

INTRODUCTION

One of the most important activities an entrepreneur should undertake before launching a company is to conduct a feasibility analysis, and based on a successful result, build a business plan. This Unit deals with a range of issues pertaining to a feasibility analysis.

CONDUCTING A FEASIBILITY ANALYSIS

According to Scarborough et al (2009), a feasibility analysis is the process of determining whether an idea is a viable foundation for creating a successful business. A feasibility analysis answers the question "should we proceed with this business idea?" It is primarily an investigative tool. The feasibility analysis gives an entrepreneur a picture of the market, sales, and profit potentials of a particular business idea. The role of the feasibility analysis is to serve as a filter, screening out ideas that lack the potential for building a successful business, before you commit additional resources. When the result is the realisation that an idea will simply not result in a viable business, you move on to the next opportunity and avoiding wasting time, money, energy, and other resources before creating a bull-blown business plan. More importantly you avoid launching a business that is likely to fail because it is based on a flawed concept.

A feasibility analysis consists of three interrelated components: an industry and market feasibility analysis, a product or service feasibility analysis, and a financial feasibility analysis. Making a critical evaluation of the business concept at an early stage will allow the entrepreneur to discover, address, and correct any fatal flaws before investing time in preparing the business plan.

INDUSTRY AND MARKET FEASIBILITY ANALYSIS

When you are evaluating the feasibility of a business idea, a basic analysis of the industry and targeted market segments becomes essential. The focus in this phase is twofold:

1. To determine how attractive an industry is overall as “home” for a new business
2. To identify possible niches a business can occupy profitably.

The first step in assessing industry attractiveness is to paint a picture of the industry with broad strokes, assessing it from a “macro” level. Answering the following questions will help you establish this perspective:

1. How large is the industry?
2. How fast is it growing?
3. Is the industry as a whole profitable?
4. Is the industry characterised by high profit margins or razor-thin margins?
5. How essential are its products or services to customers?
6. What trends are shaping the industry’s future?
7. What threats does the industry face?
8. What opportunities does the industry face?
9. How crowded is the industry?
10. How intense is the level of competition in the industry?
11. Is the industry young, mature, or somewhere in between?

Addressing these questions helps you determine whether the potential for sufficient demand for their services and products exist. A useful tool for analysing an industry’s attractiveness is the five forces model developed by Michael Porter of the Harvard business school. This model recognises the influence of five industry forces:

1. Rivalry among the companies competing in the industry
2. Bargaining power of suppliers to the industry

3. Bargaining power of customers
4. Threat of new entrants to the industry
5. Threat of substitute products or services

These five forces interact with one another to determine the setting in which companies compete and the attractiveness of the industry.

Rivalry among companies competing in the industry: The strongest of the five forces in most industries is the rivalry that exists among businesses competing in a particular market. Much like the horses running in a race, businesses in a market are jockeying for position in an attempt to gain a competitive advantage. When a company creates an innovation or develops a unique strategy that transforms the market, competing companies must compete or run the risk of being forced out of business. This force makes markets a dynamic and highly competitive place. Generally, an industry is more attractive when:

1. The number of competitors is large, or, at the other extreme, quite small (fewer than five)
2. Competitors are not similar in size or capability
3. The industry is growing at a fast pace
4. The opportunity to sell a differentiated product or service is present

Bargaining power of suppliers to the industry: The greater the leverage of suppliers of key raw materials or components have, the less attractive is the industry. Generally, an industry is more attractive when:

1. Many suppliers sell a commodity to the companies in it
2. Substitute products are available for the items suppliers provide
3. Companies in the industry find it easy to switch from one supplier to another or to substitute products (i.e., “switching costs” are low)
4. The items suppliers provide the industry account for a relatively small portion of the cost of the industry’s finished products.

Bargaining power of buyers: Just as suppliers to an industry can be a source of pressure, buyers also have the potential to exert significant power over a business, making it less attractive. When the number of customers is small and the cost of switching to competitors' products is low, buyers influence on companies is high. Generally, an industry is more attractive when:

1. Industry customers' switching costs to competitors' products or to substitute products are relatively high.
2. The number of customers in the industry is large
3. Customers demand products that are differentiated rather than purchase commodity products that they can obtain from any supplier (and subsequently can pit one company against another to drive down price).
4. Customers find it difficult to gather information on suppliers' cost, prices, and product features—something that is becoming easier for customer in many industries to do by using the internet.
5. The items companies sell to the industry account for a relatively small portion of the cost of their customers' finished products.

Threat of new entrants to the industry: The larger the pool of potential new entrants to an industry, the greater is the threat to existing companies in it. This is particularly true in industries in which the barriers to entry—such as capital requirements, specialised knowledge, access to distribution channels, and others—are low. Generally, an industry is more attractive to new entrants when:

1. The advantages of economies of scale are absent. Economies of scale exist when companies in an industry achieve low average costs by producing huge volumes of items (e.g., computer chips).
2. Capital requirements to enter the industry are low.
3. Cost advantages are not related to company size.
4. Customers are not extremely brand-loyal, making it easier for new entrants to the industry to draw them away from existing businesses.

5. Governments, through their regulatory and international trade policies, do not restrict new companies from entering the industry.

