. For example, a cake manufacturer diversifies into fresh-juice manufacturing. This diversification is within the food industry.

In unrelated diversification, there are usually no previous industry relations or market experiences. One can diversify from a food industry into the personal-care industry.

**7.3.4 Expansion Issues**

Whatever method a company chooses to utilize to expand—and whatever guiding strategy it chooses to employ its owners will likely face a combination of potentially frustrating issues as they try to grow their business in a smooth and productive manner. *Growth* means understanding, adjusting to, and managing a whole new set of challenges in essence, a very different business.

**IX) Growing Too Fast**

This is a common disease that strikes ambitious and talented entrepreneurs who have built a flourishing business that meets a strong demand for a specific set of goods and/or services.

Success is wonderful, of course, but rapid growth can sometimes overwhelm the ill-prepared business owner. Companies growing at hyper-speed sometimes pay a steep price for their success. According to management experts, controlling fast-track growth and the problems that come with it can be one of the most frightening tasks an entrepreneur will face. This problem most often strikes on the operational end of a business. Demand for a product will outpace production capacity, for example. Effective research and long range planning can do a lot to relieve the problems often associated with rapid business expansion.

**X) Recordkeeping and Other Infrastructure Needs**

It is essential for small businesses that are undergoing expansion to establish or update systems for monitoring cash flow, tracking inventories and deliveries, managing finances, tracking human resources information, and myriad other aspects of the rapidly expanding business operation. In addition, growing enterprises often have to invest in more sophisticated communication systems in order to provide adequate support to various business operations.

**XI) Expansion Capital**

Small businesses experiencing growth often require additional financing. Finding expansion capital can be a frustrating experience for the ill-prepared entrepreneur, but for those who plan ahead, it can be far less painful. Businesses should revise their business plan on an annual basis and update marketing strategies accordingly so that you are equipped to secure financing under the most advantageous terms possible.

**XII) Personnel Issues**

Growing companies will almost always have to hire new personnel to meet the demands associated with new production, new marketing campaigns, new recordkeeping and administrative requirements, etc. Careful hiring practices are always essential, but they are even more so when a business is engaged in a sensitive period of expansion.

**XIII) Customer Service**

Good customer service is often a significant factor in small business success, but ironically it is also one of the first things that tend to fall by the roadside when business growth takes on a hectic flavor. When the workload increases tremendously, there's a feeling of being overwhelmed. And sometimes you have a hard time getting back to clients in a timely fashion.

So the very customer service that caused your growth in the first place becomes difficult to sustain. Under such scenarios, businesses not only have greater difficulty retaining existing clients, but also become less effective at securing new business. A key to minimizing such developments is to maintain adequate staffing levels to ensure that customers receive the attention and service they demand (and deserve).

**XIV) Disagreements among Ownership**

On many occasions, ownership arrangements that functioned fairly effectively during the early stages of a company's life can become increasingly problematic as business issues become more

complex and divergent philosophies emerge.

**XV) Family Issues**

Embarking on a strategy of aggressive business expansion typically entails an extensive sacrifice of time and often of money on the part of the owner (or owners). But as many growing companies especially those founded by younger entrepreneurs, are established at a time when all of the cofounders are either unmarried or in the early stages of a marriage. As the size of the company grows, so does the size of the cofounder’s family. Cofounders with young children may feel pressure to spend more time at home, but their absence will significantly cut their ability to make a continuous, valuable contribution to the company's growth. Entrepreneurs thinking a strategy of business growth, then, need to decide whether they are willing to make the sacrifices that such initiatives often require.

**XVI) Transformation of Company Culture**

As companies grow, entrepreneurs often find it increasingly difficult for them to keep the business grounded on the bedrock values that were instituted in its early days. Owners are ultimately the people that are most responsible for communicating those values to employees.

But as staff size increases, markets grow, and deadlines proliferate, that responsibility gradually falls by the edge and the company culture becomes one that is far different from the one that was in place and enjoyed just a few short years ago. Entrepreneurs need to make sure that they stay attentive to their obligations and role in shaping company culture.

**XVII) Changing Role of Owner at the Initial State**

You have few employees; you're doing lots of things yourself. But when a company experiences its first real surge of growth, it's time for you to change what you do. You need to become a

CEO—that is, the leader, the strategic thinker, and the planner—and to delegate day-to-day operations to others. Moreover, as businesses grow in size they often encounter problems that increasingly require the experience and knowledge of outside people.

