

## **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 begins 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.

**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 not 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 not 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<sup>TM</sup> 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<sup>TM</sup> 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 not 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