CHAPTER II

THEORETICAL BACKGROUND

2.1 Business Plan Definition

For start-ups company, a business plan has to be developed in order to analyze the feasibility of the business on how it could make money. A firm's business plan is a reflection of the firm's business model at a point in time and explain how the firm plans to make money (Afuah, 2003).

There are many definitions of business model. Chessbrough and Rosenbloom (1999:7) give an operational definition of Business Model:. The functions of a business model are to:

- articulate the value proposition,
- identify a market segment,
- define the structure of the value chain within the firm required to create and distribute the offering;
- estimate the cost structure and profit potential of producing the offering, given the value proposition and value chain structure chosen;
- describe the position of the firm within the value network linking suppliers and customers, including identification of potential complementors and competitors;
- formulate the competitive strategy by which the innovating firm will gain and hold advantage over rivals."

Afuah (2003) describes business model as a set of which activities a firm performs, how and when it performs them as it uses its resources to perform activities,

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given its industry, to create superior customer value (low-cost or differentiated products) and put itself in a position to appropriate the value.

2.2 Key Element of Business Plan

Within many definitions of business model, it has the same essence which describes “how firm make money” and shares several key elements. As stated by Afuah (2003), several key elements of business model that forms a business plan are:

1. Competitive position
2. Connected activities
3. Competitive and macro-environments
4. Critical industry value drivers
5. Capabilities and resources
6. Change and sustainability
7. Cost of activities
8. Execution of the plan
9. Expected Performance

2.3 The Description of The Elements of A Business Plan

According to Afuah (2003), business plan elements consist of:

1. Competitive position

A firm’s business plan should start with a clear statement of its value-proposition (what it intends to offer to customer that competitors could not). This company position/intent in providing value-proposition will determine its competitive-position. Company could gain this value-proposition by choosing either a low cost strategy or differentiated products or services strategy.

In addition, company should outline the market segment that it intend to target and the value offered to each segments, company expected source of revenue,

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bargaining power over its competitors and its price strategy. All of those determinant must company's value-proposition decision.

2. Connected Activities

The activities that company performs should be connected and designed to align its strategy thus support its competitive position. The ability to deliver better customer value than its competitors is a function of which business activities it chooses, how and when it performs and how all of this activities are connected altogether and aligned to the strategy.

A business-plan should describe its system of activities that it intends to perform. There are several factors that should be taken into consideration on activities that firm chooses in which these activities when connected to strategy can give competitive advantage. They are activities that take benefit of critical industry value drivers, internal or outsource activities, and pricing activities.

First, it is important that a firm takes advantage of critical industry value drivers those characteristics of an industry that have the most impact on cost or differentiation. If the connection of activities that a firm performs forms a system that is difficult to imitate, they can give the firm a competitive advantage.

Second, an activity that a firm chooses to perform can be performed internally or be outsourced or be performed jointly through an alliance. A firm's choice whether to perform internally, outsource or do alliance is depend on whether the firm has superior core competence on those activities. Core competences that are central to offering right customer value to the right market segment is should be perform internally or jointly through alliance while non core activities can be outsourced.

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Third, another important activity that is worth also to identify is pricing. When a firm set prices too high it can drive away customers while setting them too low leaves money on the table. A good pricing strategy carefully considers the customer value that the firm offers and its bargaining position versus customers.

3. **Competitive forces**

An important determinant of the profitability of firms in an industry is the competitive forces from suppliers, customers, rivals, new entrants, and substitute products that act on industry firms.

A business plan should show the competitive and macro-environment forces in the industry in which the firm intends to compete. More importantly it should detail the actions that can be taken to reduce the impact of these forces.

Powerful suppliers can force firms to take lower-quality inputs at prices that deserve higher quality. Powerful customers can force industry firms to take lower prices for their products than the quality of the products warrants. It can make them sell higher-quality products than prices the customers willing to pay. High rivalry forces industry firms to lower their prices or spend more on advertising in an effort to differentiate their products. High threat of new entrance can force industry firms to spend more to raise barriers to entry or lower their prices to discourage new entrants. High threat of substitutes can force industry firms to lower their prices to keep customers from switching to substitutes. High threat of substitutes can also force industry firms to advertise or take other measures to differentiate their products without necessarily commanding a higher price.

4. Critical industry value drivers

In every industry, certain factors represent a significant percentage of cost or have a high potential for creating differentiation. These factors are the critical industry

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value drivers since they stand to have a significant impact on low cost and/or differentiation.

