CHAPTER 2

DEVELOPING THE BUSINESS IDEA

True-False Questions

T. 1. For ventures that first get to market or create intellectual property rights, it's common to price new products or services at high markups or profit margins.

F. 2. Lifestyle firms are growth-driven in terms of revenues, profits, and cash flows and also performance-oriented as reflected in rapid value creation over time.

T. 3. "Salary-replacement" firms provide their owners with income levels comparable to what they could have earned working for much larger firms.

T. 4. An entrepreneur may start a number of different types of businesses, including salary-replacement firms, lifestyle firms, and entrepreneurial firms or ventures.

F. 5. "Entrepreneurial ventures" are firms that allow owners to pursue specific lifestyles while being paid for doing what they like to do.

F. 6. Entrepreneurial ventures emphasize survival and providing an acceptable living for their owners with growth being a secondary goal.

F. 7. A sound business model is a plan to generate investor interest, make profits, and grow asset investments.

T. 8. A sound business model should provide a plan to generate revenues, make profits, and produce free cash flows.

F. 9. Mark Twain said: "Like I tell anybody, if you fail to plan, you're planning to fail."

T. 10. Best practices of high-growth, high-performance firms applied in the marketing practices area include "developing new products or services that are considered to be the best."

F. 11. Best practices of high-growth, high-performance firms applied in the marketing practices area include "preparing detailed monthly financial plans for the next year and annual financial plans for the next five years.

T. 12. Best practices of high-growth, high-performance firms applied in the financial practices area include “preparing detailed monthly financial plans for the next year and annual financial plans for the next five years.

T. 13. Best practices of high-growth, high-performance firms applied in the management practices area include “assembling a management team that is balanced in both functional area coverage and industry/market knowledge.”

T. 14. Business opportunities, because they exist in real time, have a relatively narrow window of opportunity to become a successful business venture. However being the first to market does not guarantee success.

T. 15. Ideas that are said to be “ahead of their time” are too early to become viable business opportunities for the inventor or innovator.

T. 16. Once conceptualized, a new idea should be examined for its business feasibility.

T. 17. A SWOT analysis is an examination of the strengths, weaknesses, opportunities, and threats to determine the business opportunity viability of an idea.

F. 18. A SWOT analysis focuses on strengths (S), worries (W), opportunities (O), and treats (T).

F. 19. A “venture opportunity screening” is the same thing as preparing a business plan.

T. 20. A SWOT analysis should consider as potential strengths or weaknesses whether there are unfilled customer needs and the extent to which intellectual property rights exist.

F. 21. A SWOT analysis should consider the extent of existing competition and the likelihood of substitute products or services as potential strengths or opportunities.

T. 22. Venture opportunity screening involves assessment of an idea’s commercial potential to produce revenue growth, financial performance, and value.

F. 23. A venture with a low score on the VOS Indicator should always be abandoned.

T. 24. The VOS Indicator is useful in assessing the commercial potential of a venture, but should not be used as the sole tool to determine a venture’s fate.

T. 25. The VOS Indicator provides both qualitative and quantitative information about a venture's commercial potential.

T. 26. A venture opportunity-screening guide, called the VOS Indicator, is used to determine potential attractiveness of venture opportunities as business opportunities.

F. 27. Asset intensity is the net after-tax profit divided by total assets.

T. 28. One way to describe asset intensity is the dollar investment in assets needed to generate a dollar in sales.

F. 29. Business changes resulting in higher net profit always increases ROA.

T. 30. The compound rate of return that equates the present value of the cash inflows with the initial investment outlay is called the internal rate of return (IRR).

T. 31. Bootstrapping refers to the process of minimizing resources such as the need for financial capital and finding unique sources for financing a new venture.

F. 32. Free cash flow to equity is the cash flow from producing and selling a product or providing a service.

F. 33. In a typical business plan, the section covering the management team does not need to disclose the expertise and experience of the management.

T. 34. The non-financial option available to managers as the venture progresses through its lifecycle is known as real options.

F. 35. The process of moving from entrepreneurial opportunities to new businesses, products, or services begins with ideas, then moves to the preparation of a business plan, and finally ends with a feasibility study.

T. 36. A well-designed entrepreneurial venture bins with an idea that survives an analysis of its feasibility and results in a business model/plan.

F. 37. A successful, sound business model does not have to ultimately produce free cash flows.

T. 38. The first component of a sound business model is the need to generate revenues.

F. 39. Asset intensity and asset turnover are calculated as revenues divided by total assets.

T. 40. A high asset intensity implies a large investment in fixed assets and/or net working capital is needed to support revenue growth.