**7.3.5 Choosing not to Grow**

Small business owners choose not to expand their operations even though they have ample opportunity to do so. For many small business people, the greatest satisfactions in owning a business, which often include working closely with customers and employees, inevitably diminish as the business grows and the owner's role changes. Many entrepreneurs would rather limit growth than give up those satisfactions. Other successful small business owners, meanwhile, simply prefer to avoid the headaches that inevitably occur with increases in staff size, etc. And many small business owners choose to maintain their operations at a certain level because it enables them to devote time to family and other interests that would otherwise be allocated to expansion efforts.

**7.4 Business Ethics and Social Responsibility**

**7.4.1 Three Approaches to Corporate Responsibility**

According to the traditional view of the corporation, it exists primarily to make profits supported by stockholder theory. From this money-centered perspective, insofar as business ethics are important, they apply to moral dilemmas arising as the struggle for profit proceeds. These dilemmas include: “What obligations do organizations have to ensure that individuals seeking employment or promotion are treated fairly?” “How should conflicts of interest be handled?” and

“What kind of advertising strategy should be pursued?” “What pricing strategy should be pursued?”

While these dilemmas continue to be important throughout the economic world, when businesses are conceived as holding a wide range of economic and civic responsibilities as part of their daily operation, the field of business ethics expands correspondingly. Now there are large sets of issues that need to be confronted and managed outside of an independent of the struggle for money. Broadly, there are three theoretical approaches to these new responsibilities:

1. Corporate social responsibility (CSR)

2. The triple bottom line

3. Stakeholder theory

**Corporate Social Responsibility (CSR)**

The title corporate social responsibility has two meanings. First, it’s a general name for any theory of the corporation that emphasizes both the responsibility to make money and the responsibility to interact ethically with the surrounding community. Second, corporate social responsibility is also a specific conception of that responsibility to profit while playing a role in broader questions of community welfare. For its definition, CRS is a philosophy in which the company’s expected actions include not only producing a reliable product, charging a fair price with fair profit margins, and paying a fair wage to employees, but also caring for the environment and acting on other social concerns.

As a specific theory of the way corporations interact with the surrounding community and larger world, corporate social responsibility (CSR) is composed of four obligations:

**The economic responsibility to make money**. Required by simple economics, this obligation is the business version of the human survival instinct (to live we have to eat). Companies that don’t make profits are in a modern market economy doomed to perish. Of course there are special cases. Nonprofit organizations make money (from their own activities as well as through donations and grants), but pour it back into their work. Also, public/private hybrids can operate without turning a profit. In some cities, trash collection is handled by this kind of organization, one that keeps the streets clean without (at least theoretically) making anyone rich. For the vast majority of operations, however, there have to be profits. Without them, there’s no business and no business ethics.

2. **The legal responsibility** to adhere to rules and regulations. Like the previous, this responsibility is not controversial. What proponents of CSR argue, however, is that this obligation must be understood as a proactive duty. That is, laws aren’t boundaries that enterprises skirt and cross over if the penalty is low; instead, responsible organizations accept the rules as a social good and make good faith efforts to obey not just the letter but also the spirit of the limits. In concrete terms, this is the difference between the driver who stays under the speed limit because he can’t afford a traffic ticket, and one who obeys because society as a whole is served when we all agree to respect the signs and stoplights and limits.

3. **The ethical responsibility** to do what’s right even when not required by the letter or spirit of the law. This is the theory’s keystone obligation, and it depends on a coherent corporate culture that views the business itself as a citizen in society, with the kind of obligations that citizenship normally entails. When someone is racing their Porsche along a country road on a freezing winter’s night and encounters another driver stopped on the roadside with a flat, there’s a social obligation to do something, though not a legal one. The same logic can work in the corporate world. Many industrial plants produce, as an unavoidable part of their fabricating process, poisonous waste. Think of a plant producing toxin in the manufacturing process. The law governing toxic waste disposal may be ambiguous, but even if the companies are not legally required to enclose their poisons in double-encased, leak-proof barrels, isn’t that the right thing to do so as to ensure that the contamination will be safely contained? True, it might not be the right thing to do in terms of pure profits, but from a perspective that values everyone’s welfare as being valuable, the measure could be recommendable.

4. **The philanthropic responsibility** to contribute to society’s projects even when they’re independent of the particular business. A lawyer driving home from work may spot the local children gathered around an impoverished area stand and sense an obligation to buy food to contribute to the neighborhood project. Similarly, a law firm may volunteer access to their offices for an afternoon every year so some local schoolchildren may take a field trip to discover what lawyers do all day. An industrial chemical company may take the lead in rehabilitating an empty lot into a park. None of these acts arise as obligations extending from the day-to-day operations of the business involved. They’re not like the responsibility a chemical firm has for safe disposal of its waste. Instead, these public acts of generosity represent a view that businesses, like everyone in the world, have some obligation to support the general welfare in ways determined by the needs of the surrounding community.