To analyze whether critical industry value drivers has been taken into the firm activities, several identification steps could be taken. First, identify the industry factors that account for a significant percentage of cost or potentially can produce the most cost savings (so called primary influencers of costs). Second, identify the industry factors that have a high potential for creating differentiation (so called primary influencers of differentiation). Third, understand the objectives that the firm should pursue to take advantage of these factors

A business plan should detail the characteristics of the industry that have the most impact on cost and differentiation. It should also state what kinds of activities can be performed to take advantage of these value drivers.

5. Capabilities and resources

To perform the activities that enable a firm to offer superior customer value and appropriate the value, a firm needs resources e.g. equipment, patents, skilled labor, brand-name reputation, geographic location, client relations, distribution channel and trade secrets. Resources by themselves do not produce customer value and profits, firms must also have the ability or capacity to turn resources into customer value and profits.

Assets or resources can be categorized as tangible, intangible and human. Tangible assets can be physical or financial. These are the types of assets that are usually identified and accounted for in financial statements. Intangible assets are non physical and nonfinancial assets such as patents, brands, copyrights, relationship with customer, relationship with vendors and knowledge databases. Human assets are the skills and knowledge that employees carry with them.

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A firm needs to have the ability to convert its assets into customer value. Assets must be converted into something that customers want. A firm's ability or capacity to turn its resources into customer value and profits is usually called a competence or capability. Competences usually involve the use or integration of more than one asset.

For start-up, one of the most important resources is the people who will carry out the business plan. It is important for business plan detail the firm's existing resources, its resource gap and by which to fill the gap. In example, it is important that a start-up detail the background of top managers, explaining how their experiences and skills relate to the activities of business plan.

It is important to do several activities. First, identify the resources and capabilities that the firm has that are valuable, rare, inimitable, non-substitutable, and appropriable.. Second, identify the extent to which the resources and capabilities can be used to offer customer value or reduce competitive forces exerted by suppliers, customers, rivals, potential new entrants and substitutes. Third, identify the extent to which the resources need to be built.

6. Change and sustainability

A firm competitive advantage usually comes from the system of activities that it performs or the resources and capabilities that underpin the activities. It is important to explicitly state in business plan:

- The characteristics of the firm's system of activities and capabilities that allow it to have competitive advantage.
- The characteristics of competitor that prevent them imitating and leapfrogging.

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Since most advantages are eventually eroded by change, business plan should state what changes are anticipated and how the firm plans on dealing with them.

There are two major reasons that competitors may not be able to imitate or leapfrog firm competitive advantage. First, there may be something about the firm and its activities that make it difficult for others to imitate or leapfrog it. If a firm has resources or capabilities that are rare, valuable, non-substitutable, appropriable, and inimitable, competitors may find it difficult to erode the firm's competitive advantage. If a firm's activities form a system, competitors may be able to imitate some components of the system but may find it difficult to imitate the whole system. Imitating a system means not only imitating the components but also imitating the linkages between them. Second, there may be something in the competitors that makes them difficult to imitate a firm with a competitive advantage. Certain prior commitments, organizational systems, processes and cultures make them difficult from being able to effectively imitate a firm with a competitive advantage.

7. Cost of Activities

A business plan must contain a section that details how the firm keep its cost low. In performing the activities of a business model, firms incur costs. Irrespective of whether a firm pursues a differentiation or low-cost strategy, its costs ought to be tracked and their drivers understood. In addition to identifying any cost savings or losses that result from agency costs, economies of learning, and economies of scope and scale, it is also important to look for obvious waste.

In analyzing the sources of a firm's profitability and competitive advantage, it is important to identify any agency costs, identify any obvious resources waste other than agency costs and look for employee production differences by, for example, benchmarking.

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8. Execution of Plan

In order to execute the business plan it is important to identify what types of people does the firm need to run the business model and what types of structure, systems, processes and culture does the firm need to execute the business model.

9. Expected performance

A business plan should contain a detailed forecast of how the firm expects to perform over the years. It should show how this performance is consistent with the position, activities, resources, cost drivers and environment of the firm.

Given the different elements of the business plan, how is the firm expected to perform over the years? How is its performance expected to compare with potential competitors.

2.4 Analysis of Growth Strategy

Based on the research of Chris Zook (2001:153), to analyze growth strategy, there are ten questions that management teams should periodically ask themselves about their companies. Absolutely, companies will discover themselves in every unlimited kind of strategic situations. The tenth questions of growth strategy should be addressed when they are facing the strategic situation:

1. Identify the most tightly defined profitable core of the business, and identify whether it is gaining or losing strength.
2. Identify what defines the boundaries of the business that the firm is competing for, and where are those boundaries going to shift in the future.
3. Identify whether there are new competitors currently at the fringe of our business that pose potential longer-term threats to the core.
4. Ascertain whether the firm is achieving the full strategic and operating potential of core business, the "hidden value" of the core.