Multiple-Choice Questions

b. 1. Firms that allow owners to pursue specific lifestyles while being paid for doing what they like to do are referred to as:
   a. salary-replacement firms
   b. lifestyle firms
   c. entrepreneurial ventures
   d. rapid value creation firms

d. 2. U.S. small businesses are predominately:
   a. salary-replacement or entrepreneurial firms
   b. lifestyle or entrepreneurial firms
   c. entrepreneurial ventures
   d. salary-replacement or lifestyle firms

b. 3. The definition of an entrepreneurial firm is:
   a. survival, high growth
   b. high growth, high performance
   c. survival, average performance
   d. high, growth, average performance

c. 4. A sound business model provides a plan which includes all of the following except?
   a. generates revenues
   b. makes profits
   c. retains all its earnings
   d. produces free cash flows
   e. all of the above are included

d. 5. A sound business model includes a plan to:
   a. generate revenues, make profits
   b. make profits, produce free cash flows
   c. produce free cash flows for the owners of the venture
   d. generate revenues, make profits, and produce free cash flows

a. 6. Which one of the following components is not a standard component of a sound business model?
   a. produce low-cost products
   b. generate revenues

c. make profits
d. produce free cash flows

b. 7. Free cash flows, which can be paid back to investors occurs when cash generated from operations exceeds all of the following except?
a. borrowing costs
b. non-cash depreciation
c. taxes
d. investment in assets

d. 8. A venture's value is determined by
a. the size and timing of its future free cash flows
b. time value of money
c. its net income
d. *a* and *b*
e. *a* and *c*

a. 9. Developing new and delivering high-quality products or services that command higher prices and margins best describes strong
a. marketing practices
b. financial practices
c. operating practices
d. management practices

e. 10. Effective entrepreneurial management teams should include all of the following except?
a. provide expertise in the areas of marketing, finance, and operations
b. have successful experience in the venture's industry and markets
c. work collaboratively with each other
d. share the entrepreneurial spirit
e. in-house accounting, auditing, and tax professionals

b. 11. A viable venture opportunity is characterized by all of the following except?
a. creating or meeting a customer need
b. has perceived attraction to prospective investors
c. provides an initial competitive advantage
d. is timely in terms of time-to-market
e. offers the expectation of added value to investors

c. 12. A SWOT analysis does <u>not</u> focus on which of the following components or areas?
a. strengths
b. weaknesses
c. new ideas

d. opportunities
e. threats

e. 13. A SWOT analysis focuses on which of the following components or areas?
a. strengths
b. weaknesses
c. opportunities
d. threats
e. all of the above
f. a, *b,* and *d*

e. 14. When conducting a SWOT analysis, “unfilled customer needs” are examined in terms of:
a. strengths
b. weaknesses
c. opportunities
d. threats
e. *a* or *b*
f. *c* or *d*

e. 15. SWOT analysis should at the very least consider which of the following areas:
a. experience/expertise
b. reputation value
c. first mover
d. *a* and *b*
e. *a*, *b,* and *c*

e. 16. Which one of the following is <u>not</u> a part of the VOS indicator?
a. industry/market considerations
b. pricing/profitability considerations
c. financial/harvest considerations
d. management team considerations
e. location/profitability considerations

a. 17. The evaluation of “entry barriers” occurs under which one of the following parts of the VOS indicator?
a. industry/market considerations
b. pricing/profitability considerations
c. financial/harvest considerations
d. management team considerations

a. 18. A VOS indicator stands for:
a. venture opportunity screening indicator

b. viable opportunity statement indicator
c. venture only success indicator
d. viable assessment screening indicator

e. 19. The factor categories in a VOS indicator are:
a. industry/market considerations
b. pricing/profitability considerations
c. financial/harvest considerations
d. management team considerations
e. all of the above
f. a, *b*, and *d*

c. 20. A “score” in the range of 2.34-3.00 using the VOS Indicator™ would be considered a:
a. a low score
b. an average score
c. a high score
d. a very, very high score

c. 21. An average score on using the VOS Indicator™ would fall in the range:
a. 0.00-0.99
b. 1.00-1.66
c. 1.67-2.33
d. 2.34-3.00

a. 22. At the end of a qualitative-based venture opportunity screening exercise, the interviewer prepares a subjective assessment and indicates one of the following except for:
a. natural commercial potential
b. high commercial potential
c. average commercial potential
d. low commercial potential

e. 23. Direct costs of producing a product or providing a service is called
a. gross profit
b. gross profit margin
c. net profit
d. net profit margin
e. cost of goods sold

a. 24. Revenues minus the cost of goods sold is called
a. gross profit
b. gross profit margin
c. net profit
d. net profit margin

c. 25. Dollar profit left after all expenses, including financing costs and taxes have been deducted from the firm's revenues is called

a. gross profit
b. gross profit margin
c. net profit
d. net profit margin
e. cost of goods sold

d. 26. Return on assets can be stated as which of the following?

a. net after-tax profit divided by total assets
b. net profit margin times asset turnover
c. net cash flow divided by total assets
d. both *a* and *b*
e. both *a* and *c*

a. 27. All else held constant, a higher asset turnover:

a. increases ROA
b. decreases ROA
c. has no effect on ROA
d. may raise or lower ROA, depending on how it affects revenues.

