

Chapter 2 Starting a business

Questions

1. Charlene is a chiropodist who has worked for several years as a health service employee. She has decided that she would like to set up in private practice, offering chiropody services, including foot massage and aromatherapy. Charlene is cautious and does not want to take more risks than necessary. She is thinking about three possible modes of operation:

- a) A mobile service. This would involve purchasing a car or small van to carry her equipment to clients' own homes
- b) Working from rented premises in a town centre. This would involve taking out a lease for a minimum period of two years
- c) Converting a room of her house into a chiropody surgery. This would involve some building conversion costs. Charlene's house is located in a suburb, two miles from the town centre.

Charlene has consulted you, as a small business adviser, for some advice on choosing between the options set out above.

Required: advise Charlene on the advantages, drawbacks and risks associated with each of her options. You should include both financial and non-financial issues in your analysis.

2. Chantelle is planning to start a business wholesaling discount cosmetics to small pharmacies, grocers and corner shops. She completed a course in floristry a couple of years ago, and since then has been working as a florist's assistant. She is bored with being an employee, but feels that there is no realistic opportunity to set up her own floristry business as there is just too much competition from established businesses. The idea of selling discount cosmetics occurred to her as a result of a conversation with Joseph, a friend of her brother's who works for a business which manufactures and distributes budget cosmetics. Chantelle feels that the business he works for is not taking advantage of all the distribution opportunities that exist and she can see an opportunity for targeting very small outlets.

Chantelle has recently read a business magazine survey which says that almost all businesses fail within their first five years. Because you are doing a business course, she has asked you to tell her something about the major causes of business failure, and how she, personally, can avoid them as far as possible.

Answers

1. Charlene

Note that all three options will involve the purchase of the same basic array of equipment. Equipment costs, therefore, will mostly be ignored as they are not a factor in distinguishing between the three options.

A. The mobile service

Advantages include:

- Low financial outlay, with low risk. Charlene will have to buy a van or car, but if the business fails, it can be sold on at (probably) a fairly minimal loss.
- Access to housebound clients. There may be many people who are unable to travel to a surgery and who would therefore welcome the provision of a mobile service.

Drawbacks and risks include:

- Loss of opportunity to attract passing trade. If Charlene is based in a surgery, especially if it is in the town centre, people are more likely to drop in to see if they can get an appointment.

B. Rented premises

Advantages include:

- The opportunity to attract passing trade (see point above)
- Convenience for clients who regularly come into town

Drawbacks and risks include:

- The risk of going out of business with a substantial proportion of the lease left to run
- The possibility of greater competition locally (Charlene should investigate the extent of the competition in the town centre)

C. Conversion of part of her house

Advantages include:

- Convenience for Charlene. She does not have to incur the cost and inconvenience of travelling to work.

Drawbacks and risks include:

- Possibility of going out of business and being left with a converted room in her house for which she has no use
- Risk of not getting planning permission for the change of use of part of her house from residential to commercial
- Costs of building conversion, which could be substantial (depending upon what the plans involve).

Summary

Charlene will have to carefully weigh up the risks, drawbacks and advantages of each option. Her next steps should involve

- Market research, including an analysis of the competition
- Costing each of the three options.

2. Chantelle

Notes on the major causes of business failure

a) Poor management

This can be a particular problem for people who start up in business on their own. They have to be their own experts in production, selling, sourcing goods, personnel management and financial management. Few people combine all the necessary skills. Chantelle's training and experience in floristry are not likely to be particularly relevant in running a cosmetics wholesale business. She needs, from the outset, to be quite honest with herself about her areas of strength and weakness in management. She may eventually be able to employ people who can deal with areas in which she is particularly weak, but this can probably not be done immediately. She could consider taking a short course, or perhaps an evening course, in basic business management skills.

b) Lack of working capital

Many businesses fail because they simply run out of money. It is important to be as realistic as possible about the amount of money which will be required for investment. In Chantelle's case, she will probably have to buy and pay for stocks of goods from the manufacturer. She will also incur costs of storage. Her business will need to have a car or van so that she can visit customers. She may have to use this vehicle for distribution, too. So, she is going to need a certain amount of money in advance to finance these purchases. She also needs to think carefully about how much credit she offers to her customers. If money owed to her is slow to come in cash shortages will become more of a problem.

c) Lack of long-term finance

This means not having enough money to invest in the longer-term future of the business, for example, in new machinery. In Chantelle's case this is likely to be less of a risk in the early stages. If she needs premises she will probably be able to rent them, rather than having to spend very large sums of money in purchasing. However, as the business expands (if it is successful) lack of long-term finance could become more of an issue.

d) Bad debts

See also point b) above. It is bad enough when customers are slow to pay, but sometimes they don't pay at all, perhaps because they themselves have gone out of business. This is an ever-present business risk for anyone who trades on credit. The risk can be managed to some extent by investigating potential customers to see if they are credit-worthy. However, when trying to build up a business, it can be very hard to turn down a potential selling opportunity on the grounds that it might be difficult to collect debts.

e) Loss of market

At this stage, it does not look as though Chantelle really knows whether she has a market or not. However, there is bound to be competition in the market for discount cosmetics, and Chantelle may be entering a market where it is actually very difficult to make money. Even if she is initially successful it is quite possible that the firm(s) she buys from will decide that they might as well try to sell directly to her customers themselves. If the manufacturers sell directly to the retailer, cutting out the wholesaler, it is quite likely that they will be able to undercut Chantelle's prices. This is a risk for any 'middleman' in a market.