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5. Identify, the full set of potential adjacencies to core business and possible adjacency moves (single or multiple moves).
6. Identify point of view on the future of the industry, whether the team in the firm have consensus. Find out, how this point of view shaping firm adjacency strategy and point of arrival.
7. Identify whether major new growth initiatives are pursued inside, next to, or outside the core. Consider the way to make decision.
8. Identify whether industry turbulence changing the fundamental source of future competitive advantage. If yes find out how it happened, whether through new models, new segments, new competitors and what need to monitor on a regular basis.
9. Identify whether organizational enablers and inhibitors to growth in the right balance for the needed change.
10. Identify what the guiding strategic principles that should apply consistently to all of our major strategic and operating decisions.

Chris Zook (2001) classified the tenth into 3 major:

1. Build market power and influence in the core business of in a segment of that business
2. Having done that, expand into logical and reinforcing adjacencies around the core
3. Shift or redefine the core in response to industry turbulence.

According to Chris Zook (2001) almost companies seem to move through this cycle Focus-Expand-Redefine (F-E-R) cycle in business (see figure 2.1).

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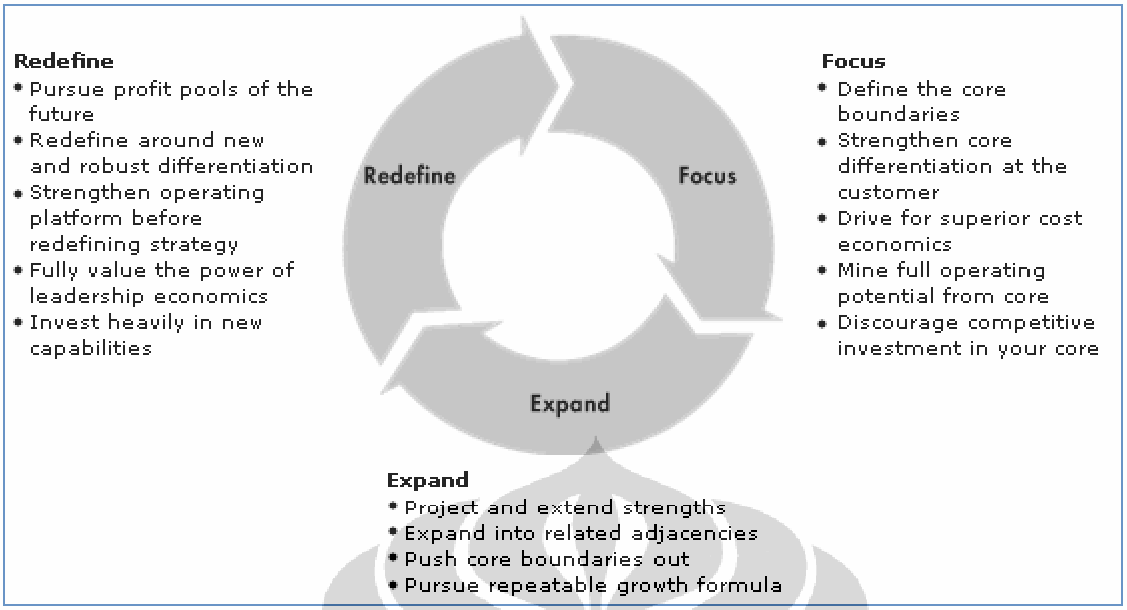

(Source: http://profitfromthecore.com)

Picture 2.1. Company Growth Cycle

Focus phase: companies will concentrate on building their core business to its full potential. They expand their markets, cut costs, improve operations, and develop innovations in their core products. This is will be become base of expand step. Identification of strength and weakness by identifying key assets, the most profitable customer, the most differentiated and strategic capabilities, preparing registration of patents and brand name will strengthen the core business.

Expand phase: in this step they will take advantage of these capabilities and market positions to move into adjacent markets. They seek out new customer segments, new geographies, new distribution channels, and new-but-related product lines. Main central idea of Chris Zook's growth strategy is growth through adjacency. Chris Zook (2004) outlines an expansion strategy based on putting together combinations of adjacency moves into areas away from, but related to, the core business, such as new product lines or new channels of distribution.

Redefine phase: this phase where the growth and the profit of the company is declining or tapering off due to market saturation, pool of available profit has shifted and new competitors with lower cost structures or innovative product have appeared.

Three basic types of Chris Zook's adjacency expansion (2004):

1. Direct move into an immediate opportunity.

2. Option purchased in a business related to the core.

3. Series of sequential moves that expand the boundaries and capabilities of the core business.

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