Threat of substitute products: Generally, an industry is more attractive when:

1. Quality substitute products are not readily available
2. The prices of substitute products are not significantly lower than those of the industry's products.
3. Customers' cost of switching to substitute products is high.

PRODUCT OR SERVICE FEASIBILITY ANALYSIS

Once you discover that sufficient market potential for your service or product idea actually exists, the tendency is to rush in too quickly. With exuberant enthusiasm, you may launch your business without actually considering whether you actually produce the product or provide the service at reasonable cost. A product or service feasibility analysis determines the extent to which a product or service idea appeals to potential customers. It also identifies the resources necessary to produce the product or provide the service. This portion of the feasibility analysis addresses two questions:

1. Are customers willing to purchase our goods and services?
2. Can we provide the product or service to customers at a profit?

Entrepreneurs need feedback from potential customers to successfully answer these questions. Acquiring that feedback might involve engaging in primary research such as customer surveys and focus groups, gathering secondary customer research, building prototypes, and conducting in-home trials. Primary research involves collecting data first-hand and analysing it; secondary research involves gathering data that has already been compiled and is available, often at a very reasonable cost or sometimes for free. Both types of research gather quantitative and qualitative information you can use to draw accurate conclusions about a product's or services' market potential. Primary research techniques include:

1. **Customer surveys and questionnaires**-keep surveys and questionnaire short. Word questions carefully to avoid biasing the results and use a simple ranking system. For example, a 1-to-5, with 1 representing “definitely would not buy” and 5 representing “definitely would buy.” Test the survey for problems on a small number of people before putting it to use. The survey results impact policy, product development and marketing efforts.
2. **Focus groups**- A focus group enlisting a small number of potential customers (usually eight to twelve) to give you feedback on specific issues about your product or service (or the business idea itself). Listen carefully for what focus group members like and don’t like about your product or service as they tell what is on their minds. Here you need to take into account opinions on such things as product’s name to packaging.

Secondary research, which usually is less expensive to conduct than primary research, includes the following:

1. **Forecasts**- many government agencies offer forecast on everything from interest rates to the housing starts.
2. **Market research**- someone may have compiled the market research you need.
3. **Articles**-magazine and journal articles pertinent to your business are a great source of information.
4. **Local data**- your local chamber of commerce probably has useful data on the local market of interest to you.
5. **The internet**-entrepreneurs can benefit from vast amount of marketing information available on the web. This is an efficient resource with up to date information, and much is free.

Other sources of secondary data you may find valuable are trade associations and business directories; direct mail lists; census data as well as demographic data.

Product prototypes: An effective way to gauge the viability of a product is to build a prototype. A prototype is an original, functional model of a new product that entrepreneurs can put into the hands of potential customers so that they can see it, test it, use it, and provide feedback. Prototypes usually point out potential problems in a product's design, giving you the opportunity to address them in the product development process. The feedback customers give entrepreneurs based on prototypes often leads to design improvements and the identification of new features, some of which the entrepreneurs might never have discovered on their own. Makers of computer software frequently put prototypes of new products into customers' hands as they develop new products or improve existing ones. Known as beta tests, these trails result in an interactive design process in which software designers collect feedback from users and then incorporate their ideas into the product for the next round of tests. Existing companies can benefit from creating prototypes as well.

In-home materials: One technique that reveals some of the most insightful information into how customers actually use a product or service is also the most challenging to coordinate: in-home trails. An in-home trail involves sending researchers into customers' homes to observe them as they use the company's product or service.

FINANCIAL FEASIBILITY ANALYSIS

The final component of a feasibility analysis involves assessing the financial feasibility of a proposed business venture. At this stage of the process, a broad financial analysis is sufficient. If the business concept passes the overall feasibility analysis, you should conduct a more thorough financial analysis when creating a full-blown business plan. The major elements in a financial feasibility analysis include the initial capital requirement, estimated earnings, and the resulting return on investment.

1. **Capital requirements:** Just as a boy scout needs fuel to start a fire, an entrepreneur needs capital to start a business. Some businesses, such as manufacturing and retail businesses, require large amounts of capital. Other businesses, such as service businesses, require less capital to launch. Start-up companies often need capital to purchase equipment, buildings, technology, and other tangible assets as well as to hire and train employees, promote their products and services, and establish a presence in the market. A thorough feasibility analysis will provide an estimate of the amount of start-up capital an entrepreneur will need to get the business up and running.
2. **Estimated earnings:** The financial aspect of the financial feasibility analysis combines the estimated earnings and the capital requirements to determine the rate of return the venture is expected to produce. One simple measure is the rate of return of the capital invested, which is calculated by dividing the estimated earnings the business yields by the amount of capital invested in the business. Although financial estimates at the feasibility analysis stage typically are rough, they are an important part of the entrepreneur's ultimate "go" or "no go" decision about the business venture. A venture must produce an attractive rate of return relative to the level of risk it requires. This risk-return trade-off means that the higher the level of risk a prospective business involves, the higher the rate of return it must provide to the entrepreneur and investors. If the analysis shows that the idea has potential as a profitable business, you can pursue it, using the information gathered during the feasibility analysis as the foundation for building a sound business plan.