

Opportunity Analysis

OVERVIEW

Before you write a business plan for a new business or venture, you need to complete an Opportunity Analysis. Why? An Opportunity Analysis will verify that the proposed enterprise is viable before you spend the time and money into doing a full-blown business plan.

Do not worry, any information you gather and the time you spend on the Opportunity Analysis will be directly useful in developing the business plan.

PURPOSE

The purpose of the Opportunity Analysis is to make sure that you are on the right track – who wants to be on the wrong track. Two basic questions need to be answered with the analysis:

1. Is there sufficient demand for the product or service?
2. Can the product or service be provided on a profitable basis?

Please note that a Opportunity Analysis is not a whole study of the anticipated business – but more like a preview of the business plan with the cogent issues discussed.

Purpose

The Opportunity Analysis should be no more than 15 (fifteen) pages suggested in length (and I mean suggested):

1. A brief overview of what the business is about (1-2 pages).
2. Overview of the market for the product or service and the results of the market analysis (3-5 pages).
3. Competitive advantage of your product or service over the competitor, and the strengths and weaknesses of your competitors (2 - 4 pages).
4. Rough proformas, including the income statement, which should show the expected level of profit over the next five years (2 -4 pages).

Please, please remember as you write the Opportunity Analysis that the whole purpose for this document is to assist you in assessing whether or not to move on with your business concept. If at this stage it looks as if your idea is not feasible – that is okay. Like most entrepreneurs, you have tons of ideas and the nature of the Opportunity Analysis is to ensure that you embark on your path of the tremendous success. If a few ventures do not pass, then this is fine. We all have options and we must be very careful not to fall in love with the first, or second, idea that pops into our heads. The primary purpose, therefore, of the Opportunity Analysis is to act as filter or screening device.

I would recommend that you not only limit the pages of this document (15), but that you also limit your time as well to no more than 16 to 30 hours.

GETTING STARTED

Okay, how do you get started? Well, the first step is to draft a brief description of the business. Shown below is an example write-up:

Eastport Furniture

This new business venture will design and build high-end custom furniture. Primarily it will focus on building dining room tables and chairs, and bedroom suites (including headboards, footboards and frames; night stands and dressers). Hardwoods such as cherry, curly and bird's-eye maple and walnut shall be used. Style shall be directed at craftsman, Stickly and Green & Green. Hand rubbed oils will be the finish of choice.

The product currently has superficial competition from three companies, Paul Mason, Green & Green Designs and Hardwood Furniture. The closest in physical location is about nine hundred and fifty miles away based just outside of Cleveland Ohio. Another is based in Seattle and the last is located just outside of San Diego.

The manufacturing of our product line will be based in Tahlequah in a new structure that will be built just for the company.

Notice how in the above discussion just the basics of the Opportunity Analysis are laid out, including some information about production and sales.

MARKET ANALYSIS

The next step in the Opportunity Analysis is to do the market analysis. Of course you are saying, "What is a market analysis?"

A market analysis is simply the act of ascertaining if there is the demand for the product or service. This is the heart of both the Opportunity Analysis and the business plan. You must show on an empirical level, that people want to buy your products or services. I can not stress how important this step is in the Opportunity Analysis. You must do a thorough job in this area!

Okay, you are convinced it is important, now how do you do this marketing analysis? Well like most things there are two parts:

1. Looking at the health of the industry.
2. Quantifying the demand for the product or service.

Health of the Industry

By health of the industry I mean looking at the industry you are going to be operating in and assessing its viability and future growth. The US INDUSTRIAL OUTLOOK is a great document that assesses the health of numerous industries. Also, you might want to check out the web for various sources (do not want to list anything here as things tend to change so rapidly). Also, please feel free to call your local reference librarian, as they are happy to help.

One of the key elements in this section is to ascertain the future growth of the industry. This is important as you do not want to be selling in a declining market, if you can avoid this. Clearly you do not want to be in the adding machine business when computers are coming out.

Where do you go to get this information? Most industries put out estimates of future growth rates. Look for the industry publications on the web. Sometimes, unfortunately, you will not be able to find industry information. Do not give up and “persevere.” However, if you still can not find this information, there are a couple of alternatives to assist you.

One way to get some quick industry data or growth rates is to look at other firms in the industry and what analysts are saying as to their expected growth rates.

