

Feasibility Studies

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It is natural for promoters to get excited about a new business opportunity and be anxious to get going without delay. Unfortunately, this same excitement and tendency to rush leads to a lack of objectivity. The high failure rates among business start-ups in the past clearly show that it is very easy to overestimate the potential of a new business idea or to underestimate the obstacles and the costs involved. This is why time spent on carefully researching the idea will dramatically reduce the risks of failure by establishing whether or not the project is:

- * feasible in technical terms,
- * viable in terms of market demand and
- * sufficiently profitable to justify the risk.

The process of finding out whether a project meets all three of these criteria is called a "Feasibility Study". The study is not usually as comprehensive as that required for the business plan. It's objective is to establish viability as early and as cheaply as possible consistent with a sufficient level of confidence in the findings.

Projects that fail on one or more of the three criteria listed above can be scrapped before significant amounts of time and money are invested and lost. On the other hand, where a project meets all three criteria, the information gathered in compiling the feasibility study is very useful in the further planning of the project and significantly increases its chance of success.

Technical Feasibility

The technical feasibility of the project may be clear from the outset because the project involves no technical innovations and the entire process is well understood. However, some feasibility studies have to include the production of a prototype to test out the technical ideas involved.

Even when there are no technical innovations, a feasibility study should show whether all of the equipment required is available and whether the

technical skills required in the business can be sourced.

Marketing Viability - Market Size and Share

The marketing part of the feasibility tries to answer to two questions:

- * How many units can be sold?
- * At what price?

The first of these questions is the most difficult to answer. One approach is to find out how many units are being sold in the market at present and how this is likely to change in future. An estimate is then made of what percentage of these sales (or "market share") will be captured by the new product or service.

The first place to look for information on market size and trends is in government statistics, trade association literature, trade publications or commercial market research publications. The South Dublin County Library main branch at Tallaght has a reference collection that contains some of the most widely used sources of business information. There are larger collections at the Dublin Corporation central library in the Ilac Centre and at the Enterprise Ireland Market Information Centre in East Point Business Park.

Promoters researching newer, specialised products and services will not usually find direct answers to their questions in published sources. They may, however, find some information that is useful in estimating roughly what the size or growth trend in the market might be.

Ultimately, the question of market share can only be decided in relation to the new product or service itself and how potential customers view it relative to the competition. No published source can provide any useful information on this issue. Equally, as the promoters do not normally have a product or service to demonstrate, it is usually not possible to carry out direct or "primary" research among potential buyers to establish what percentage of them would buy the new product or service.

In these circumstances, it is normal to base the feasibility study on the results of a series of in-depth 'unstructured' interviews with a variety of key people

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in the trade concerned. These may be major buyers, distributors, wholesalers, business journalists with an interest in the area, professional associations, even, in some instances, owners of existing similar businesses who would not be competitively threatened by a new arrival. The insights gathered in these interviews are then used to come up with a very conservative 'guestimate' of market share and this should be highlighted in the report as an important unproved assumption.

Projects that are not selling directly to the mass market can use another approach called 'bottom-up' forecasting. This involves compiling a list of customers and estimating, on the basis of direct discussions with all of these customers, how much each one would be likely to buy of the new product or service. An allowance of between 10% and 30% can be added for other customers who have not yet been identified.

In conducting interviews, it is important to emphasise that the purpose of the interview is purely to do research. Interviewees should be encouraged to be realistic in their assessments of overall market size or their own purchasing requirements. While many such interviews with potential buyers can lead to actual sales, it is more common to find that interviewees overstate their actual volume of purchases and seldom actually buy as much as they claimed they required during the interview.

In some cases, trend analysis and/or analogy with other markets can be used to provide an estimate of market size. For instance, if the size of the UK market for shampoo is known through some published source to be say €75 million, an estimate of the current size of the Irish market can be calculated using the fact that the population of Ireland is roughly one twentieth that of Britain (about €3.8 million). Similarly, older data can be updated if the rate of change is known. Rough estimates of this kind are sufficiently reliable for use in feasibility studies.