c. 28. The return on assets (ROA) model measures:

a. revenues divided by net profit times the asset turnover
b. net profit margin times the equity multiplier
c. net profit margin times asset turnover
d. net profit divided by total assets multiplied by the asset turnover

a. 29. Free cash flow to equity is the cash available to the entrepreneur and venture investors after all of the following except?

a. net cash flows
b. operating cash outflows
c. financing and tax cash flows
d. investment in assets needed to sustain the venture's group
e. net increase in debt capital

e. 30. The free cash flows to equity of an entrepreneurial firm includes cash flows to:

a. venture investors
b. creditors
c. the entrepreneur
d. *a* and *b*
e. *a* and *c*
f *a*, *b*, and *c*

c. 31. Determine the cost of goods sold for a venture with the following financial information: revenues = $50,000; net profit margin = 20%; gross profit margin = 70%

a. $40,000
b. $35,000
c. $15,000
d. $10,000

c. 32. Determine gross profit of a venture with the following financial information: cost of goods sold = $30,000; net profit = $17,000; asset turnover = 1.6; return on assets 32%

a. $85,000
b. $72,000
c. $55,000
d. $38,000

d. 33. Determine the return on assets (ROA) for a venture with the following financial information: revenues = $500,000; net profit = $70,000; and asset turnover = 2.00 times.

a. 10%
b. 14%
c. 20%
d. 28%
e. 34%

b. 34. Determine the dollar amount of total assets for a venture with the following financial information: revenues = $500,000; net profit = $70,000; and asset turnover = 2.00 times.

a. $100,000
b. $250,000
c. $375,000
d. $500,000
e. $650,000

c. 35. Determine the dollar amount of net profit for a venture with the following financial information: revenues = $500,000; return on assets = 20%; and asset turnover = 2.00 times.

a. $10,000
b. $25,000
c. $50,000
d. $60,000
e. $75,000

a. 36. Determine the dollar amount of revenues for a venture with the following financial information: net profit = $60,000; assets turnover = 1.5 times; and return on assets 30%.

a. $300,000
b. $500,000
c. $800,000
d. $1,000,000
e. $1,200,000

b. 37. Determine the asset intensity of a venture with the following financial information: net profit = $22,000; revenues = $132,000; return on assets 30%.
a. .05
b. .56
c. 1.8
d. 20

b. 38. In the venture life cycle, moving from the development stage to the startup stage frequently begins with the preparation of a business plan. The business plan is a written document that describes the proposed venture in all of the following terms except:
a. the proposed product or service opportunity
b. the accounting data for the last five years
c. current resources available to the venture
d. financial projections

d. 39. A typical business plan includes all of the following sections except:
a. executive summary
b. business description
c. marketing plan and strategy
d. disclosure of pending litigation
e. operations and support

c. 40. When composing the financial plans and projections section of a business plan, all of the following should be included except:
a. income statements and balance sheets
b. statement of cash flows
c. past and present dividend per share information
d. breakeven analysis
e. funding needs and sources

e. 41. A typical business plan includes all of the following except:
a. management team
b. financial plans and projections
c. risk and opportunities
d. timeline and milestones
e. initial public offering information

a. 42. The first two requirements of a sound business model are:
a. generate revenues, make profits

b. make profits, produce free cash flows
c. produce free cash flows for creditors and owners of the venture
generate revenues and produce free cash flows

b. 43. The process involving minimizing the need for financial capital and finding unique sources for financing a new venture is referred to as:
a. mezzanine financing
b. financial bootstrapping
c. seed financing
d. startup financing

b. 44. A written document that describes the proposed venture in terms of the product or service opportunity, current resources, and financial projections is called a:
a. financial plan
b. business plan
c. entrepreneurial plan
d. survival plan

d. 45. In the Kauffman Center study of best practices of high-growth, high-performance firms, which of the following practices was not included?
a. marketing practices
b. financial practices
c. management practices
d. production/operations practices

d. 46. When moving from entrepreneurial opportunities to new businesses, products, or services, which one of the following is <u>not</u> considered a component?
a. ideas
b. feasibility
c. business plan
d. harvest of venture

d. 47. A firm's option to abandon a venture is an example of a:
a. bootstrapping option
b. financial option
c. survival option
d. real option

a. 48. A venture's value to its owners is determined by the:
a. size and timing of its future free cash flows (to equity)
b. level of its past revenues
c. prior losses and expenses
d. all of the above

e. 49. A well-designed entrepreneurial venture typically includes:
a. generating ideas
b. analyzing the feasibility of ideas
c. producing business models/plans
d. only *a* and *c* above
e. *a*, *b*, and *c* above

c. 50. Some venture investors like to draw analogies between baseball terms and venture performance. The baseball term used to reflect a total loss of an investment is:
a. home run
b. single
c. strikeout
d. double

a. 51. Asset intensity is:
a. total assets divided by total revenues
b. total revenues divided by total assets
c. calculated the same as asset turnover
d. one-half of the asset turnover

c. 52. If the asset intensity is .80, the asset turnover would be:
a. .80 times
b. 1.00 times
c. 1.25 times
d. 1.50 times