Quantifying the demand for the product or service

Of the parts of the Opportunity Analysis that we have discussed so far, quantifying the demand for the product or service is the most critical. It is this portion of the Opportunity Analysis that states what people will pay to buy your product. One thing you do not want to do, is ask your friends or relatives what they think of your products or services, but they are a great choice for sources of funds. They clearly are not going to be your friends very long if they give you negative feedback, and at this stage of the analysis you need as much feedback, both positive and negative, as is possible.

It is preferable for you to do a survey of at least 20 people who are randomly selected. By random selection, I am not talking about surveying folks from just standing in front of the grocery store. Try to get as many varied people (in terms of age, gender, and race) as you can. The written or verbal should contain at brief description of the product and at least the following two questions:

- Would you buy the product or service? YES NO
- If you answered yes to the previous question, what would you be willing to pay for the product?

Some other questions to ask this time would be:

1. What suggestions would make you want to buy this product more (The more input, the better)?
2. Where would you expect to find this product for sale (This helps in planning distribution)?

Competitive Advantages

3. If you did not want to buy this product or service, why? (This is very important information)
4. Any other comments that they may want to give. By doing this study of market demand you are verifying that people would consider buying your product and the numbers serve as the basis for ascertaining if you can generate adequate levels of profitability.

What happens, however, if the results are very negative? Then there could be two problems, first it could mean that the sample of people you surveyed is not representative of the entire market. If is the case then you just need to do another test in different geographical areas. If you repeat the process again, and still find yourself receiving negative responses; then it is time to consider abandoning the project. While this at the time might seem harsh, it is even harsher for you to continue on with the project if people will not buy your product.

I have seen numerous projects that should have stopped at this point, continue on and the entrepreneurs lost all of their money and had to file for bankruptcy. It is better to pull the plug early on a project and devote your energy and finances to other projects that will be successful.

COMPETITIVE ADVANTAGES

This next section of the Opportunity Analysis is divided into two parts.

1. Competitive Advantages
2. Strength and weaknesses of your major competitors

Competitive Advantages

With competitive advantages it is important to lay out what really differentiates your product from your competitors. Some of these ideas could be:

- Quality
- Features
- Location
- Price (Not a good idea)
- Service
- New Application

Price is not a very good competitive advantage for most entrepreneurs as it does not generate repeat business. Most entrepreneurs want and need to have repeat business. By selling on a price basis you do not generate repeat business. Customers are only interested in price and are not loyal to the business – this is not the type of customers an entrepreneur should be after.

The strengths and weaknesses of the competition portion of the Opportunity Analysis is where you need to list each competitor and their critical attributes on how they relate to your product. SWOT analysis looks at the Strengths, Weaknesses, Opportunities and Threats which surround your business. This helps the entrepreneur to assess the viability of their options and determine a competitive advantage.

FINANCIALS

The last section (finally we get to this) of the Opportunity Analysis is the financials. In this section we need to determine the firm's breakeven point and a proforma or forecasted income statement. The purpose of this section is to quantify if we can generate a profit off the product or service. While having a demand for the product or service is great, the litmus test of the entire Opportunity Analysis rests on the financials. We want to know does it look reasonably promising that the business will make adequate money (very important)!

Breakeven Analysis

(Here we go into some simple math so hang on). The breakeven point is the dollars of revenue or units of sales that will be necessary to cover both the fixed and variable expenses.