Marketing Viability - Pricing

There are three factors affecting the price of a new product and all three should be taken into consid-

eration. They are:

- * Costs
- * Competitive pricing ('The going rate')
- * Perceptions of value ('What the market will bear')

Ideally the feasibility study will show that the price at which the project can sell the product or service (including a reasonable profit margin), is less than what competitors are charging and that price, in turn, is less than what customers see the new product as being worth. However, it is possible in a worst-case scenario that customers will see the new product or service as being worth less than it's competitors and even their prices are below the cost of production or service provision because the new venture has higher costs than it's competitors. Such a situation obviously spells disaster for the new project unless it can make it's product or service more valuable to customers and/or reduce it's costs of operation/production.

It is essential that all costs are taken into account in arriving at pricing decisions. Not only the direct costs such as materials and direct labour need to be included but also allowances for all kinds of overheads, such as marketing and selling costs, as well as items such as allowances for depreciation on machinery. The allowances for overheads will depend on the level of operation but it should already be clear from the research on market size and share what scale of operation is required. Remember also that in a small business, and in the short term, most costs are fixed. Except in the case of piecework or sales commission, employee's wages have to be paid even for time they may have spent doing nothing.

Clearly, the price of a new product or service must be in-line with its competitors. It is not necessary to be dramatically cheaper and it is sometimes possible to charge somewhat more. An analysis should be conducted of the features and quality of existing products/services as compared with their price and to apply the same analysis to the intended product or service in order to estimate where it might fit in to the scale of competitive pricing.

The most important factor in pricing is how customers view the value of what they are being offered, relative to the other choices available to them, in the circumstances in which they are buying it. Ticket 'scalpers'



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and airlines are both adept at charging widely differing amounts for identical products to people in differing circumstances.

Unlike the other two factors, perceptions of value can only be properly assessed by direct primary research among potential customers who are given a reasonable sample of the actual product or service to compare against competitive offerings. As mentioned above, this is unlikely to be possible in the context of a feasibility study and is commonly left out.

Financial Viability

Once estimates of the volume of sales and the price or value of these sales have been arrived at, a sales forecast can be calculated by multiplying volume by value. This is the point where the financial analysis takes over from the marketing analysis.

The financial analysis process takes this sales forecast and asks the following questions:

- * What investment is required to get going?
- * Are the potential profits sufficient to justify the risks

Estimating the investment required involves, firstly, pricing all of the equipment and facilities needed as well as any one-off setup costs. This is the 'fixed capital' required for the project. However, another key element of the total investment required is the 'working capital'. This is the amount of money you will have tied up in your stocks and debtors less the amount of credit you can get from your suppliers. To put it another way, it is the amount of money in use in the business at any one time to bridge the delay between payments for goods and services going out and actual receipt of sales revenue coming in, plus the value of your stocks.

The total amount of outside financing required for the project can be reliably estimated by making a detailed monthly cashflow projection which shows the net effect on the bank balance of money actually received each month versus money actually paid out. If the cashflow projection is calculated excluding all sources of funds other than sales revenue, then the monthly closing bank balance figures will

show the duration and extent of financing required. This requirement will have to be met from the promoter's cash investment as well as bank loans and some overdraft facility to cover the months of maximum demand. Repayment of capital and interest on any loans required will have to be fed back into the payments section of the cashflow projection and the closing balances re-calculated.

Cashflow projections are usually prepared in detail to cover the period until the net cashflow is on a clear long-term upward trend. For most small businesses this means a monthly cashflow for one or possibly two years and an annual statement of cashflow from then up to the end of three or five years.

Once a cashflow projection has been prepared, a projected profit & loss and balance sheet can be extracted. This is a specialist topic with which the South Dublin County Enterprise Board can arrange assistance. These statements show how much profit or loss has been made during of each period and what is the ownership position of the enterprise at the end of the period. Between them they allow the calculation of a figure for the return on investment (after tax) which the project may generate. This figure should compare very favorably with the rates for no-risk investments such as Building Society deposit accounts. It should even exceed the returns available in risk carrying investments such as the stock market because the work and stress involved for the owners is far greater.

The South Dublin County Enterprise Board operates a scheme of grant aid for qualifying feasibility studies that provides 50% of eligible costs up to a maximum of €10,000. To qualify, the following conditions must be met:

- * The promoter must live within South Dublin County.
- * He or she must intend to set up any resulting business within the county.
- * There must be a high degree of innovation and risk in the project.
- * Preliminary market research results must also be available.