**The Triple Bottom Line**

The triple bottom line is a form of corporate social responsibility dictating that corporate leaders formulate bottom-line results not only in economic terms (costs versus revenue) but also in terms of company effects in the social realm, and with respect to the environment. There are two keys to this idea. First, the three columns of responsibility must be kept separate, with results reported independently for each. Second, in all three of these areas, the company should obtain sustainable results.

The notion of sustainability is very specific. At the intersection of ethics and economics, sustainability means the long-term maintenance of balance. As elaborated by here below how the balance is defined and achieved economically, socially, and environmentally:

 **Economic sustainability** values long-term financial solidity over more volatile, short-term profits, no matter how high. According to the triple-bottom-line model, corporations have a responsibility to create business plans allowing stable and prolonged action. That bias in favor of duration should make companies hesitant about investing in things like dot-coms.

While it’s true that speculative ventures may lead to windfalls, they may also lead to collapse. Silicon Valley, California, for example, is full of small, start-up companies. A few will convert into the next Google, Apple, and Microsoft. What gets left out, however, of the newspaper reports hailing the accomplishments of a Steve Jobs or a Bill Gates are all those other people who never made it—all those who invested family savings in a project that ended up bankrupt. Sustainability as a virtue means valuing business plans that may not lead to quick riches but that also avoid disastrous losses.

 **Social sustainability** values balance in people’s lives and the way we live. A world in which a few Fortune 500 executives are moving down millions a year, while millions of people elsewhere in the world are living on pennies a day can’t go on forever. As the imbalances grow, as the rich get richer and the poor get both poorer and more numerous, the chances that society itself will collapse in anger and revolution increase. The threat of governmental overthrow from below sounds remote almost absurd for powerful nations such as to

The **fair trade movement** fits this ethical imperative to shared opportunity and wealth.

Developed and refined as an idea in Europe in the 1960s, organizations promoting fair trade ask businesses—especially large producers in the richest countries to guarantee that suppliers in impoverished nations receive reasonable payment for their goods and services even when the raw economic laws of supply and demand don’t require it. An array of ethical arguments may be arranged to support fair trade, but on the front of sustainability, the lead argument is that peace and order in the world depend on the world’s resources being divided up in ways that limit greed, resentment, and anger. For instance, there is a fair trade practice for specialty coffee from

Finally, social sustainability requires that corporations as citizens in a specific community of people maintain a healthy relationship with those people. Corporations should not affect the health of community negatively.

 **Environmental sustainability** begins from the affirmation that natural resources—especially the oil fueling engines, the clean air we breathe, and the water we drink—are limited. If those things deteriorate significantly, our children won’t be able to enjoy the same quality of life most of us experience. Conservation of resources, therefore, becomes tremendously important, as does the development of new sources of energy that may substitute those we’re currently using.

Further, the case of an industrial chemical company pouring toxins into the ground that erupt years later with horrific consequences evidences this: not only are resources finite, but our earth is limited in its ability to naturally regenerate clean air and water from the pipes and runoff of our industries.

**Stakeholder Theory**

Stakeholder theory, which has been described by Edward Freeman and others, is the mirror image of corporate social responsibility. Instead of starting with a business and looking out into the world to see what ethical obligations are there, stakeholder theory starts in the world. It lists and describes those individuals and groups who will be affected by (or affect) the company’s actions and asks, “What are their legitimate claims on the business?” “What rights do they have with respect to the company’s actions?” and “What kind of responsibilities and obligations can they justifiably impose on a particular business?” In a single sentence, stakeholder theory affirms that those whose lives are touched by a corporation hold a right and obligation to participate in directing it.

As a simple example, when a factory produces industrial waste, a CSR perspective attaches a responsibility directly to factory owners to dispose of the waste safely. By contrast, a stakeholder theorist begins with those living in the surrounding community who may find their environment poisoned, and begins to talk about business ethics by insisting that they have a right to clean air and water. Therefore, they’re stakeholders in the company and their voices must contribute to corporate decisions. It’s true that they may own no stock, but they have a moral claim to participate in the decision-making process. This is a very important point. At least in theoretical form, those affected by a company’s actions actually become something like shareholders and owners. Because they’re touched by a company’s actions, they have a right to participate in managing it.