In order to find the breakeven point, we need to find where

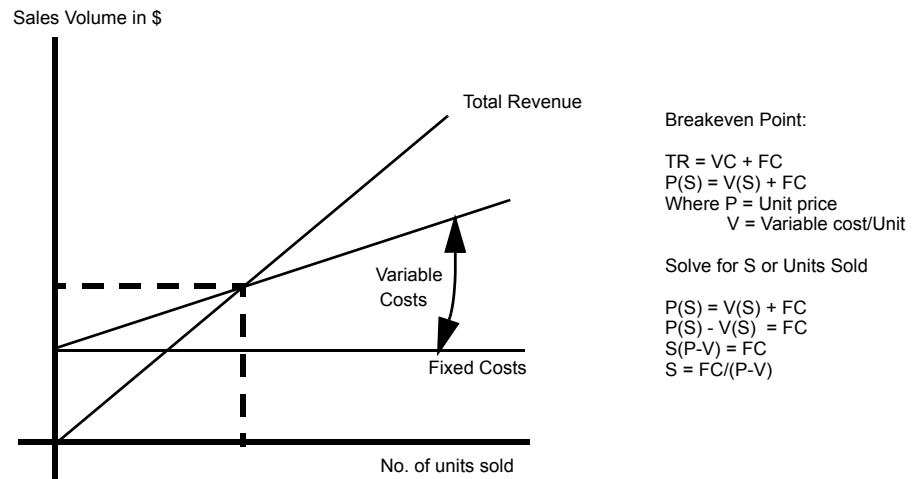
$$TR = VC + FC$$

Where, TR = Total Revenue,

VC = Variable Costs, and

FC = Fixed Costs.

At the point where $TR = VC + FC$ this is the breakeven point and this can be shown in the graph below :



The breakeven value can be ascertained by solving for “Units Sold. The simplest way to demonstrate this is by doing a problem.

For example, you have created a specially scented candle that you plan on wholesaling for \$5.00 each. The fixed cost to run your business is \$23,750 (rent, utilities, etc.) and the variable cost of your candle is about \$2 per unit, which is composed mainly of labor expenses.

The breakeven point is:

- $S = \$23,750 / (\$5 - \$2)$
- Units sold = 7,916

Okay, so what does this mean? It means that if we expect have sales higher than 7,916 units, we will make a profit. So if we are considering the project, we would be darn sure that our sales are going to exceed this number, before we do a full-blown business plan.

Proforma Statement

A proforma income statement is just fancy buzzwords for a forecasted income statement. The proforma income statement is just a statement of future profitability of the business broken down into revenue and expenses. The revenue will be a function of the market research you have done, adjusted for growth rate in sales. For example, if you forecast that you will generate sales of \$1,000,000 in the first year of operations then estimate the expected growth in sales. So if we anticipated sales in year 1 to be \$1,000,000 and then grow at the 10% growth rate, the resulting sales levels are shown below.

Year	1	2	3	4	5
Sales	\$1,000	\$1,100	\$1,221	\$1,343	\$1,475

Remember in the Opportunity Analysis that we are not trying to get these sales estimates exact, but rather we just need to have numbers that are in the ballpark.

The next step in the proforma income statement development is to estimate what various expenses per year will be. Some of the typical major expenses will be:

1. Cost of Goods Sold (COGS)
2. Rent
3. Labor
4. Utilities
5. Office supplies
6. Advertising
7. Administrative
8. Miscellaneous

Financials

Then we apply these costs to the sales estimates to produce a proforma income statement that is similar to one shown below:

Year	1	2	3	NOTES
Sales	\$1,000,000	\$1,100,000	\$1,210,000	10% Increase
COGS	\$600,000	\$660,000	\$726,000	60% of sales
Gross Profit	\$400,000	\$440,000	\$484,000	Sales - COGS
<i>Operating Expenses (O.E.)</i>				
Rent	\$20,000	\$21,000	\$22,050	5% Increase
Labor	\$125,000	\$131,250	\$137,81	3 5% Increase
Utilities	\$15,000	\$16,050	\$17,174	7% Increase
Advertising	\$40,000	\$44,000	\$48,400	4% of Sales
Administrative	\$25,000	\$26,250	\$27,563	5% Increase
Misc.	\$3,000	\$3,150	\$3,308	5% Increase
Total O.E.	\$228,000	\$241,700	\$256,306	
Gross Profit	\$172,000	\$198,300	\$227,694	Before Tax
Tax	\$51,600	\$59,490	\$68,308	Assume 30%
Net Profit	\$120,400	\$138,810	\$159,386	After Tax

Notice that there is profit attained in every year (but this is not necessarily a requirement), therefore, we can move on to the full-blown business plan. If the Net Profit resembles the following example:

Year	1	2	3
Net Profit	<\$50,000>	<\$32,000>	<\$16,345>

We should then reject this idea and move to a more profitable and viable business venture.

SUMMARY

This paper addressed the Opportunity Analysis as a screening device before a complete business plan is done.

The two critical sections of the business plan are the marketing section and the financial section. With the marketing section of the business plan you need to ascertain if there is a demand for the product and the price people would be willing to pay for the product or service. With the financial section, the purpose is to forecast the financial viability of the business. The Opportunity Analysis is a great way to do a preliminary test of a new venture.