Who are the stakeholders surrounding companies? The answer depends on the particular business, but the list can be quite extensive. If the enterprise produces chemicals for industrial use and is located in a small town, the stakeholders and their interests in parentheses include:

 Company owners, whether a private individual or shareholders, (reasonable profit)

 Company workers (reasonable salaries that enable them to live decent lives),

 Customers and potential customers of the company (quality products at fair prices),

 Suppliers and potential suppliers to the company (fair prices for their inputs),

 Everyone living in the town who may be affected by contamination from workplace operations,

 Creditors whose money or loaned goods are mixed into the company’s actions,

 Government entities involved in regulation and taxation (fair tax),

 Local businesses that cater to company employees (restaurants where workers have lunch,

grocery stores where employee families shop, and similar),

 Other companies in the same line of work competing for market share (fair competition for

competitiveness of the industry),

Once a discrete set of stakeholders surrounding an enterprise has been located, **stakeholder ethics may begin**. The purpose of the firm, underneath this theory, is to maximize profit on acollective bottom line, with profit defined not as money but as human welfare. The collectivebottom line is the summed effect of a company’s actions on all stakeholders. Companymanagers, that means, are primarily charged not with representing the interests of shareholders(the owners of the company) but with the more social task of coordinating the interests of allstakeholders, balancing them in the case of conflict and maximizing the sum of benefits over themedium and long term.

**7.4.3 Business Ethics Principles**

There are certain universal ethical principles that managers of enterprises must adhere to. Ethical values, translated into active language establishing standards or rules describing the kind of behavior an ethical person should and should not engage in, are ethical principles. The following list of principles incorporates the characteristics and values that most people associate with ethical behavior.

1. **Honesty**. Ethical executives are honest and truthful in all their dealings and they do not deliberately mislead or deceive others by misrepresentations, overstatements, partial truths, selective omissions, or any other means.

2. **Integrity**. Ethical executives demonstrate personal integrity and the courage of their convictions by doing what they think is right even when there is great pressure to do otherwise; they are principled, honorable and upright; they will fight for their beliefs. They will not sacrifice principle for suitability, be hypocritical, or unscrupulous.

3. **Promise-Keeping & Trustworthiness**. Ethical executives are worthy of trust. They are candid and forthcoming in supplying relevant information and correcting misapprehensions of fact, and they make every reasonable effort to fulfill the letter and spirit of their promises and commitments. They do not interpret agreements in an unreasonably technical or legalistic manner in order to rationalize non-compliance or create justifications for escaping their commitments.

4. **Loyalty**. Ethical executives are worthy of trust, demonstrate fidelity and loyalty to persons and institutions by friendship in adversity, support and devotion to duty; they do not use or disclose information learned in confidence for personal advantage. They safeguard the ability to make independent professional judgments by scrupulously avoiding undue influences and conflicts of interest. They are loyal to their companies and colleagues and if they decide to accept other employment, they provide reasonable notice, respect the proprietary information of their former employer, and refuse to engage in any activities that take undue advantage of their previous positions.

5. **Fairness**. Ethical executives are fair and just in all dealings; they do not exercise power arbitrarily, and do not use overreaching nor offensive means to gain or maintain any advantage nor take undue advantage of another’s mistakes or difficulties. Fair persons manifest a commitment to justice, the equal treatment of individuals, tolerance for and acceptance of diversity, they are open-minded; they are willing to admit they are wrong and, where appropriate, change their positions and beliefs.

6. **Concern for Others**. Ethical executives are caring, compassionate, benevolent and kind; they like the **Golden Rule**, help those in needs, and seek to accomplish their business objectives in a manner that causes the least harm and the greatest positive good.

7. **Respect for Others.** Ethical executives demonstrate respect for the human dignity, autonomy, privacy, rights, and interests of all those who have a stake in their decisions; they are courteous and treat all people with equal respect and dignity regardless of sex, race or national origin.

8. **Law Abiding**. Ethical executives abide by laws, rules and regulations relating to their business activities.

9. **Commitment to Excellence**. Ethical executives pursue excellence in performing their duties, are well informed and prepared, and constantly endeavor to increase their proficiency in all areas of responsibility.

10. **Leadership**. Ethical executives are conscious of the responsibilities and opportunities of their position of leadership and seek to be positive ethical role models by their own conduct and by helping to create an environment in which principled reasoning and ethical decision making are highly prized.

11. **Reputation and Morale**. Ethical executives seek to protect and build the company’s good reputation and the morale of its employees by engaging in no conduct that might undermine respect and by taking whatever actions are necessary to correct or prevent inappropriate conduct of others.

12. **Accountability.** Ethical executives acknowledge and accept personal accountability for the ethical quality of their decisions and omissions to themselves, their colleagues, their companies, and their communities.